

The Dynamics Study of Regulations on Syariah Banking Indonesia

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Abstract

Syariah banking as a business entity, which becomes a part of the national banking system, One of the important supporting facilities is regulation facility which can provide legal certainty for the existence of syariah banking, either in the institutional, productive, servicing, or operational pattern which is in line with syariah principle. syariah banking becomes a need for keeping public trust in the implementation of banking intermediary function and, at the same time, providing a sense of security for people to invest their productive funds. This approach is new to the Islamic banking literature. We find that Islamic banks are typically on a par with conventional ones in terms of gross efficiency, significantly higher on net efficiency and significantly lower on type efficiency.

Keywords: Regulation, Syariah Banking, Indonesia

I. Introduction

The Islamic economic development has strengthened the role of syariah banking in various sectors of public life. The existence of the Islamic banking becomes more important in the midst of the Islamic economic development. Various business transactions in society use the facilities of syariah banking services, either as the place for saving funds and financing business or as a means for accelerating the mechanism of paying system in all economic sectors. A banking institution can be said as the core of the economic system as a whole.

Banking becomes a very important influence in transfer business and economic development.¹ Banking plays a very important role in the development of a certain country since various economic and business activities cannot be separated from the existence of banking sector. Undoubtedly, banking has an important position and role in people's economic mode of living in the form of financial intermediary and in accelerating the payment of domestic and international business transaction.² In modern economy, banking facilitates exchanges and helps develop highly mass scaled production and capital in the human history.³ Big scaled production and the amount of capital involved in the development and the growth of modern industry cannot be achieved without the help of banks. Without the role of a bank, there will be no modern society that can achieve rapid development or can even maintain the rate of growth without the role of a bank.⁴

Referring to the strategic role and function for the development and the growth of modern industrial society, banking constitutes industry which must be maintained and is mostly heavily regulated industries.⁵ Organizing is important not only for safeguarding a bank and for guaranteeing protection and maintaining public trust, but also for protecting economy and preventing from the concentration of power.⁶

¹ Muthafa Dib Al-Bugha, *Buku Pintar Transaksi Syariah*, (Jakarta: Hikmah, 2010), p. 71

² Zulkarnain Sitompul, *Perlindungan Dana Nasabah Bank: Suatu Gagasan Tentang Pendirian Lembaga Penjamimpanan Di Indonesia*, (Jakarta: Program Pascasarjana Fakultas Hukum Universitas Indonesia, 2002), p. 23

³ Muhammad Nejatullah Siddiqi, *Bank Islam*, (Bandung: Pustaka, 1984), p. 58

⁵ Nindyo Pramono, *Bunga Rampai Hukum Bisnis Aktual*, (Bandung: Citra Aditya Bakti, 2006), p. 211

⁶ Zulkarnain Sitompul, *OP.Cit.* p. 11

The role and the function of banking, as it has been described above, adhere to conventional banking and Islamic banking. Indonesian banking system recognizes the existence of conventional banks and syariah banks. Syariah banks, in particular, have grown and developed in their business operation not only by the support from syariah scholars and from the great number of Muslims but also from the healthy and strong appearance or performance of the Indonesian economy. The most important thing is that support from the regulation system constitutes *condition sine quanon* for the existence of syariah banking.⁷ Legal provisions become the factor which provides certainty for the recognition of syariah banking and its operational pattern which is in accordance with its function and role as a financial intermediary. Regulating syariah banking must be able to accommodate the operational system of a bank which is in line with the Islamic legal provisions as its business core.

II. Syariah Banking Regulations in Indonesia

Every government has its own policy in appreciating the existence of Islamic banking; *first*, by changing all financial systems into the Islamic system, as it is found in Iran, Pakistan, and Sudan; *secondly*, by recognizing the existence of dual banking system, by recognizing both Islamic banking and conventional banking, as it is found in Bahrain, Brunei, Malaysia, Kuwait, Turkey, and the United Arab Emirates; *thirdly*, by being neutral: these countries (Egypt, Yemen, and Singapore) are not for or against Islamic banking in their jurisdiction; and *fourthly*, by limiting the existence of Islamic banking to be independent as it is found in Saudi Arabia and Oman.⁸

Islamic banking in Indonesia, which is also called syariah banking, has obtained regulations which become the legal basis for the recognition of the existence of syariah banking institution and its products. Regulation is important in giving strong position for syariah banking institution. It is also important in providing legal certainty for people to do transaction on products and services, and, at the same time, to provide protection for people in their syariah banking activities. It is also important that regulation is functioned to develop people's trust in transferring their funds to be managed and invested productively by syariah banks.

After Indonesia got its independence, banking regulation was started by the issuance of Law No. 14/1967 on Banking Judicial Bases. Even though it was regarded that this law had organized the banking system comprehensively, syariah banking was not yet recognized. Political condition became the obstacle because its ideological connotation was related to the concept of the Islamic State, so that it was not intended by the government.⁹

After it was 25 years old, Law No. 14/1967 was considered to be not in accordance with the national and international economic development. The national banking regulation then occurred in 1992 by the issuance of Law No. 7/1992 on Banking. As the revision of Law No. 14/1967, the regulation through Law No. 7/1992 was intended to follow the economic development which always moved rapidly, along with broadening challenge, so that it had to be followed responsively by the National Banks in performing their function and responsibility to people. The establishment of Law No. 7/1992 was considered as the important historical landmark in the framework of the Indonesian Islamic banking in Indonesia which is now known as "bank which is based on profit and loss sharing principle."

The term, *bank syariah* (syariah banking) or *bank Islam* (Islamic banking) is not found in Law No. 7/1992; there is only a phrase, (bank which is based on profit and loss sharing principle) to indicate the activity of a syariah bank although it has described the existence of syariah bank activity. However, the term, 'bank which is based on profit and loss sharing principle' has not accommodated all kinds of activity and product patterns of a syariah bank. Besides products, syariah bank also uses the patterns of deposit, buy and sell, hire, and so on which are permitted by syariah.¹⁰ The products of syariah bank have different characteristics from the products of conventional banking.

⁷ Iki Ismal, *The Indonesian Islamic Banking: Theory and Practices*, (Jakarta: Gramata Publishing, 2011), pp. 3-4

⁸ Frank E. Vogel and Samuel L. Hayes III, *Hukum Keuangan Islam: Konsep, Teori, dan Praktek*, (Bandung: Nusamedia, 2004), p. 24

⁹ Wirnyaningsih, Karnaen Perwataatmadja, Gemala Dewi, and Yeni Salma Barlinti, *Bank dan Asuransi Islam Di Indonesia*, (Jakarta: Kencana, 2005), p.49

¹⁰ Ascarya, *Akad dan Produk Bank Syariah*, (Jakarta: Raja Grafindo Persada, 2007), p.41

Syariah banking can perform financial transactions more than that of conventional banking. Unlike conventional banking, the activities of syariah banking include financing transaction which is usually performed by multi finance company.¹¹

The development of regulation occurred through Law No. 10/1998 on the Amendment of Law No. 7/1992 on Banking which provided big opportunity for developing syariah banking in Indonesia. The concept of the Islamic Banking was more stressed by changing the term, bank based on the principle of profit-sharing (bank the which is based on profit and loss sharing principle) in Law No. 7/1992 to the bank based on Islamic principles (bank which is based on syariah principle) Law No. 10/1998. The change was followed by the issuance of a Letter from the Directors of Bank Indonesia No. 32/34/KEP/DIR on Commercial Bank which was Based on Syariah and No. 32/36/KEP/DIR on People Credit Bank Based on Syariah Principle. Law No. 10/1998 gave the stress on the application of the Islamic law in banking. Banking transaction should be in line with syariah principle: financing was based on profit and loss sharing (*mudharabah*), financing was based on the principle of equity participation (*musarakah*), the principle of trade in goods was based on profit (*murabahah*), financing capital goods was based on the principle of pure banking, without alternative (*ijarah*), or the alternative of the transfer of ownership on the goods which are hired from the bank by another party (*ijarah wal iqtina*).¹²

As a part of the national banking system, syariah banking nowadays does not only become an alternative for conventional banking but also becomes a solution for facing the crisis, and even simultaneously becomes the solution in facing various banking problems and global economy. The comparison of the superiority of the Islamic economy with conventional economy can be analyzed from three main issues as follows: *first*, the practice of financial transaction and the position of interest system; *secondly*, opinion about distributive equality and the implication of its policy; and *thirdly*, opinion about the moral basis in each activity and economic decision.¹³

After passing the phases of introduction and recognition, a specific regulation of syariah banking in Law No. 21/2008 is regarded as the phase of purification in various activities of syariah banking business which is in line with Islamic values.¹⁴ The phase of purification constitutes the most important and the most serious phase whose implementation must be watched over and managed. As long as people do not feel comfortable and do not feel the difference from the practice of conventional banking, the efforts of syariah banking toward complete (*kaffah*) purification have not yet completed; therefore, they have to be made continuously.¹⁵

III. Syariah Principle as the Key of Resilience of Islamic Banking

Syariah banking showed it resilience in facing monetary fluctuation and crisis some years ago. During the economic crisis, syariah banking was not a burden on the state's finance as what occurred to conventional banking which needed infused funds from the government.¹⁶ *Bank Muamalat Indonesia* as a commercial bank which applied syariah principle in its operational pattern became the only bank which did not undergo negative spread during the monetary upheaval.¹⁷

Syariah banking was free of negative spread because the performance of syariah banking was determined by the performance of the real sector. The Islamic concept keeps the balance between real sector and monetary sector so that financing growth will not be separated from the real sector which is financed by it.

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¹¹ Sutan Remy Syahdeini, *Perbankan Syariah: Produk-Produk dan Aspek-Aspek Hukumnya*, (Jakarta: Jayakarta Afung Offset, 2010), p. 35

¹² Law No. 10/1998, Article 1, paragraph 13

¹³ Veithzal Rivai and Antoni Nizar Usman, *Islamic Economics and Finance: Ekonomi dan Keuangan Islam Bukan Alternatif, Tetapi Solusi*, (Jakarta: Gramedia, 2012) p. 257. See also Veithzal Rivai and Arviyan Arifin, *Islamic Banking: Sebuah Teori, Konsep, dan Aplikasi*, (Jakarta: Bumi Aksara, 2010)

¹⁴ Kamaen A. Perwataatmadja and Hendri Tanjung, *Bank Syariah: Teori, Praktek, dan Peranannya*, (Jakarta: Celestial Publishing, 2011), p. 91

¹⁵ Ibid., p. 92

¹⁶ Zulfhairi Hasan, *Undang-Undang Perbankan Syariah: Titik Temu Hukum Islam dan Hukum Nasional*, (Jakarta: Rajawali Press, 2009), 19

¹⁷ Muslimin, "Reformasi Kebijakan Perbankan Islam di Indonesia", *Miqot: Jurnal Ilmu-Ilmu Keislaman*, Vol. XXVIII, No. 1 (January, 2004), p. 150

When economy is flagging, the yield received by syariah banking declines which, in turn, the return which is shared in the profits to depositors also declines. On the other hand, when economy is booming, the return which is shared in profits inclines.¹⁸

Methodology Studying banking efficiency can be done in two possible ways: either by use of traditional financial ratio analysis (FRA) or by the distance function approach which leads to frontier estimation methods such as DEA and SFA. The pros and cons of FRA as a method of efficiency measurement are well known (Ho and Zhu, 2004; Hasan, 2005). In the context of Islamic banking, the most severe drawback is the assumption underlying financial ratios of cost minimization or profit maximization; these are unlikely to be the most pressing objectives in the context of Islamic banking (Abdul-Majid et al., 2010). The distance function approach, whereby a firm's observed production point is compared to a production frontier which denotes best practice, does not assume any specific optimizing objective on the part of the firms, and is therefore our preferred method of approach. It is worth reflecting upon our intention to compare directly the efficiency of Islamic and conventional banks. Critics argue that the objectives of the two banking systems differ so much that such a comparison is invalid: for example, conventional banks can be seen to be motivated only by profit; Islamic banks have additional objectives which compass social value and ethical behaviour (in line with Shariah principles). Objections to a direct comparison can be rejected using one or other of two possible arguments: (a) Conventional and Islamic banks increasingly compete in similar markets comprising customers who are seeking products which conform to their religious principles and customers who are not so constrained (Warde, 2010). Evidence cited includes: Islamic subsidiaries and/or windows opened by conventional banks; the availability of Islamic financial products outside of Islamic countries; the establishment of Islamic banks in non-Islamic countries; and the targeting of some Islamic products at all types of customers (Warde, 2010). Direct competition between the two bank types in the same markets allows a direct comparison between Islamic and conventional banks. (b) In the event that the objectives and markets of the two types of banks are indeed different, we believe that it is still possible to make a direct comparison so long as the estimation method appropriately allows for differences between (and within) the banking systems. We have a choice of estimation methods, namely the parametric SFA or the non-parametric DEA (Majumdar, 1996; Coelli et al., 2005) both of which make the assumption that production units are comparable. While the general advantages and disadvantages of each of these are well-known one aspect must be emphasized. DEA, by estimating a frontier which envelops the observed production points with piecewise linear segments, allows each bank to have its own objectives as it will only be compared with banks of similar input and output mix. For example, a small Islamic bank, financing its loans using a balanced mix of equity and deposits, would not in DEA be compared with a large conventional bank with a different input-output mix financing its loans predominantly using deposits. Similarly, an Islamic bank mainly involved in sale and mark-up transactions will not be compared with one which undertakes joint venture finance as they will have different mixes of outputs. SFA, on the other hand, applies the same parameters to all observations in the sample. By choosing DEA rather than SFA as our estimation method in the first stage, we therefor overcome any criticism of pooling banks with different objectives as DEA only compares like with like. The effectiveness of policies to improve bank efficiency depends on the source of inefficiency, for example, whether it is managerial incompetence or whether it is the banking system in which the bank operates.

Therefore, the basic resilience of the Islamic financial institution, including syariah banking, is on two fundaments: (i) transaction that occurs, either financing or equity participation (co-financing), always keeps in touch with the economic activity in the real sector, and (ii) profit sharing based transaction, the risk is born by mutual risk sharing. These two fundaments constitute the characteristic of banking which uses syariah principle as its operational pattern. It means that the implementation of syariah principle becomes the key for the resilience of the Islamic financial institution in facing crisis.¹⁹

Syariah principle becomes the soul which maintains and gives resilience to all activities and products of syariah banking so that it is important to be understood properly and correctly.

¹⁸ M. Rifin Hamid, *Hukum Ekonomi Islam (Ekonomi Syariah) Di Indonesia*, (Jakarta: Ghalia Indonesia, 2007), p. 18. See also Veithzal Rivai, Andria Permata Veithzal, and Ferry N. Idroes, *Bank and Financial Institution Management*, (Jakarta: Raja Grafindo Perintis, 2007), p. 739

¹⁹ M. Luthfi Hamidi, *The Crisis: Krisis Mana Lagi Yang Engkau Dustakan?*, (Jakarta: Republika, 2012), p. 316

Syariah principle becomes a basic character which is adhered to syariah banking and has broad implication in order to make it difference from conventional banking. Syariah principle becomes the basic framework of syariah banking, not only from its institutional framework, business activities, and the method and the process to carry out its business activities, but also from its goal which supports the implementation of national development to improve justice, togetherness, and the equality of people's welfare. In order to achieve this goal, syariah banking always sticks fast to syariah principle completely (*kaffah*) and consistent (*istiqomah*).

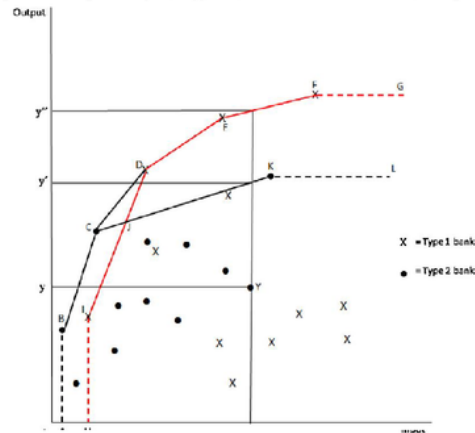


Figure 1: DEA Efficiency – Derivation of Gross, net and Type Efficiency

The meaning of syariah principle in Law No. 21/38/08 can be found in two different places. Article 1, paragraph 12 states that syariah principle is Islamic legal principle in banking activities, based on the edict issued by an institution which has the authority to issue an edict in the syariah field. The institution which has the authority to issue an edict (fatwa) is the Indonesian Council of Ulama that is presented through the National Syariah Board. Various activities of syariah banking can be implemented after it has been obtained from the National Syariah Board of the Indonesian Council of Ulama.

Article 3 on business activities which are in line with syariah principle are any activity which does not contain the elements of *riba*, *maisir*, *gharar*, *haram*, and *zalim*. This explanation provides the line of some elements which must not be violated in syariah banking business activities. These five elements which are prohibited must be avoided; they cannot be adhered to any activity in syariah banking business, and automatically become the corridor which must not be violated by the National Syariah Board of the Indonesian Council of Ulama in issuing an edict (fatwa).

These five elements (*riba*, *maisir*, *gharar*, *haram*, and *zalim*) differentiate the implementation of the activities of syariah banking business from that of the conventional banking. Therefore, the profits which are going to be obtained from the activities of syariah banking have to be free from the elements of *riba*, *maisir*, *gharar*, *haram*, and *zalim*. The profits which are obtained must be *halal* (legitimate according to Islamic law) and is in accordance with the Islamic law.

IV. Conclusion

Banking regulations in Indonesia bring about syariah banking as an integral part of the national banking system. By these regulations, Indonesia belongs to the countries that follow dual banking system: the existence of syariah banking is recognized to live side by side with conventional banking. The dynamics of banking regulations in Indonesia experiences significant development in providing recognition for syariah banking. Regulation reached their peak by the issuance of Law No. 21/2008 which became a specific regulation for syariah banking. Before this, under Law No. 7/1992 which was later amended to Law 10/1998, syariah banking was still regulated coinciding with conventional banking. The dynamics of the regulations of syariah banking cannot be separated from the demand for Islamic based economic development wanted by most people, particularly by Muslims.

The regulations of syariah banking have come to the purification phase so that its business product is not mixed with conventional products anymore.

The syariah principle is the character of syariah banking which is adhered to various business activities after it is implemented in the form of the edict of the National Syariah Board of the Indonesian Council of Ulama. Various aspects of syariah banking have obtained regulations which strengthen its existence institutionally and its business activities and its products, including syariah compliance which is presented through the establishment of Syariah Supervisory Board in every syariah bank and syariah business unit.

The dynamics of syariah banking will hopefully bring about people's trust and lift up people's awareness of syariah banking so that various economic activities always use syariah financial institution in the form of syariah bank as its facility. Syariah banking which used to be an alternative should be the solution which is needed in the national and international economic mode of living.

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