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ISLAMIC FINANCIAL REFORM AND MACROECONOMIC POLICIES: A CASE OF MALAYSIA

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ABSTRACT

Malaysia's overarching economic objective is to achieve developed country status by the year 2020. On the back of sluggish global economic condition and tight fiscal space, the economy will need to grow by a stable and rapid rate over the next few years. Currently, macroeconomic policies in Malaysia follow the conventional model based on the risk-transfer paradigm. Over the next decade, the potential for risk sharing as an alternative to risk transfer is expected to grow rapidly. As pointed out by a number of scholars and researchers, economies can be made more resilient to shocks by adopting financing methods that limit risk transfer (interest rate based debt contracts) and allow greater risk sharing among the market participants on a broad scale. Risk sharing is also the essence of Islamic finance. The question arises as to the design and implementation of macroeconomic policies in a risk sharing system. This concept paper will model the Malaysian economy based on macroeconomic policies that applies the fundamental principle of Islamic finance, i.e., risk sharing. Firstly, a monetary policy that is targeted directly at asset market activities and private sector portfolio adjustments. Secondly, it suggests mobilization of funds for financing fiscal operations based on risk sharing through sale of government low-denomination equity participation papers directly to the public tradable in secondary markets. The latter proposal is supplemented with a reform of the tax structure. The paper will demonstrate its benefits in spurring growth, promoting distributive justice, rendering the economy more stable, strengthening the potency of monetary policy, enhancing fiscal governance and improving financial inclusion.

Keywords: Monetary and fiscal policy, Equity participation shares, Risk sharing.