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Islamic Banks and Strategies of Economic Co-operation.

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This book is based on discussions of a three day international symposium on Islamic banks held in Baden-Baden, West Germany from May 6 to 8, 1981. The symposium was organized to review the operational style of Islamic banks and their investment participation approach in providing development assistance and commercial capital. It was hoped that the symposium would help in better understanding of the nature and potential of Islamic banks and in exploring the possibilities of cooperation between Islamic banks and the Western world whereby surplus funds of Islamic banks and the technical know-how of industrialized nations could be combined to enhance development in the Third World. The book summarizes the proceedings of symposium along with the text of the communiqué, the reports of the four working groups and the inaugural address by Prince Mohammad AI-Faisal Al-Saud.

Among the papers, two relate to the nature of Islamic economics, five to the nature of Islamic banking and the possibilities of cooperation with Western financial institutions and two to the role of Islamic banks in meeting the financial needs of developing countries.

The five working group reports relate to:

i) Islamic Banking and European Inter-market Banking Experience with Investment Participation.
ii) Feasibility Analysis of Islamic Bank's Investment Participation.
iii) Policy Design of Islamic Economics.
iv) Monetary Theory of Islamic Economics.

The two papers on the nature of Islamic Economics have little to add to the literature on the subject. The fact that Islam as religion deals with economic matters and gives its own economic principles, is no longer a novel idea. If any point is made in these papers then it is that there should be a cooperation between Islamic economists and western economists in order to look for a new paradigm to solve the economic problems of the world - a rather optimistic ambition, yet, not misplaced in an international forum.

That Islam gives its own economic principles, may not be as big a surprise to the modern world as is the Islamic injunction that the economy should function without interest and that no financial or economic transaction should be interest based. In theory, a lot has been written about this too but there always remains the question: "Will it work in the present world"? There are now several Islamic banks in different parts of the world practicing on the basis of Islamic principles, providing a living example. The experience of these banks is valuable not only in providing an example to the Western world but also to provide blue prints for other Muslim financial institutions to follow. Hence, two presentations explain the working of the Islamic financial institutions. The explanation, however, is too short to encompass the entire workings of an Islamic financial institution. But, perhaps, the objective is simply to explain that there is nothing weird or strange about the operations of Islamic banks and that what they are doing is already in practice in the Western world in one form or the other and, therefore, should pose no obstacle to any conceivable effort for cooperation with the West.

The major contribution of the symposium, as is evident from the title of the book, is to explore the feasibility and possibility of cooperation of Islamic banks with Western financial institutions. The presentations of the participants from the Western financial institutions reflect substantial enthusiasm on their part to explore possibilities of such cooperation. One of the presentations is analytically quite rigorous and persuasive to indicate that despite abundance of loan capital in Western world, business enterprises are finding it difficult to raise sufficient risk-capital (i.e., capital willing to bear risk). According to this presentation, if risk-capital were available in greater measure, it would be easier to over come the present business recession which characterizes a number of industrial countries. It has been argued that Islamic banks have the potential to fill this institutional gap. This raises an interesting issue not only for the peculiar role of Islamic banks but also for the role of Islamic economics in development and growth in the economy. One of the major features of an Islamic economic system emerging directly from the elimination of interest and indirectly from several other Islamic injunctions is that it promotes entrepreneurship in the economy. For a developing country, which is capital scarce, the only real factor that can be indigenously promoted for development and growth is entrepreneurship. Similarly for a developed country (or even a developing country which is surplus in loan capital) the only factor that can save the country from recession (or stag nation) is the promotion of risk bearing capital, that is, capital which can assume the role of entrepreneur rather than be a claimant of a fixed profit irrespective of the entrepreneurial risks. Islamic banks that provide risk bearing capital, thus would be welcome both in the developed world and the developing world.

The symposium concludes that there are vast opportunities of cooperation between Islamic banks and the financial institutions in the West for co-financing of profits in both the developed and developing countries. The directions of cooperation, however, fail to explicitly emerge from the discussions. The dialogue in the symposium clearly indicates what Islamic banks are offering and what the Western institutions are willing to accept from the Islamic banks - Islamic finance on the basis of participatory investment, i.e., investment which is willing to bear entrepreneurial risks. What the Western institutions are offering in return to Islamic banks is not clear.

Islam has nothing against modern operational techniques or against cooperation with Western institutions unless they conflict with Islamic injunctions. In the present world, it is not possible to live in isolation and autarky. Exchange and cooperation are required to improve human welfare. But can the cooperation, particularly in the economic and financial field, really take place between Islamic and non-Islamic institutions without violating Islamic injunctions in letter and spirit? A symposium can hardly provide answers to all relevant questions. It should not be ignored that all operational systems emerge from a particular ethical base. Unless we thoroughly discuss the areas of divergence and convergence of the ethical bases of the two systems, we can hardly arrive at any meaningful base for cooperation particularly from the Islamic banking point of view. The areas of divergence are clear to the Islamic bankers at least. For example, justice is the spirit of an Islamic system, while, as was admitted in the introduction of the book, "cleverness in making money is now the sole criterion of success in the West" (p.6). Can the two systems blend? Will the blend be desirable? A mere dialogue on the mechanisms of the two systems, as was the focus of the symposium, should not be enough to determine the possibilities and feasibilities of a cooperation. Further thinking and dialogue is required on the ethical implications of the desired cooperation. Islamic bankers and for that matter Islamic economists should not forget that it is not merely the mechanical elimination of interest but the ethical base that is making the Islamic economic system different from other systems. A common ethical base for cooperation could be, for example, social objectives that banking institutions in the two systems can agree to pursue.

An important focus of the symposium is the role of Islamic banks in providing development finance to developing countries particularly Muslim. Now when certain capital scarce Muslim countries are trying to eliminate interest from heir economies, their main worry is how to meet their resource gap. Presently, interest-based external finance is meeting this gap. Will these Muslim countries be able to obtain external finance on the basis permitted by Islam? The presentations in the symposium reflect positive indications from Western financial institutions of joining hands with Islamic banks in providing capital on participatory investment basis. There are interesting discussions indicating how Islamic banks, with cooperation from Western institutions, can play an important role in productive recycling of petro-dollars for meeting the financial needs of developing countries.

In the context of development assistance, it has been highlighted in the inaurugural address that "all Islamic banks, with the exception of, may be one or two, are in the non-oil producing countries" (p.11). The fact, however, is that the entry of Islamic banks into really poor countries to take up their development projects is yet to be seen. Islamic banks, even though they are mostly in non-oil producing countries, still seem to be generally preferring the European countries or the affluent of the non-European countries. It is repeatedly mentioned by the Islamic banks (and the same was reported in this symposium too) that Islamic banks have to pursue social objectives along with their commercial objectives. The Islamic banks have yet to prove this claim beyond rhetoric. If Islamic banks really believe that they have a role to play in developing countries and that they have to pursue social objectives then they will have to enter the more poor and the least developed countries first, particularly to deploy their funds while collecting funds and deposits from the affluent countries may continue.

The activities of Islamic banks in the field of development finance for the Third World countries is constrained by the nature of the equity capital and the deposits of the Islamic banks that do not permit them to take up development projects. As one of the working groups reported, the contribution of the Islamic banks to the financing of industrial projects in the developing countries depends on the nature and form of the Islamic banks, the nature of their equity capital and the composition of their resources, whether short term or long term. Experience has shown that most of their funds are short term deposits. So their activities in this field for the time being are limited (p.71). But if this is true then this is exactly the area where cooperation from Western financial institutions can really help and is required to be discussed. It is not enough to suggest that there was a need for having "more long term capital" in order to make investments in the developing countries. Western institutions have enough long term capital and Islamic banks have short term capital. The two capitals differ with respect to their risk preference. The investments in developing countries and developed countries also differ with respect to profit-abilities and risks involved. The elements, thus, are present to lead to working out a meaningful co-operation between Islamic banks and Western financial institutions not only for the mutual benefit of the two institutions but also for the benefit of the Third World.

Reports of the working groups, perhaps, are the most interesting part of the symposium as they reflect the results of a direct dialogue between theoreticians and practitioners on a few very pertinent issues. The reports of the working groups on "Policy Design of Islamic Economics" and on "Monetary Theory of Islamic Economics" are particularly interesting. These reports, on the one hand, clarify several issues relating to the operational aspect of Islamic banking and Islamic economics and on the other hand raise some crucial issues for researchers.

A lacuna throughout the presentation, in general, and in the report of the working groups in particular, is seriously felt by a reader who has already had exposure to theoretical readings on Islamic banking and Islamic economics. After seeing names of several practitioners of Islamic banking in the list of participants of the symposium, the reader expects to see some factual evidence and empirical support to the theoretical claims about the positive aspects of Islamic banking. No such factual evidence and empirical data has been made available from the experience of Islamic banks. When a working group reports, "Islamic banks are adopting a policy through which they are approaching the poorer, the grass root sections of society. Unlike the Western banks, they are not tending to provide financial resources to those who already have them" (p. 79), it does not make an objective statement. A presentation on empirical features and performance of Islamic banks to substantiate such claims was required.

In general, the book offers interesting reading for those who have interest in Islamic economics. Islamic economics is a challenge with a lot of hopes not only for the *Ummah* but also in that, it can "contribute to the solution of the problems that are existent in the economies of the world today" (p.10). Such symposia and their proceedings are extremely valuable to expose the challenge to the scholars and the operational experts and managers in the field. The editor has done a good job in summarizing the entire proceedings in a monograph of only 120 pages. This provides quick reading to give an overview of the key issues relating to Islamic banks. The brevity, however, deprives the readers of the different shades of opinions by not giving the details of the discussions and comments on different presentations. This curiosity will, however, end if the future volume, as promised by the editor to document the entire discussion spread over several hours, appears soon.