INDONESIA-MALAYSIA JOINT ISLAMIC SHARIA CAPITAL MARKET

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Introduction

With the ASEAN Economic Community [hereinafter "ASEAN"] around the corner and further economic integration underworks, it is important to consider the source of funding for such an ambitious project. ASEAN as an economic community, functions as a singular entity that aids in the growth, development and setbacks of all participating member states. However, such a community can only exist due to each nation's ambition for economic prosperity and the existence of a regional cooperative spirit. This unique situation coupled with the very distinct and diverse history of each ASEAN country can either result into a chaotic catastrophe or a well-oiled machine with each nation providing contribution. However for the latter to be achieved, ASEAN will have to first address the issue of economic disparity between member states and the source of funding for all future ASEAN collaborations. Currently, according to the Economic Freedom of the World: 2015 Annual Report, Singapore is the only ASEAN member to be in the first quartile of the report with Malaysia (58), Indonesia (76), Brunei (62), Philippines (67) and Cambodia (52) far behind in the second quartile. Vietnam (109) and Thailand (103) are placed in the third quartile while the worst performing country in ASEAN, Myanmar is placed at 146. This economic disparity however is not uniquely ASEAN and is also faced by other economic entities, such as with the Greece, Spain and Portugal debt crisis in the European Union [hereinafter "EU"] and poor states of Mississippi, West Virginia and Arkansas in the United States of America [hereinafter "USA"]. As such avoiding the extreme ideology of communism and the impossibility of implementing socialism over independent states, there is a need for ASEAN to address future obstacles it may face as an integrated economic community.

To quote Paul Samuelson a famous American Economist, "Globalization presumes sustained economic growth. Otherwise, the process loses its economic benefits and political support". Similarly, the existence of an economic integrated entity is also solely for the economic growth of each member states, without it the regime would simply fail. For ASEAN this is not just a theory, but also one that has been implemented, tested and proven. Looking back at the 1998 Asian financial crisis prior to the collapse of Thai Baht in 1997, Asia was at its financial peak. With foreign investor money pouring in, economic growth and regional cooperation in the region was at an all time high, but when the bubble burst so did the entire system. Blame it on poor foresight or a lack of risk management, the withdrawal of foreign investment caused panic and turmoil resulting into an economic meltdown. It has been a decade or two since the collapse and Asia is still in recovery. The experience although ominous and grim in light of the panic and increased crime rate of the times teaches the Asian people the vulnerability of solely relying on foreign investment to fuel its growth. If anything, the financial collapse of Thailand, Indonesia and Malaysia, 1998 allowed these countries to rectify the rampant corruption and inefficiency within the country, as well as dispel the illusion of its borrowed growth. Such an experience will only prove to be useful if it paves a path for ASEAN to return to its former financial glory, but this time doing so sustainably and without an unhealthy dependency on foreign investment.

This sustainable growth can only be achieved through a sustainable and socially responsible financial plan. Without it, ASEAN is doomed to repeat the mistakes of the US and their mortgage crisis of 2008 and the EU with their current debt crisis of 2010. These crises occurred due to the fact that conventional banking relies on predicting future growth, by applying interests on all form of investments. This financial model makes the assumption that all investments will prove to be profitable, however this is not the case in reality. The US had a mortgage crisis precisely because the bank guaranteed sure AAA grade investments, which turned out to be faulty and problematic. Similarly, EU places its trust that each of its member state will be equal in the economic community, however with different economic policies and national disadvantages, it was inevitable for one or in this case three countries to not catch up. All in all, the current conventional financial model relies on the fact that the market will continue to stay good and that any bad market can be covered with the surplus gained from a good market. This system however has inevitably resulted in multiple financial crises and promotes a culture of hoarding. Moreover, this model also serves to only secure the wealthy who is able to make reserves and does not account for the poor whom would suffer on either market situation. This type of inequality and discrimination can only be solved through the implementation of a socially responsible and risk-averse wealth management.

Islamic finance as a system that stems from a religion of law that promotes social equality and justice is suitable solution to replace the current faulty financial system. With its three prohibition of unnecessary risk (*gharar*), interests without real growth (*riba)* and gambling (*maisir)*, most if not all the problems currently faced by the market will be solved. These three elements are prevalent in the entire financial crisis of the past century. First, the 1998 Asian financial crisis occurred due to the fact that Asian countries pegged their currency to the US dollars without actually having real growth to match (*riba*), then using the artificially strong Baht/ Rupiah they take on loans from abroad (*gharar*), to which created an illusion of rapid growth causing mass speculation and a bubble (*maisir*). Second, the 2008 Housing crisis where American Banks issued mortgage based securities (MBSs) or house loans and collateralized debt obligations (CDOs) or diversified risky loans to consumers with the assumption that ALL consumers will pay and not default (*gharar*). These complex financial instruments are basically a collection of debtors grouped together to be sold to the highest bidder for their continual monthly payment, or in other word the monetization of speculative account receivables, without actual collateral (*riba*). The high popularity and profitability of these products, encouraged banks to further speculate and leverage their assets, to the point at which they held almost $7.4 trillion (double of 2008) worth of MBSs and over $500 billion dollars in CDOs (quintuple of 2004), all thanks to greed and speculation (*maisir*). This unhealthy leveraging of unreal assets, combined with human greed and speculation resulted in the US housing market crash and the current global economic slowdown that is faced by the world today. To allow for the current model to continue and be implemented for the future of ASEAN stock exchange, would be to allow for a third financial crisis arising from speculation and bubble to occur again in Asia, the results of which could be catastrophic.

Currently, this paper proposes a joint development of a separate and independent ASEAN Sharia Capital Market supervised and monitored by appointed Indonesian and Malaysian representatives. Similar to the concept of establishing smaller capital markets for startup and technology IPOs, this separate capital market will provide a medium for capital to fund future ASEAN project in an economically sustainable manner. The idea of a separate capital market to provide an outlet for smaller based funds without affecting the main market has been done in various countries including South Korea with Korea New Exchange [hereinafter "KONEX"] and Singapore with its refurbished Stock Exchange of Singapore Dealing and Automated Quotation [hereinafter "SESDAQ"], Catalist; Both of which has proven to be very successful in terms of promoting economic growth and tapping into new demands.

Similarly, the establishment of an alternative Islamic Capital Market [hereinafter "ICM"] run by ASEAN will ensure that market share does not overlap between Asian countries, knowledge, resources and opportunities on Sharia finance is shared equally and the stability of the exchange is not dependent on the political climate of each country. ICM mainly differs from conventional capital markets in two regards, firstly, investors are treated as buying into the company and that stock performance is not dependent on demand or supply of the market but rather actual reported growth by the company; Secondly, the listed products available for investors to invest their capital in is limited to companies that are *halal* and benefits society. To understand what constitute as *halal*, one can borrow the filter system from Malaysia's ICM, namely the qualitative and quantitative method. The qualitative method prohibits companies that carry out any non-permissible core activities such as financial services based on *riba* (interest), *maisir* (gambling), the manufacture or sale of non-halal products or related product and other activities that are regarded as not permitted according to Sharia. However, in instances where the company has a mixture of core activities, a secondary criterion can be applied namely to consider the public perception or image of the company and whether the core activities of the company are important and beneficial to the country. Now proceeding with the second criteria, the qualitative method requires that registered companies or projects meets the percentage benchmark of non-compliant Sharia activities set by the Sharia Advisory Council in Malaysia. These two criteria combined will ensure that all project and companies funded by the ASEAN ICM avoid the shortcomings and potentially destructive cycle of the bubble and boom of conventional capital market as any investment has to be met with real growth or no returns. Moreover, unlike conventional capital market that relies on trading and speculation, the ASEAN ICM will serve as a funding outlet for investors to collaborate and work with startups much like Venture Capital only cross-ASEAN and based on sustainable Islamic principles.

After the outline of an ASEAN ICM has been discussed, the next natural question is why would Malaysia and Indonesia give up its advantage of developing its own ICM. Although admittedly, both countries have experienced a surge in global demands for its alternative investment products, with Malaysia's ICM tripling in value from 2005 and 2015, and Indonesia's doubling the amount of its investors since 2010, there is still room for more growth. Especially considering that most of the investors found within the Indonesian ICM are local investors rather than foreign ones. These growth can be expedited through the combination of ICM of both Malaysia's and Indonesia's similar to which has been done with the current ASEAN Exchange, which hosts the various ASEAN stock exchanges. However, rather than merely hosting and relaying information, the ASEAN ICM will instead serve also as a regulator. The benefit of establishing such an institution will outweigh the autonomy lost by each state in regulating their ICM, as the joint ASEAN ICM will provide a larger coverage, better infrastructure and more universal and consistent Sharia principles to regulate trade. The platform would also allow increased exposure of Islamic finance towards non-Muslim majority ASEAN countries as well as gain the financial expertise of Singapore. All in all, establishing and ASEAN ICM will serve to catapult the growing Sharia market that it is now into bigger and newer stage, allowing for a more sustainable ASEAN economic development.

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