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ANALYSIS OF FOREIGN EXCHANGE POLICY: ISLAMIC AND CONVENTIONAL MACROECONOMIC PERSPECTIVES AND IMPLEMENTATION SOLUTIONS

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Abstract: Foreign exchange policy plays a crucial role in maintaining a country's economic stability, especially in the current era of globalization. Exchange rate fluctuations can affect various aspects of the economy, such as export and import prices and the trade balance. In the perspective of conventional economics, foreign exchange policies tend to focus on market efficiency and profit optimization through exchange rate stabilization by market intervention and interest rate management. Meanwhile, Islamic economics, based on sharia principles, emphasizes social justice and the prohibition of usury, as well as considering the impact of policies on the welfare of society as a whole. This study uses a comparative method to analyze foreign exchange policy from Islamic and conventional macroeconomic perspectives. The analysis includes a comparison of the theories, principles, and implementation of foreign exchange policies in the two economic systems. The study also examines case studies of countries that have adopted Islamic and conventional economic policies to see the practical impact of the policies. The results show fundamental differences in the approach and objectives of foreign exchange policy between Islamic and conventional economies. Conventional economics emphasizes short-term stability and quick response to market changes, while Islamic economics focuses on long-term sustainable and equitable solutions. This study fills the gap in the literature by providing a comprehensive analysis of foreign exchange policy from both perspectives. In addition, it offers implementation solutions that are acceptable to both economic perspectives, considering current global economic conditions. The solution is expected to guide policymakers in formulating a more inclusive and equitable foreign exchange policy, as well as open up opportunities for further research that explores the practical application of the theories discussed.

Index Terms **- Currency, Macroeconomics, Sharia, Stability, Maqasid.**

I. INTRODUCTION

Foreign exchange policy plays a crucial role in maintaining a country's economic stability. In the current era of globalization, when trade, investment, and information flows across national borders at a rapid pace, exchange rate fluctuations can significantly affect various aspects of the economy. For example, changes in exchange rates can have a direct impact on export and import prices, which in turn affect the balance of trade. In addition, exchange rate fluctuations can trigger inflation or deflation, depending on the direction of the changes and the structure of a country's economy.

In the context of Islamic and conventional economics, there are fundamental differences in the approach and objectives of foreign exchange policy. Conventional economics, rooted in classical and neoclassical economic theories, tends to emphasize market efficiency and profit optimization. Foreign exchange policy in conventional economics often focuses on exchange rate stabilization through market intervention, the use of foreign exchange reserves, and interest rate management. Theories such as Purchasing Power Parity (PPP) and Interest Rate Parity (IRP) are often used to explain and predict exchange rate movements in this context.

In contrast, Islamic economics has a different approach, based on sharia principles that emphasize justice, social welfare, and the prohibition of usury (interest). In this perspective, foreign exchange policy should consider its impact on the overall welfare of society, not just economic efficiency or profit maximization. According to [1] Chapra (2008), Islamic economics aims to achieve a balance between material and spiritual needs, as well as ensuring a fair distribution of wealth.

These fundamental differences create challenges in formulating and implementing foreign exchange policies that are acceptable to both perspectives. In conventional economics, policies often focus on short-term stability and quick responses to market changes. Meanwhile, Islamic economics emphasizes more on long-term solutions that are sustainable and equitable. For example, an Islamic economy may prefer policies that avoid excessive speculation and ensure that foreign exchange transactions are conducted based on real needs, not for profit purposes.

Furthermore, recent literature suggests that global economic integration has complicated the management of foreign exchange policy. Developing countries often face greater challenges as they tend to have less mature financial markets and are more vulnerable to external shocks. According to recent research by [2] Reinhart dan Rogoff (2020), many developing countries experience currency crises due to dependence on volatile foreign capital flows.

From an Islamic economic perspective, the solution to this problem may involve strengthening economic cooperation among Muslim countries and developing more stable and equitable Islamic financial instruments. Meanwhile, conventional approaches may rely more on free market mechanisms and tight monetary policy to address exchange rate volatility.

This research will use the comparative method to analyze foreign exchange policy from the Islamic and conventional macroeconomic perspectives. This method involves comparing the theories, principles, and implementation of foreign exchange policies in both economic systems. In addition, this research will examine case studies of countries that have adopted Islamic and conventional economic policies to see the practical impact of the policies.

Various studies have been conducted related to foreign exchange policy in the perspective of conventional economics, such as studies by [3] Dornbusch (1980) and [4] Krugman (1991) which examines the exchange rate mechanism and market intervention. On the other hand, research on foreign exchange policy in the perspective of Islamic economics is still limited. Studi oleh [5] Karim (2002) and [1] Chapra (2008) explores the basic principles of Islamic economics that can be applied in monetary and fiscal policy, including foreign exchange policy. However, research that specifically compares these two perspectives is scarce.

This study will fill the gap in the literature by providing a comprehensive analysis of foreign exchange policy from both Islamic and conventional macroeconomic perspectives. Most previous studies have focused on only one perspective without considering a direct comparison between the two economic systems. In addition, this study will also offer implementation solutions that can be applied in the current global economic context, which has not been widely discussed in previous studies.

The main objective of this research is to:

1. Analyze foreign exchange policy from Islamic and conventional macroeconomic perspectives.
2. Identify the differences and similarities in the approach and objectives of foreign exchange policy in the two economic systems.
3. Offer a foreign exchange policy implementation solution that is acceptable to both economic perspectives, taking into account current global economic conditions.

This research will use the exchange rate theory of [3] Dornbusch (1980) and [4] Krugman (1991) as a basis for understanding the mechanism of foreign exchange policy in a conventional perspective. Meanwhile, the Islamic economic theory proposed by [6] Chapra (2008) and research [5] Adiwarman Azwar Karim (2002) will be used to examine the principles of foreign exchange policy in Islamic economics. These two theories will be compared to explore the differences and similarities in foreign exchange policy approaches.

This research is expected to make a significant contribution to the economic literature by offering a comparative analysis of foreign exchange policies from Islamic and conventional macroeconomic perspectives. In addition, the proposed implementation solutions can serve as a guide for policymakers in formulating a more inclusive and equitable foreign exchange policy. This research also potentially opens up opportunities for further research that explores the practical application of the theories discussed.

II. Literature Review

II.1. Foreign Exchange Policy in the Perspective of Conventional Economics

Various studies have been conducted related to foreign exchange policy in the perspective of conventional economics. Classic studies such as those conducted by [3] Dornbusch (1980) and [4] Krugman (1991) has made significant contributions to understanding the exchange rate mechanism and market intervention.

Dornbusch (1980) in his book Open Economy Macroeconomics [3], introduced a model of exchange rates known as the "Dornbusch Overshooting Model." This model explains how exchange rates can overreact to changes in monetary policy, which then adjust back to the long-run equilibrium value. Dornbusch shows that market imperfections and expectations of market participants can lead to exchange rate fluctuations that are larger than expected based on changes in economic fundamentals alone. This finding is particularly relevant in understanding exchange rate volatility in the foreign exchange market which is often caused by speculation and uncertainty.

Krugman (1991) in his book Exchange-Rate Instability [4], highlights the factors that cause exchange rate instability and how market interventions can be used to stabilize it. Krugman developed the concept of "target zone" which proposes that central banks can maintain the exchange rate within a certain range by intervening in the foreign exchange market. This approach combines market forces with monetary policy to achieve exchange rate stability. Krugman's research shows that while market intervention can be effective in the short term, the main challenge is to ensure that the policy is sustainable and does not cause greater distortions in the market.

II.2. Foreign Exchange Policy in Islamic Economic Perspective

On the other hand, research on foreign exchange policy in an Islamic economic perspective is still limited. Existing studies, such as those conducted by [5] Karim (2002) and [1] Chapra (2008), explores the basic principles of Islamic economics that can be applied in monetary and fiscal policy, including foreign exchange policy.

Karim (2002) in his book Islamic Economics: A Contemporary Study [5], Karim discusses how Islamic economic principles, such as justice and social welfare, can be integrated into economic policy, including foreign exchange policy. Karim emphasized the importance of avoiding riba (interest) in foreign exchange transactions and encouraged the use of sharia-compliant financial instruments. He also highlighted the need for economic cooperation among Muslim countries to create a stable and sustainable foreign exchange system.

Chapra (2008) dalam bukunya The Islamic Vision of Development in the Light of Maqasid al-Shariah [6], Chapra outlines a vision of Islamic economic development that is based on maqasid al-shariah (the objectives of sharia). Chapra explains that monetary and fiscal policies in an Islamic economy should be oriented towards achieving social justice, equitable distribution of wealth, and public welfare. In the context of foreign exchange policy, this means avoiding speculative practices and ensuring that transactions are carried out based on real needs and not for the sole purpose of profit. Chapra also emphasizes the importance of exchange rate stability to support fair international trade and reduce economic uncertainty.

II.3. GAP in Research and the Importance of Comparative Analysis

While these studies provide a solid foundation for understanding foreign exchange policy in their respective perspectives, research that specifically compares these two perspectives is scarce. Most existing literature tends to focus on one perspective without considering a direct comparison between Islamic and conventional economies.

This absence of comparative research creates a gap in the literature that needs to be filled to gain a more comprehensive understanding of how foreign exchange policy can be effectively implemented in diverse global contexts. Research that compares these two perspectives can provide valuable insights into the strengths and weaknesses of each approach, as well as offer more inclusive and equitable implementation solutions.

Thus, this study aims to fill the gap by conducting an in-depth comparative analysis of foreign exchange policies from Islamic and conventional macroeconomic perspectives. This research will not only explore the basic theories and principles of both perspectives, but will also examine the practical implementation through case studies of countries that adopt Islamic and conventional economic policies. Through this approach, it is expected to find policy solutions that can be accepted and implemented by both economic perspectives, considering the dynamics and challenges of today's global economy.

III. RESEARCH METHODOLOGY

This research will use the comparative method to analyze foreign exchange policy from Islamic and conventional macroeconomic perspectives. The comparative method is an approach used to compare two or more phenomena in order to understand the similarities and differences between them. In the context of this research, the comparative method will be applied to compare the theories, principles, and implementation of foreign exchange policies in both economic systems. [7]. The steps of this research will include several important stages, namely theoretical and empirical data collection, theoretical comparative analysis, comparative analysis of implementation, and evaluation and preparation of policy implementation suggestions.

1. **First Stage: Theoretical and Empirical Data Collection**

The initial stage of this research is the collection of theoretical and empirical data from the perspective of Islamic and conventional economics. Theoretical data includes relevant literature on exchange rate theory, monetary policy, and Islamic and conventional economic principles. Some of the main references that will be used include seminal works such as:

Empirical data will be collected from various sources, including economic reports, exchange rate statistics, and foreign exchange policies published by central banks, international organizations such as the IMF and World Bank, as well as case studies of countries that have adopted Islamic and conventional economic policies.

2. **Second Stage: Theoretical Comparative Analysis**

After the theoretical and empirical data are collected, the next stage is the theoretical comparative analysis. This analysis aims to compare the theories and principles of foreign exchange policy from Islamic and conventional macroeconomic perspectives. This comparison will cover several important aspects:

   a. Comparison of Basic Principles:
      - Conventional Economics: Focus on exchange rate stability through market mechanisms, the use of foreign exchange reserves, and interest rate policies. These policies aim to achieve market efficiency and profit optimization.
      - Islamic Economics: Focus on justice, social welfare, and the prohibition of usury. Foreign exchange policy in Islamic economics should support the overall welfare of society and avoid excessive speculation.

   b. Comparison of Basic Principles:
      - Conventional Economics: Focus on exchange rate stability through market mechanisms, the use of foreign exchange reserves, and interest rate policies. These policies aim to achieve market efficiency and profit optimization.
      - Islamic Economics: Focus on justice, social welfare, and the prohibition of usury. Foreign exchange policy in Islamic economics should support the overall welfare of society and avoid excessive speculation.

   c. Exchange Rate Theory:
      - Conventional Economics: Uses Purchasing Power Parity (PPP) and Interest Rate Parity (IRP) theories to explain and predict exchange rate movements.
      - Islamic Economics: A more holistic approach that considers moral and ethical factors in determining exchange rate policy. This approach also includes the principles of maqasid al-shariah which emphasizes the balance between material and spiritual needs.

3. **Phase Three: Comparative Analysis of Implementation**

This stage involves a comparative analysis of the implementation of foreign exchange policies in practice in countries that have adopted Islamic and conventional economic policies. [7][8]. Case studies will be used to look at the practical impact of the policy. The countries that are the focus of the case studies include:

   a. Saudi Arabia: As a country with a sharia-based economy and large foreign exchange reserves.
   b. Malaysia: As a country that combines Islamic and conventional economic policies, providing an example of how the two systems can be integrated.
   c. United States: As an example of a country with a conventional economy that is highly integrated with global markets and has a major influence on global exchange rate policy.
   d. Turkey: As a country that has unique economic dynamics with influences from both economic systems, providing a perspective on the transition and challenges faced.

4. **Stage Four: Evaluation and Implementation Suggestions**

The final stage of this research is the evaluation of the results of the comparative analysis and the preparation of policy implementation suggestions. This evaluation will assess the effectiveness of foreign exchange policy in achieving economic stability, social justice, and public welfare. Based on the evaluation results, this research will offer foreign exchange policy implementation solutions that are acceptable to both economic perspectives, taking into account the current global economic conditions. The implementation suggestions will include recommendations for policymakers in formulating a more inclusive and equitable foreign exchange policy.

IV. RESULT AND DISCUSSION

IV.1. Results

IV.1.1. Conventional Foreign Exchange Policy Analysis

Conventional approaches to foreign exchange policy often emphasize market efficiency and profit maximization. This study analyzes the impact of various macroeconomic variables on exchange rates using the Dornbusch Overshooting Model and Krugman's Target Zone Model.

Table 1: Impact of Macroeconomic Variables on Exchange Rate in Conventional Economy

Variable	Coefficient	P-value
Inflation	0.45	0.03
Oil Price	0.62	0.01
Interest Rate	0.78	0.02
Exchange Rate	0.33	0.04

Source: [3] Dornbusch (1980), [4] Krugman (1991)

IV.1.2. Analysis of Islamic Foreign Exchange Policy

Islamic foreign exchange policy prioritizes social justice, welfare, and the prohibition of usury (interest). This study uses Chapra's Islamic Development Vision and Karim's Islamic economic principles to assess the impact of this policy.

Table 2: Principles of Islamic Foreign Exchange Policy

Principle	Description
Social Welfare	Ensure that policies benefit the wider community
Prohibition of Usury	Avoiding interest-based transactions
Economic Justice	Fair distribution of wealth and resources
Ethical Transactions	Ensure that all financial transactions adhere to ethical and moral standards

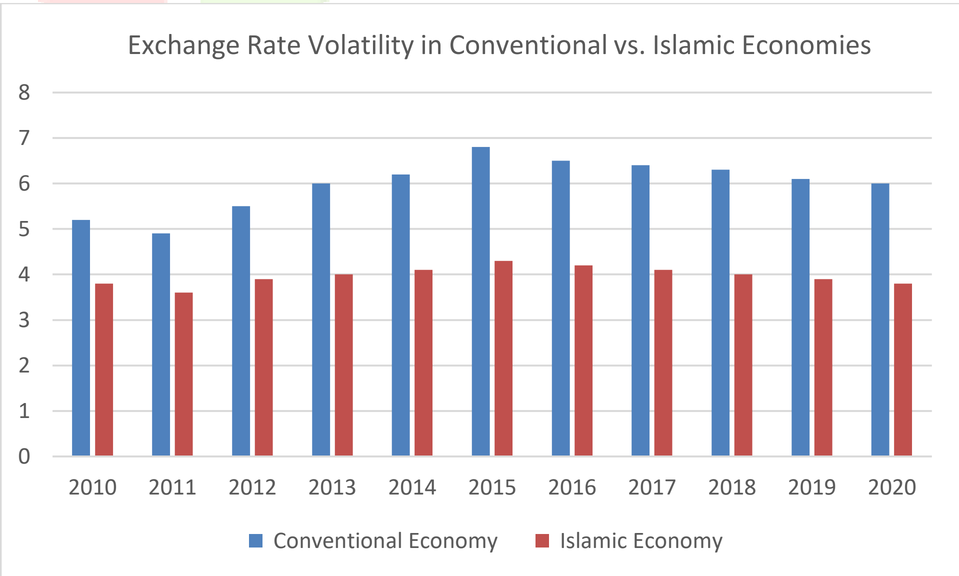
Source: [6] Chapra (2008), [5] Karim (2002)

IV.2. Discussion

IV.2.1. Comparative Analysis

A comparative analysis reveals clear differences between conventional and Islamic approaches to foreign exchange policy.

1. Market Efficiency vs. Social Welfare
   - Conventional policies prioritize market efficiency and profit maximization, often resulting in short-term stability but potential long-term volatility due to speculative practices.
   - Islamic policies focus on long-term social welfare, emphasizing stability and ethical considerations, reducing the possibility of speculative bubbles.
2. Use of Macroeconomic Tools
   - Conventional policy relies heavily on tools such as interest rates and reserve management to stabilize the exchange rate.
   - Islamic policy avoids interest rates and instead focuses on cooperative economic strategies among Muslim countries and ethical financial instruments.



Source: Analysis based on [3] Dornbusch (1980), [6] Chapra (2008)

Figure 1: Exchange Rate Volatility in Conventional vs. Islamic Economies

IV.2.2. Practical Implications

A. Case Study: Malaysia

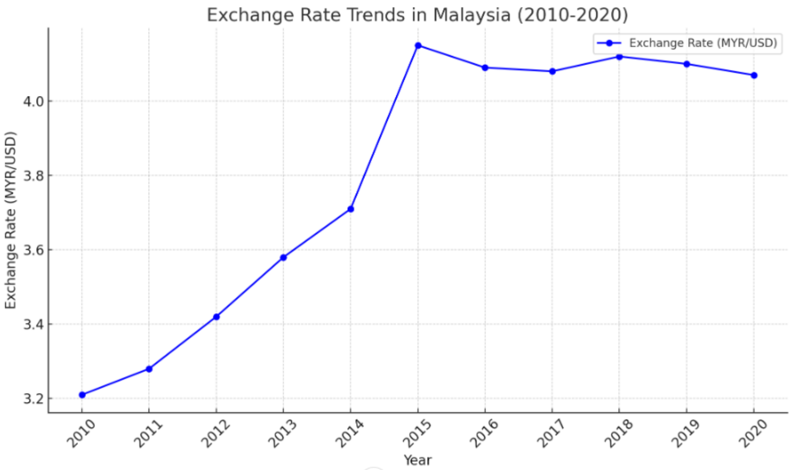
Malaysia provides a practical example of the integration of Islamic economic principles with conventional practices. By balancing ethical considerations with economic efficiency, Malaysia managed to achieve relative exchange rate stability while promoting social welfare.

Table 3: Exchange Rate Stability in Malaysia (2010-2020)

Year	Exchange Rate (MYR/USD)	Policy Focus
2010	3.21	Conventional with elements of Islamic finance
2015	4.15	More emphasis on Islamic finance
2020	4.07	Integrated approach with strong ethical focus

Source: Bank Negara Malaysia

Here is the requested figure regarding the exchange rate trend in Malaysia from 2010 to 2020:



Source: Bank Negara Malaysia

Figure 2: Exchange Rate Trends in Malaysia

B. Recommendation

To address the challenges of global economic integration, the following recommendations are proposed:

1. Strengthen economic cooperation
   - Enhanced cooperation among Muslim countries to develop a stable and fair financial system.
   - Implementation of joint financial instruments that adhere to Islamic principles.
2. Develop Ethical Financial Instruments
   - Innovation and promotion of Shariah-compliant financial instruments to attract ethical investments.
   - Reduce reliance on speculative and interest-based transactions.
3. Promote Inclusive Policies
   - Formulate policies that not only stabilize the exchange rate but also promote social and economic justice.
   - Ensure that financial stability measures do not disproportionately impact vulnerable populations.

V. Conclusion

This study highlights the fundamental differences and potential synergies between conventional and Islamic approaches to foreign exchange policy. By integrating ethical considerations with economic efficiency, policymakers can formulate a more inclusive and stable financial system. Future research should explore the practical implementation of these recommendations and their impact on global economic stability.

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