

# **Monetary Policy, Islamic Finance, and Islamic Corporate Governance**

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# Monetary Policy, Islamic Finance, and Islamic Corporate Governance: An International Overview

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# Preface

In a typical literature, one can see that monetary transmission works through the channel of interest rate, and policy analyst are observing its impact on inflation, for example, if nominal interest rate increases it leads to incremental change in the user cost of capital, therefore, leading to an overall decrease in general prices level. Because higher interest rate has a negative impact on consumption (postponement) and also on desired investment due to which prices are going down. Another important channel of monetary transmission is the exchange rate. It is observed that an increase in the domestic interest rate has positive impact on the strength of currency which ultimately leads to downward pressure on the prices of tradable goods. A stronger exchange rate has a negative impact on net exports and aggregate demand. It is also an undeniable fact that appreciating currency increases the activities of the economy. Likewise, financial market development or institutional policy frameworks, and other country characteristics have impact on the transmission of monetary policy. Generally, in developing countries, majority of the households and firms are dependent on the bank lending.

On the contrary, the management of the corporations are always keeping their eyes on the amount of leverage. In this respect, financial stability has a strong relationship with the corporate governance. There is a strong consensus among the policy makers that financial stability increases the confidence of all stakeholders in the business sector. Financial stability reflects the overall stability and consequently it provides an effective platform to all stakeholders to perform their functions efficiently. Consequently, it leads to an effective corporate governance.

However, there is no room for the interest rate in the system of Islam, therefore, its monetary policy and the way it is transmitting should be different. Consequently, the impact of Islamic monetary policy on corporate governance should be different than the conventional monetary policy. Moreover, those corporations offering the *Shari'ah* compliance products and services are also behaving in a different way. It is witnessed that during the financial crises of 2007–2008, Islamic financial institutions (IFIs) showed more resilience than their conventional counterparts.

With this standpoint, the current volume argues that monetary policy based on moral and religious values plays a different role in building the confidence of the business sector in attaining its objectives, and the necessary outcomes under the umbrella of *Shari'ah*. Therefore, a humble effort is made to integrate the three dimensions of the subject together in one volume, that is, monetary policy, corporate governance and financial sector under the umbrella of *Shari'ah*. We hope our

humble effort would provide better understanding in developing a substantial research in future. In this volume, we followed two assumptions. The first is, that Islamic monetary policy approximately has the same targets but works with the different instruments, this fulfills the necessary condition. Whereas the second assumption is that moral and religious values are basic foundations of human behavior, this fulfills the sufficient condition.

Keeping these assumptions, the scholars are invited for their contributions. Therefore, as editors of this current volume, we provide a platform to our readers to start a discussion on the above mentioned three dimensions. We invited scholars to contribute their theoretical discourse, empirical investigations and relevant analysis. The contributors put a lot of efforts to discuss their arguments by following the above assumptions and provide a new path for the further research. However, the credit goes to the contributors for their discussion, analysis, and filling the gap in the current literature of monetary policy and corporate governance under the moral and religious environment with special reference to Islamic jurisprudence. In this environment, 2Rs (responsibility and resilience) are in front of the actors of policy makers and corporate governance.

The current volume has three parts, after introductory chapter, we presented theoretical underpinning in Part I, while in Part II, the association between governance and monetary policy is discussed. Finally, in Part III we shed light on corporate governance by focusing on IFIs.

Chapter 2 insinuates that CG can probably be improved by applying Islamic Moral Economy principles from Islamic economics. However, Abdullah and Asutay argued that for the achievement of this objective a strong political ground is required, that is, Islamic political economy to help with setting up laws and regulations to operationalize Islamic Economy.

Chapter 3 is based on the analytical study of the available material on features of Islamic finance and the applicable regulations, evaluates the effectiveness of the governance framework and steps taken for evolving the systems, Ayub argues, in order to align the business of the IBFIs (Islamic Banking and Financial Institutions) with the Divine objectives of *Shari'ah* and the value-based and corporate social responsibility (CSR) related functions, the governance framework must provide for the focus of financial institutions on the value based direct and indirect intermediation. In Chapter 4, Harahap discusses the implementation of Zakat through CSR partnership in overcoming poverty. In her opinion, this principle of social concern is realized through the concept of zakat. And the people living in the same jurisdiction, must be materially responsible for the poverty in their environment. Furthermore, the concept of zakat is aimed at maintaining religion, mind, soul, descent and wealth. Akbar and Amijaya, in Chapter 5, review the stock *waqf* product of Indonesian securities company. They suggested the capital gain or dividend will be distributed to the beneficiaries according to the demand of waqif (investors). In Akbar's view, there are five categories of benefits stipulated in the waqf statement form: (a) economic empowerment, (b) public welfare, (c) scholarship, (d) health services, and (e) Islamic preaching.

Choudhury, in Chapter 6, explains the complementary use of monetary and fiscal regimes although much desired for economic expansion, this phenomenon

remains plagued with uncertainty, unpredictability, and subject to perturbations that adversely affect stable price and output relations. Throughout this chapter, fiscalism is equated with spending (aggregate demand stimulation) rather than with government spending only. In Chapter 7, Uddin et al. explore the suitability of interest rate as monetary policy instrument for OIC countries. In their findings, interest rates have lost its edge significantly as a monetary policy instrument after the global financial crisis in Muslim countries. They suggested that in this changing macroeconomic condition, Muslim countries need to explore the alternative policy instruments for maintaining stable economy and sustainable development. Bayuni and Srisusilawati describe the contribution of *Shari'ah* monetary instrument to control inflation in an Islamic country like Indonesia in Chapter 8. They suggested that *Shari'ah* monetary instruments applied in Muslim countries might be applied in Indonesia such as Modharabha Certificate, COM, Commercial Papers-i, and Promissory FX Contract-i. Kiaee and Mahabadi elucidate the effects of monetary policy on the stability of Islamic banks with different governance models in Chapter 9. They carry out comprehensive empirical investigations by focusing on the economy of Iran. They endorsed that for Iranian Islamic banks, institutional investors and large investors, are those corporate governance characteristics which could bring stability to the banks. Also, the cost–deposit ratio is the only bank's stability variable which is affected by both monetary and corporate governance variables. In Chapter 10, Ahmad and Siddiqua find that through using transaction cost theory, Islamic finance institutions can ensure that they do not make money against money, rather make asset against money through their transactions applying ethical values. So far, the theoretical analysis of the study is concerned, the “Ronald Coase” model has been taken into consideration.

Marie et al. examine whether culture moderates the relation between AAOIFI adoption and earnings management (EM). Using Gray and Hofstede culture framework a sample of 122 Islamic banks across 24 countries for the period 2010–2017 is utilized in Chapter 11. Their analysis shows that cultural values of individualism; masculinity and UA positively strength the AAOIFI-EM association. Abdullah and Asutay, in Chapter 12, explore the corporate governance and risk management disclosure performance nexus in Islamic banks of Malaysia. They documented that one of the most profound traits of Islamic banks is its ethical foundation, and ethicality in contemporary times is not limited to the ethical nature of businesses but also the disclosure of activities as stipulated by international agencies. In Chapter 13, Rashedul Hasan et al. highlight the importance of appointing an appropriate number of independent members on the board and strengthening the internal control system as part of the efficient governance framework for IFIs. This chapter also contributes to addressing areas of improvement required in the Malaysian Code of Governance which will be helpful for regulators, market analysts, investors and financial institutions. Tanin et al. investigate how different variables drive the profitability of Turkish banks, conventional and Islamic in Chapter 14. Their findings show that non-fund-based income (and conventional bank's non-interest income) noticeably affects profitability. However, Islamic banks appear to be more profitable, which is in line with their initial expectation. Kasri and Kamal explore the application of integrated

reporting (IR) in annual reports of two Malaysian Islamic banks namely Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad in Chapter 15. Their chapter contributes to the dearth of literature on IR particularly on Malaysian IFIs as the existing literature focus more on the application of IR in conventional commercial institutions.

In Chapter 16, Rahman and Ahmad indicated that how corporate governance of IFIs can play their role in the context of a developing country. They found that the governance of IFIs in Bangladesh is an excellent blend of CG and IG. Several indicators demonstrate that the performance of IFIs is superior compared to their conventional counterparts. Given that, effective governance of IFIs can lead them toward achieving excellence in their respective businesses. Furthermore, such achievements of IFIs will ultimately contribute to society and Bangladesh's economy enormously. Musari and Fathorrazi, in Chapter 17, describe some of the practices of the Islamic social finance partnership model for micro-small-medium enterprises in Indonesia. They discuss five partnership models. Then, they explain the relationship between each stakeholder of the five partnership models by the Helix Approach. In the last chapter, editors present the summary and their suggestions for the further future research.

# Foreword

This edited volume is a welcome addition to the literature on Islamic finance. It covers two important areas, hitherto not treated together, namely monetary policy and corporate governance. Monetary policy is in the realm of macroeconomics, whereas corporate governance choices are at the institutional level, and, therefore, can be classified as microeconomic. There have been considerable advances in developing models of corporate governance that adequately serve Islamic financial institutions. Unfortunately, the same cannot be said for monetary policy, where there remains confusion about how *Shari'ah* law can be applied.

From an Islamic perspective, conventional monetary policy is, at best problematic, as interest rates are the most important policy tool. Manipulation of interest by central banks and monetary authorities to stimulate or restrain economic activity all too often has unjust consequences and is socially divisive. An increase in interest rates will not only result in the costs of financing new debt rising, but may also adversely affect existing borrowers. Those with variable rate contracts linked to interest rate proxies will have to immediately pay more, irrespective of whether they can afford the increased premiums. Of course, some may argue that borrowers were foolish in signing variable rate contracts. Many have taken on these contracts, however, because they are cheaper than fixed rate agreements.

Even those with fixed rate contracts will be exposed to higher rates when they re-finance. Banks are increasingly unwilling to provide fixed rate contracts for longer than 3–5 years, despite long-term residential mortgages often not repaid until 20 or even 30 years have elapsed. At present with negative interest in many economies to avoid Covid-19 having a recessionary effect, the only direction for interest rates is up. Consequently borrowers should beware.

Given the amoral financial consequences of relying on interest rates as the main determinant of monetary policy, economists committed to Islamic finance have sought alternative instruments. The authors of three of the chapters in this volume have addressed this issue. Md. Akther Uddin, Abu Umar Faruq Ahmad, and Fatima El Morabit ask if interest rates are an appropriate monetary policy instrument for OIC countries. The simple answer is undoubtedly no, but they describe themselves as on a quest. Their efforts represent a preliminary investigation which has considerable promise. A major strength of this book is the country experiences outlined. Hasan Kiaee and Samaneh Eftekhari examine the effects of monetary policy on Islamic banking in Iran. This is of particular interest as Iran portrays itself as having a *Shari'ah* compliant financial system with all its banks designated as Islamic. However, as the researchers report, the banks have adopted

different governance systems. Does this make a difference? Read the chapter and find the answer! At the macroeconomic level, the chapter by Eva Misfah Bayuni and Popon Srisusilawati on Indonesia is especially interesting. There, as in Malaysia, *Shari'ah* complaint monetary instruments have been introduced to control inflation. How do these work, and how successful have they been? Again, read the chapter and find out!

Ten of the eighteen chapters are focused on corporate governance issues in Islamic financial institutions. Hanimon Abdullah and Mehmet Asutay contribute two of these chapters, one which is categorized as theoretical and a second which focuses on the critical areas of risk management and financial disclosure. Again much of the strength of the corporate governance chapters is the country case studies covering Pakistan, Malaysia, Turkey, Bangladesh, and Indonesia. There is a wealth of material in these country studies that will be invaluable to future researchers, especially as the experiences have been so variable. Nevertheless, the advances in introducing appropriate corporate government structures for Islamic financial institutions is a story of success. It is a pity that this has been much less the case for monetary policy in spite of the efforts of some countries, notably Indonesia.

Rodney Wilson  
Emeritus Professor  
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## Chapter 1

# Monetary Policy, Islamic Finance, and Islamic Corporate Governance: An Introductory Note

*Toseef Azid, Murniati Mukhlisin, Nashr Akbar and  
Muhammad Tahir*

There are two main institutions which are concerned with the monetary policy, that is, executive government and central bank. The decisions of executive government are generally based on their political agenda whereas the decisions of central banks are based on the theoretical knowledge and practical experience of the technocrats. However, an agreement between two poles and sufficient condition for the implementation of the policies are necessary. Generally executive government is giving the policy targets to the central bank which is independently developing its own strategies for achieving the agenda of the executive government. In the following sections, an effort is made to review the relationship among the role of central banks, monetary policy, and corporate governance in the conventional as well as in an Islamic economy. This chapter is organized in the following manner. Section 1.1 visualizes the role of central bank in detail. In Section 1.2, a detailed discussion on the monetary transmission and corporate governance is provided. The relationship between monetary policy and corporate governance from the perspective of Islamic point of view is articulated in Section 1.3. Section 1.4 has shed some light on *Shari'ah* governance while Section 1.5 concludes the whole chapter.

### 1.1. Role of Central Bank

In the recent literature of economics, law, and political science, the role of central bank is getting more importance. In typical literature, two hypotheses got more importance in the theoretical literature. The first one is Minsky's (1986) financial instability hypothesis, in his opinion during the expansionary period of monetary policy because of good investment and high expected returns, demand for loans

increases, in resultant the banks are issuing more risky loans to their customers, therefore, the stability levels of financial institutions will decline. Other school of thought considering the supply side of money. In their opinion, banks are the primary source of transmission instruments of the monetary policy applied by the central bank. In this scenario, the pattern of lending and borrowing of banks is dependent upon the monetary policy of the central bank, that is, contractionary or expansionary. It means that the stability levels of the banking industry are dependent on the variables of monetary policy (Bernanke & Blinder, 1992). Bucher, Dietrich, and Hauck (2013) and Bikker and Hu (2002) are of the view that money growth is the main instrument which is responsible for the stability levels in the banking sector.

Mishkin (2007) described that the role of central bank is to stabilize the prices along with output stability while maintaining the low inflation rate. He argued as: "Price stability should be the overriding, long-run goal of monetary policy" (p. 41). Leybek (2004) discussed the role of central bank in the framework of economic policies and expressed as,

Good central bank governance means that the objectives and tasks delegated to an institution are performed effectively and efficiently, thus avoiding misuse of resources, which is crucial for establishing a good track record.

Tucker (2020) expressed his view about the role of central banks, "They provide public goods (such as price stability) and preserve common goods (such as financial stability) that can be enjoyed by all but eroded by the exploitative." Amtenbrink (2004) stated that Central bank has three pillars of its governance, that is, independence, democratic accountability, and transparency. There are multiple objectives to achieve for any economy; therefore, this is the policy of the central bank to develop its clear preference order. It is suggested that once executive government fixes the targets of the monetary policy, then it should be left on the central bank to achieve these targets without any influence of the government otherwise central bank will not be able to achieve those targets smoothly. The other view is based on the "so-called contract approach," that is, the central bank and government have an agreement in which monetary policy objectives are quantified. By following this approach, central bank is independent to achieve the realistic and decided targets. Due to this agreement, executive government has no choice other than to follow the strategies of central bank and it is also difficult for the executive government to criticize the central bank while it is conducting the monetary operations as agreed with the executive government. This approach is following the Central Banks of Canada and New Zealand for achieving the targets of monetary policy.

It is argued that the independence of central bank not only increases the accountability of the central bank and also its credibility. The function of transparency creates a confidence between the bank and the public. This confidence gives the strength to the decisions of the monetary policy, for example, the decision of monetary policy toward inflation and output is not the pure decision of

monetary policy but also based on the expectations and behavior of the public. The understanding of the public is an important ingredient of the implementation of any strategy of the central bank. For example, the economic behavior of the public has a significant influence of bank's decisions.

However, in this modern era of media and technology, the role of media is very much important, that is, how media is communicating the strategies of monetary policy of the central bank to the general public and how it has an impact on the understanding of the public. Goldfajn (2019) stated that general public should be satisfied and understand the rationale of the decisions of the central bank. He has given the example of Brazil, the minutes of the decision of the central bank of Brazil comes out within a week. In his opinion, it should be simple, concise, and in a clear way. In his opinion the most important element is the expectations about the inflation. If public knows that what is the objective of the monetary policy and strategies of the central bank, then the outcome will be favorable and will help in implementing the strategies.

Central bank has always trying to achieve two targets, that is, inflation and growth. There is always short-term trade off among inflation, recession, and unemployment. Currently, it is a general practice that central banks are also dealing with the markets whenever they feel any disorder in the markets. Simultaneously, the fluctuation of exchange rate is always in their under considerations. It is their task to distinguish in between the situation where they will give special attention or to leave it to work at its own.

Tucker (2020) explained about the current status of Central Banks in this way:

Today's central banks are, of course, extraordinarily powerful. First, the right to create money is always latently a power of taxation, capable of redistributing resources across society and between generations through a burst of surprise inflation (or deflation). Second, as lenders of last resort, central banks can potentially pick winners and losers. Third, through the terms of their financial operations (collateral, counterparties, and so on), they can affect the allocation of credit in the economy.

Fourth, acting as banking system supervisors, they are, like regulators in other fields, effectively delegated lawmakers and judges.

## **1.2. Monetary Transmission and Corporate Governance**

It is a consensus among the experts that monetary transmission has an impact on the behavior of banks and the conditions of corporate sector, and consequently the decision of corporate sector has a significant influence on the fluctuations of the business. It is a process which starts from the decision of monetary authorities and, at the end, it has its impact on the economy through the decisions of corporate sector (Cecchetti, 1999; de Bondt & Stokman, 2000; Guiso, Kashyap, Panetta, & Terlizzese, 1999; Kashyap & Stein, 1997, 2000).

In this context, two variables play a very important role, one is the credit issued by the banks and other is the governance characteristics of the firms. There is a big question in front of the policy makers, either that model of corporate governance of the banking sector which benefited the stakeholders of banks is leading to the bank stability or not. However, in the literature, there are two approaches discussed regarding the issue of corporate governance in the banking industry. From the one corner, it is assumed that if financial intuitions have good governance structure, then managers and shareholders are able to develop a stable and sound strategy for their functions and business. Therefore, in resultant, the stability levels of good corporate governance are far better than those who have poor corporate governance. Another corner has different opinion and, according to this group, the good corporate governance structure leads to more profit-oriented initiatives. Consequently, banks are involved in riskier activities. These riskier activities are the major cause of instability in the banking industry.

de Haan and Sterken (2002) analyzed the impact of different indicators of monetary policy on the financial structure of the firms in Netherland, that is, leverage, financial debt, loans, and trade credit. First three are becoming down in the period of contraction. They further argued that this effect is very strong when it was analyzed on the governance of private firms. Prasad and Ghosh (2005) studied the behavior of manufacturing firms during the period of the tight monetary policy in India. They observed that tight monetary policy lowers the total debt, in particular, to the private firms. It was interesting to note that short-term borrowing was increased in the listed firms and, in this way, they are adjusting their debts and also maintaining their relationship with the banks. It is important to note that maintaining the relationship with the banks is also an important aspect for the firms. Davis and Stone (2004) argued that corporates' "state of balance sheet" has a significant influence on the stability of the financial system of the economies. In their opinion, if there is continuously deterioration in the balance sheets of the corporates, then it has a significant negative impact on the adverse selection and moral hazards. They further argued that if researchers are examining the stability of the financial system, then they have to consider also the balance sheets of corporates. Prasad and Ghosh (2005) examined the role of bank debt on the balance sheets of Indian corporates and its reaction to the tight monetary policy. On the other hand, Lipton (2019) discussed the money laundering and its impact on the social well-being. In his opinion, this is a hidden money which comes from illicit activities and it is 8% of the global GDP. He stated as: "Improving governance isn't easy; it requires sustained effort over the long term. It's not only the right thing to do, it also brings tangible benefits to millions."

de Faria and Streit (2016) are in view that the degree of three pillars of central banks (i.e. independence, transparency, and accountability) are dependent on the level of maturity of democracy, if political system is more matured, then central banks are more independent and transparent. And also, information is given by the central banks that their governance practices are strengthening the process of accountability and transparency.

Dube (2018) discussed the case of Zimbabwe and concluded that there is a strong positive association between the corporate governance and the financial stability (stability in financial institutions and financial market). It is also observed that financial stability is strengthening the business confidence. There is consensus among the policy makers and experts that poor corporate governance has an impact on the efficiency of the banks and does not able to attract the foreign investors. The control of monetary policy on inflation and prices plays a very important role and gives the hope to the business sector especially in the developing countries. Brandao-Marques, Gelos, Harjes, Sahay, and Xue (2020) studied the case of different emerging markets and concluded as:

Importantly, having a modern monetary policy framework (i.e., IT, an independent central bank, and transparent monetary policy) is associated with stronger transmission, and more so than financial development or other characteristics.

Ghosh and Sensarma (2004) observed while examining the firm-level data in India and endorsed that monetary policy has an impact on the firm's debt ratio. They also found that behavior of private firms is different than the public firms in the period of negative or positive monetary policy. Moreover, they also found that the response of manufacturing firms is more visible than the services firm. They found that monetary policy has a significant impact on the governance of the firms especially in terms of borrowing and lending of the firms. de Haan and Sterken (2000) estimated the impact of contractionary monetary policy on different types of firms in Euro Area. They analyze the impact of monetary indicators on the four financial ratios, that is, leverage, financial debt, loans, and trade credit. The size of first three were reduced after monetary contraction. Especially, for the private firms, its effect is relatively stronger than the public firms.

### **1.3. Monetary Policy and Corporate Governance: An Islamic Point of View**

Islamic economic system has its unique features, Muslims believe on oneness of God, the main source of guidance is Qur'an and practice of Prophet Muhammad. Islamic epistemology is based on the worldly life and life hereafter, everyone is accountable to Allah on the day of judgment. Justice, equity, kindness, and brotherhood are the main features of this system while gambling and interest rate, pork, and wine are prohibited; earning through unfair means is not allowed; unearned income likewise begging is not appreciated in this system. There is a clear cut difference between haram and halal earnings. The main objective of Islamic financial instruments is to stimulate and mobilize the resources (Mankiv & Rashwan, 2012), investing in the real economy is the main and primary objective, therefore, the financing instruments like *mudharabah* (profit sharing), *musharakah* (joint venture and equity participation), *murabaha* (mark-up asset pricing), and

*ijara* (hire-purchase) play a very prominent role in developing and boosting the real economy. Choudhury (2009) expressed that the objective of other supplementary Islamic financing instruments is also to enhance the activities of real economy, for example, *ijara* (rental), *bay muajjal* (deferred asset valuation) and *wadia* (deposit), *salam* (contractual payment for the agricultural production), *ististna* (contractual payment for industrial products), *sukuk* (Islamic bonds), and *qard-i-hasana* (benevolence loan).

The preference order of Muslim investors is unique one and different from the conventional investors and their objective is not only to earn the profit but also to follow the objectives of *Shari'ah* or known as *Maqasid-ul-Shari'ah*. The prominent Muslim philosopher Al-Ghazali who lived between 1,058 and 1,111 specifies five of such objectives, namely, the protection of religion (*ad-dīn*), life (*nafs*), intellect (*'aql*), wealth (*maal*), and lineage (*ansab*) (Chapra, 2008). Further, Abu Zaharah (1997, p. 364) identified three classes of *Maqasid-ul-Shari'ah* such as *tahzib al-fard* (educating individuals), *iqamah al-'adl* (establishing justice), and *jalb al-mashalah* (ensuring the welfare of society). Muslims believe that they must consider life in this world as well as life in the hereafter; therefore, guidance on *Maqasid-ul-Shari'ah* plays important role in their life. They are not preferring conventional funds, even their performance is far better than the Islamic funds. *Shari'ah* guides them to prefer moral, ethical and social values over the financial benefits. Sen (1990) also emphasized on ethics in the economic reasoning. Islam emphasizes on cooperation but it does not mean that it ignores competition, it appreciates the coordinating role of competition.

It is argued by the supporters of Islamic financial system that this system is more stable than the conventional financial system because of the interest-free financing. They argued that it has been proved in the global financial crises of 2008. Similarly, it is also argued that there is less chances of hyperinflation because in the Islamic financial system, the money cannot cross the total supply of goods in the economy, in resultant the inflation is reducing and simultaneously the gross domestic product transaction is increasing because of the nature of the financial instruments. The foundations of Islamic banking are developed in a different way as compared to the conventional banking. Islamic banking is free from interest, gambling, excessive risk, ambiguity and uncertainty, exploitation, corruption, and ignorance.

The theories of Islamic monetary economics are developed without interest rate because it is prohibited and any transaction based on interest rate is not allowed. Currently, the proponents of Islamic monetary economics have strong arguments after 2008–2009 global financial crises. It is believed widely that instead of interest rate, Muslim countries can use some other conventional instruments like as legal reserve ratio, credit rationing, selective credit control, issue of directive, and moral suasion and unconventional monetary policy instruments like quantitative ease and the Muslim countries have to find some other alternatives for the stability of their economy and also for the sustainable development. Muslim scholars like Chapra (1985, 1996), Khan and Mirakhor (1989), Uddin, Ali, and Radwan (2019), and Selim and Hasan (2020) proposed some *Shari'ah* compliant instruments, that is, profit sharing ratio, refinance ratio, public share

of demand deposits, value-oriented allocation of credit, and *qard hasan* ratio. The objectives of the Islamic monetary policy are approximately the same as we have in the conventional economic systems, for example, mobilization of resources, sustainable development, balanced growth, stability in the value of money, equitable distribution of income and wealth, etc.

It is also observed that stability in the growth of money has a significant effect on the stability of the financial institutions. However, it has different impacts with the nature of the bank's corporate governance. The monetary policy of the central bank (expansionary or contractionary) has a different effect on the stability of the financial institutions because of their poor or strong corporate governance. Financial institutions react differently to these policies due to their strategies related to the loan and deposits that lead to a different state of stability.

#### 1.4. Cooperation and *Shari'ah* Governance

Eichengreen (2020) discussed in detail about the impact of COVID-19 on the economic and financial distress of the different economies, specifically the emerging ones. In the case of emerging economies he said as:

Emerging market central banks cut interest rates and in some cases undertook purchases of securities. As a result, the negative impact on economies and financial systems was somewhat less than anticipated initially.

Eichengreen (2020) invited the world for cultivating global financial corporation. He discussed in his paper about dollar dominance, role of IMF, and world bank and how to deal with debt.

However, he did not discuss the type of cooperation which is recommended by the Islamic Jurisprudence (*Shari'ah*).<sup>1</sup> The cooperation which suggested by *Shari'ah* is based on values and selfless system. The main pillars of *Shari'ah* in terms of cooperative governance are interest-free economy, free from gambling, transactions are based on transparency and honesty, maintaining the justice among the individuals and institutions. The cooperation is the foundation all the economic activities, no room for the cut throat competition. However, this cooperation is in the righteousness and piety but it is not for the aggression and sins. Furthermore, the agency arrangements are the part of legitimate cooperation.

Alaqil (2019) emphasized on the justice, accountability, and transparency in any economic system and endorsed that if the aforementioned three pillars prevail in any society and economy, then it will not observe any severe financial crises, low administrative corruption if there is any and less chances of economic collapse. It will lead to the good governance and also protecting the rights of all

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<sup>1</sup>Cooperate with one another in goodness and righteousness, and do not cooperate in sin and transgression. And be mindful of Allah. Surely Allah is severe in punishment (Al Quran 5:2).

the stakeholders. In this moral and ethical-based society, there will be automatically control on the excessive behavior of management and the role of board of directors will be matched with the objective of the organizations. The objective of *Shari'ah* is to shape the behavior of Islamic community based on the above three pillars, that is, justice, accountability, and transparency. Consequently, there will be less room for the moral hazards and asymmetric information. All the individuals and institutions must follow the Islamic legislations which in practice will lead to a moral economy and society. The first lesson of Islamic virtue is to maintain justice and remove the ignorance. In this system, individuals are not preferred over the group as capitalism and groups are not preferred over the individuals as in the socialism. In fact, Islam maintains a balance in between individuals and groups, that is, individuals and groups are enjoying their own rights which are given by the *Shari'ah*. Individuals have the responsibility toward oneself, toward his own family, and also toward the community and toward the universe as a whole. However, if there is conflict of interest between the individuals and society, then priority is given to the public interest. Islam teaches to his followers that this set of responsibilities will give them rewards in this world as well as life hereafter. Simultaneously, *Shari'ah*'s objective is to provide and protect the five necessities, that is, religion, life, mind, offspring, and property. Moreover, Islam does not appreciate the concentration of wealth.<sup>2</sup>

Keeping the above teachings of Islamic system, it endorsed that justice, accountability, and transparency are the main pillars for every discipline of Islam, in the process of the formulation of policies, and in every path of governance. Cooperation is the main ingredients in the social, economic, and financial system. However, cooperation is only in the virtues but not the cause for vice.

## 1.5. Concluding Remarks

Corporate governance is a matter of great interest for both researchers and policy makers owing to its important role in the economic growth process in the modern globalized world. The Performance of corporate sector can determine the growth performance of the economy. Therefore, policy makers have been witnessed devising and implementing various appropriate policies to strengthen the performance of the corporate sector so that to achieve the ultimate objective of satisfied economic growth. Recently, *Shari'ah* -based corporate governance has emerged as an alternative framework and has attracted attention by providing some new solutions to business problems. Similarly, no one can deny the important role of banking industry in improving economic growth of the economy. Banking industry is rightly assumed as the backbone of financial sector.

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<sup>2</sup>As for gains granted by Allah to His Messenger from the people of "other" lands, they are for Allah and the Messenger, his close relatives, orphans, the poor, and "needy" travelers so that wealth may not merely circulate among your rich. Whatever the Messenger gives you, take it. And whatever he forbids you from, leave it. And fear Allah. Surely Allah is severe in punishment (Al Qur'an 59:7).