INTEREST-FREE BANKING: HIGHWAY TO EQUITABLE GROWTH

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A New Worldwide Movement For Equity-Based Financing

Interest-Free Banking

Highway To Equitable Growth

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Notwithstanding some initial hesitation and apprehension,' Islamic Banking is now a reality. Here we find a clear illustration of the Islamic ideals taking a practical shape in the context of modern institutions and practices. Ed.

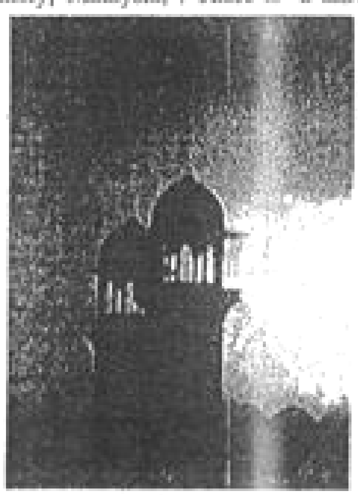
A GLOBAL PHENOMENON

The year 1975 can rightly be described as the watershed for the emergence of Islamic Banking Movement at the global stage. Although a lot of intellectual effort was consummated in the earlier decades and some pioneering spade work done in 1960s and early 1970s, it was the establishment of Dubai Islamic Bank at the national level and of the Islamic Development Bank, Jeddah, at the international level, both in 1975, that the vision began to be translated into concrete, vibrant and dynamic institutions. Since then Islamic Banking and financial institutions have been continuously and gradually established in different parts of the world and a number of Muslim countries have initiated a process to re-model their entire banking system on interest-free Shari'ah-consistent lines.

In Pakistan, Iran and Sudan, there has been afoot an effort to completely switch over from traditional banking to Islamic Banking, while other Muslim countries (namely, Malaysia, U.A.E., Kuwait, Turkey, Egypt, Algeria, Tunis, and Kazakhistan) have been experimenting with private sector Islamic banks and other financial institutions. Such banks and projects have also been started in a number of non-Muslim countries like U.S.A., U.K., Switzerland, Denmark and Luxembourg). It is estimated that about 200 banks with a deposit base of over US$.80 billion are presently operating in 30 countries of the world. According to a recent study, interest-free banks and financial institutions manage over 10 per cent of financial sector in Kuwait and Gulf region, and at the present rate of growth are expected to more than double this business by the early years of twenty-first century. In view of the vast market potential an increasing number of even interest-based banks and financial institutions in the West have opened up interest-free banking counters and are offering interest-free investment portfolios.

The phenomenon of Islamic banking is one of major innovations introduced in the last quarter of the twentieth century. It is worthwhile to examine briefly why this innovation has taken place and what may be the future role of financial institutions based on Islamic principles of *riba*-elimination and equity-based financing.

Muslims constitute over one-fifth of mankind, with 54 independent states, occupying some of the most strategic areas of the world. There is a universal realisation amongst the Muslim people to order their socioeconomic life under the inspiration and guidance of their faith and its moral values and principles and seek consolidation and integration of the Islamic Ummah. That provides the *raison d'etre* of the Islamisation movement, Islamic banking movement being a part of this worldwide Islamic resurgence. However, religious enthusiasm is not the sole explanation for the widespread acceptance of Islamic banking



practices, even though such considerations have been the prime movers for this very original and innovative financial experiment. Indeed, a lot of hard-headedness has been shown even by Muslim bankers in adapting Islamic financial principles to the real-world profit-maximising behaviour. A large part of the acceptability of Islamic Banking principles can be attributed to the realisation that equity capital may indeed be superior to debt capital. For instance, it has been suggested that the debt crisis of the decade of eighties (a by-product of recycling of petro-dollars surplus in the preceding decade) could have been avoided if developing countries had preferred equity capital to debt capital. This is so because payment due to the former can be turned on in good years and off in bad years, the same is not the case for the latter, in which case fixed charges must be paid at all times, good or bad.

The emergence of Islamic banking is a creative response on the part of Muslim economists and bankers to squarely face some of the challenges produced by economic ideologies and experiences of twentieth century.

LOP-SIDED WORLD

Despite the decline of colonialism and emergence of over 140 independent states (54 of them being Muslim states) during the last half a century, political and economic hegemony of the West remains a gruesome reality. Whereas the British and the Mughal India had roughly similar per capita levels of industrialisation and income at the beginning of the nineteenth century[1] and Turkey was more affluent and technologically ahead of most of Europe and America at that moment of world history, the picture is very different as the twentieth century is drawing towards its end. The present world economic system is controlled and manipulated by a group of 23 countries belonging mostly to Western hemisphere. "The richest one-sixth of the earth's population ...enjoys a disproportionate five-sixths of its wealth."[2] In the words of a former Secretary General of World Federation of United Nations Association: "Twenty per cent of the Northern minority controls 82.7% of world gross national product, 81.2% of world trade, 80.5% of domestic investment, and 94% of research and development."[3] According to the UN Development Studies, developing countries are losing over $500 billion a year income that they could have earned because of protectionist and restrictive barriers that exist in the North against their products, as also because of multifarious pressures of interest rates on their borrowings and other structural inequities between North and South. Add to this the role of multinational companies, around 500 of which control some 50% of the total world trade. The politico-economic crisis of the South has been further aggravated by the grafting of Western model of centrist nation-state into almost every society in the Third and the Muslim world, resulting in regional divides, ethnic conflagrations, and social tensions. The neglect of small producer and trader, who make up the backbone of economics in most of Third World countries, has further dampened the economic scene.

This has produced a lop-sided world. As Paul Kennedy puts it: "Developed Northern regions place much greater stress per capita upon the earth's resources than do developing countries, simply because the former consumes so much more. Thus, the consumption of oil in the United States – with only 4 per cent of the world's population – equals one-quarter of total world annual production; in 1989, the United States consumed 6.3 billion barrels of oil, ten times the consumption of Britain or Canada and hundreds of times that of most Third World countries. The same imbalance is true of a range of other items from paper to beef. According to one calculation, the average American baby represents twice the environmental damage of a Swedish child, three times that of an Italian, thirteen times that of a Brazilian, thirty-five times that of an Indian, and 280 times that of a Chadian or Haitian because its level of consumption throughout its life will be so much greater. That is not a comfortable statistics for anyone with a conscience."[4]

And the prospects for the future are more grave. Paul Kennedy concludes: "The gap between rich and poor will steadily widen as we enter the twenty-first century, leading not only to social unrest within developed countries but also to growing North-South tension, mass migration and environmental damage from which even the 'winners' might not emerge unscathed."[5]

BANKERS' TIGHTENING GRIP

Although this state of affairs is the result of a complex array of factors – moral, ideological, social and cultural – there is a large grain of truth in the claim that unbridled capitalism and the interest-based banking system have played an important role in the making of this crisis.

Banking is no longer a mere exercise in taking deposits and extending loans. Whatever be the beginning, the fact is that the banking system today constitutes the very nerve-system of the world economy. Finance is the lifeblood and banks control and manage this lifeline. With the disintegration of socialist politico-economic system, the opening up of Third World countries, and greater integration of global economy, the role of financial institutions in setting the pace of economy has increased manifold.

Here we are faced with a fundamental problem. The institution of banking has grown over centuries in the context of a particular ethico-economic culture. Although *riba* (usury-interest) was forbidden by almost all great religions and ethical systems, and different cultures and civilisations has given rise to their own distinct financial institution, including the medieval Christian and Islamic civilisations, modern banking grew in the lap of capitalism and around the pivot of *riba* (interest). While banks perform a number of services, financial intermediation has become their major function. Modern banking system has successfully created a vast pool of assets which otherwise would have been in different places and forms, converted them into a huge force for financing private and public projects and in this historic process these financial agents were not only able to mobilise this vast financial pool but also develop the power to create credit on its basis, and as such wield enormous power and leverage, much in excess of the real asset base.

ISLAMIC FINANCIAL NORMS FOCUS ON SIMULTANEOUS ACHIEVEMENT OF EFFICIENCY, PROFITABILITY AND EQUITY.

DERIVATIVES' SPECTACULAR GROWTH

This power has increased exponencially with the advent of a set of new financial instruments known as derivatives, which have overtaken the financial markets of the world during the last decade. Derivatives are contracts whose value is based on the value of other underlying contracts; and derivative dealers are commercial and investment banks that create, price, sell, and trade financial derivatives. These contracts give one party a claim on an underlying asset, at some point in future, and bind a counter-party to meet a corresponding liability. The contract may describe an amount of currency, or a security, or a physical commodity, or a stream of payments, or a market index. It might bind both parties equally or offer one party an option to exercise it or not.

The growth of derivatives has been spectacular. According to a BIS survey, the total value of OTC and exchange derivatives in April, 1995 was US $ 47.5 trillion. In addition to OTC derivatives, there was a further $ 16.6 trillion in national principal of exchange trade derivatives. As such the derivatives volume was somewhere over $ 64 trillion. By contrast, the estimated gross domestic product of all countries in the world was $ 28.954 trillion at the end of 1995.[6] U.S.A. excells in the derivative markets as well. It had approximately $ 18 trillion in 1994 – as against total U.S. corporate financing of around $ 1 trillion in that year. It is estimated that the present daily turnover of derivatives in the world markets is over $ 1 trillion – approximately annual turnover being over $ 300 trillion, 12 times the total GDP of the world.

The *Quarterly Banking Profile* of the U.S. Federal Deposit Insurance Corporation shows that the derivatives portfolios of the U.S. commercial banks have been increasing at the rate of 30–35 per cent per year. Moreover, the derivatives are concentrated among the largest institutions: The five top banks (Citicorp, Chemical Bank, Bankers Trust, J. P. Morgan and Chase Manhattan) held 75.5 per cent in derivatives, compared to 19.5 per cent by the next 10 banks, and 5 per cent by the remaining 653 banks. By comparison, assets of U.S. commercial banks rose 9 per cent and loans rose by 8 per cent during the year ending June 1994. Thus, the "off-balance-sheet derivatives" were almost four times the banks' total assets.

DEBT-BASED ECONOMIC CURSE

While the twentieth century has a number of achievements to its credit, it is also bequeathing a legion of problems and contradictions to the twenty-first century. The most important challenge relates to the failure of the world economy towards eliminating poverty, deprivation and gross inequalities of income, wealth and opportunity adversely affecting around one-third of the mankind. Economic expansion has taken a novel form in which the link between the monetary and the physical economies has been loosened, if not almost severed. This lies at the root of the contempórary economic malaise. And as this has also been a century characterised by globalisation, the instability generated by these developments has also assumed global proportions.

The nature and structure of a modern capitalist economy can best be described as a debt-based economy. Whether we look into the consumption sector of the individual and the household, or the production sector, private or public, economic activity revolves round the pivot of credit based on interest. The strategy for growth pursued over the last two centuries has used credit as an instrument not only for physical growth but also for fiduciary expansion. That is why financial expansion via credit creation has become the premium mobile for economy and also the major headache for the system as far as stability is concerned. External indebtedness of developing countries stood at $ 1.956 trillion in 1996. The situation in respect of developed countries is no different. America is not only the richest country of the world it is also the most indebted country on the globe. In 1960 the federal deficit stood at $ 59.6 billion and the national debt at $ 914.3 billion. (In the year 1900 the national debt was $ 1 billion). In 1991 the deficit was pushed up to well over $ 300 billion, while the national debt approached $ 4 trillion.

Paul Kennedy, in his thought-provoking study, *Preparing for the Twenty-First Century*, observes: "It was not only the national debt which soared during 1980s, but every other form of debt. Consumer debt, fuelled by 'easy money' incentives, reached $ 4 trillion, while repayments diminished personal income. Corporate debt was even worse; "as the 1990s began, about 90 per cent of the total after-tax income of U.S. corporations went to pay interest on their debt"... Public and private debt equated roughly 180 per cent of GNP,... Deficits in the balance of payments and current accounts represent a further change... As a result, the United States now pays its way by borrowing from foreigners roughly $ 100 billion each year. Once the world's largest creditor, the United States has by some measures become the world's largest debtor nation within less than a decade."[7]

ISLAM'S VISION

This is the global context in which we intend to underpin the real relevance of the principles on which Islamic banking is based and the promise they bear for the future.

Islamic approach to economics is rooted in a different vision of the economy: one that is equity-based and not credit-based. Not that there would not be a possibility for loan transaction – *'qard hasana'* exists at a certain level to meet genuine individual or business needs. But the structure of the economy would be of a very different nature – capital and entrepreneurship would be co-participants, sharing the risks as well as rewards of the enterprise.

Islam is not opposed to a return on capital. It proposes that banking systems that operate on the basis of *ex ante* fixed rate of interest be replaced by profit-sharing systems in which the rate of return to the financial resources is not known in advance and is not fixed prior to the undertaking of transactions. It is to be an *export fecti* phenomenon. Islam encourages trade and commerce. Profit is not only permissible, it is encouraged as a [illegible] tive value. Instead of fixed rate of return geared to an assumed sets of profit; Islam provides for a variable rate of return based on actual profits. This is the basis on which Islam wants capital and entrepreneurship to cooperate and co-participate in the production process. Islamic societies were able to develop a number of financial instruments and institutions during the first millennium of Islamic history and although the economic system is much more complex today, Islamic banking movement is an effort to develop an alternative system in the context of the contemporary economy.

However, it deserves to be noted that the abolition of interest is only one aspect of Islamic economics. Islam aims at establishing a just economic order, based on clearly spelled out economic rights and concepts of property, contracts, work and contribution of income and wealth. It stipulates a framework of values and disvalues, desirables and undesirables and hedges the market mechanism with a moral filter so as to ensure efficiency and equity in the process of allocation of resources.

ROLE OF STATE

The role of state has also been clearly defined, neither being a neutral police state of the *laissez-faire* type, nor a totalitarian state of the socialist order. There is limited scope for intervention for specific objectivities. Islam also emphasises the need for stabilisation of prices and protection of the value of money, which is a measure of value and standard for deferred payments. In such an economy banks are not mere financial intermediaries but also play an active role in developing and maintaining a certain pattern of economy, serving certain socio-moral objectives as well. Of course banks are not expected to act as charities, philanthropic organisations or mere "welfare institutions", but the welfare, equity and stability dimensions are as relevant to the banking ethos in an Islamic scheme as are considerations of efficiency, optimality and profitability.

Definitely there would be trade offs. As such the objective is to achieve a balance between efficiency and equity, between profitability and welfare, and between expenses and stability. Traditional banking is also trying to discover the moral dimension in a limited sense. The whole movement towards ethical banking is an instance in point.[8] But that is something on the periphery – and not even the whole periphery. Ethics and social objectives are central to Islamic banking – and that is why Islamic banking is not mere interest-free banking. It is much more than that. It represents a new and vastly different vision of the whole economy.

EFFICIENCY AND PROFITABILITY

The basic idea of Islamic banking is to devise an efficient and equitable system of the profit-and-loss (some say, only profit-sharing) (PLS). The efficiency property derives from its insistence on linkage between financial and real sectors of the economy, while the equity property is based on maximising the rate of return on deposits, depending on the length of the period for which they are held.

But to make Islamic banking efficient and equitable, its profitability – that is, the difference between the rate of return on advances and the rate of return on the deposits (which is also referred to in the literature as the "spread") – should be maximised. Yet another requirement is that the risk element inherent in the bank's operations is minimised, and scrupulously managed.

The connection between efficiency and profitability properties is provided by the fact that, as established by many empirical studies, the level of economic activity is the most significant determinant of the growth of deposits and advances, and of the "spread". In other words, to maximise the profitability of banking system, economic policy must aim at enhancing the growth rate of output. Whence follows that the Islamic banking, by strengthening the link between financial and real sectors of economy, also raises potential social profitability of Islamic banks over the traditional banks.

The link between superior equity and efficiency of Islamic banking derives from the requirement that the profits (and the losses) made by such banks are shared in accord with moral (and binding) principles of justice and beneficence *(adl wa ihsan)*. Thus, given the normal "operating expenses" incurred by Islamic banks and the rate of return on their advances, the potential rate of return on deposits must be generally higher than offered by the traditional banks.

The linkage between riskiness, efficiency, equity, and profitability of Islamic banking rests on its ability (which it must demonstrate in practice) to devise an investment portfolio which, on the one hand, satisfies the preferences of the risk-averse investors and those of the risk takers (i.e. those who take no risk and those who can afford a lot of risk); while, on the other hand, it should reflect the state of economic activity in the society.

Apart from any considerations for efficiency, equity and profitability, there is the case for the PLS instruments because they seem to reflect most faithfully the principles of Shari'ah. Such instruments also set Islamic banking (based on equity-finance) apart from traditional banking (based on debt finance). In other words, the PLS instruments make the Islamic nature of banking most visible. The revolutionary potential this type of banking bears for the future is beginning to be realised by an increasing number of Western economists and bankers.

CONTEMPORARY ECONOMIC MALAISE ARISES OUT OF LOOSE LINKS BETWEEN MONETARY AND PHYSICAL ECONOMICS.

OECD'S STUDY

A study by the Development Centre of the OECD on *Arab and Islamic Banks* touches upon this aspect. The author, Ms.Traute Wohlers-Scharf, says:

"If the South proposes how, with Islamic banking principles, a new concept of socio-economic interaction (profit-sharing systems, focus on small and medium-sized innovative entrepreneurs, with the major objective of economic asset creation), it would be a contribution to co-operation concepts so far mainly propounded by the countries of the industrialised world.

"Islamic banking is trying to change the relationship between finance on one hand and industry and commerce on the other. This new relationship is the basis of the Islamic economic system being set up. Though Islamic principles have yet to be put to the test in the competitive environment of international finance, the two systems are similar in that they both strive for closer ties between financial intermediation and economic-asset creation.

"Islamic banks could make a useful contribution to economic growth and development, particularly in a situation of recession, stagflation and low growth levels, because the core of their operations is oriented towards productive investments. All countries, both in the North and in the South, need more venture capital. Loan capital is available, particularly in industrialised economies, but at high interest rates. However, even medium-scale entrepreneurs there find it difficult to raise sufficient risk capital for expansion and innovation. This has acted as a brake on productivity and economic growth in the North. Thus, practical and intermediate co-operation possibilities exist between Islamic banks and enterprises all over the world. The intermediate process remains to be fully developed."[6]

Professors John R. Presley and J. G. Sessions of Loughborough University (UK) have in the May 1994 issue of the journal of the Royal Economic Society of Britain, *The Economic Journal* tried to examine this central contribution of Islamic principles of finance under the title *Islamic Economics: The Emergence of a New Paradigm.* They noted with regret that western economists had been somewhat remiss in the last decade to recognize what had the appearance of a new paradigm in economics – that of Islamic economics. They concluded their analysis in the following words:

"A riba contract creates an explicit mapping between the compensation and the input of capital ... The prevalent method of Mudarabah-financing tries compensation of the outcome of the project. Mudarabah therefore allows the contract to control the managers incentive to exert effort directly, since

this effort affects the relationship between capital investment and the outcome of the project. Under a Mudarabah contract the manager is let free to choose the individually optimal level of investment in each state contingent on his contractually specified level of effort. Such a contract permits a mean-variance improvement in capital investment average investment is increased whilst inefficiently large fluctuation around this level is reduced . . . We have shown that the use of the prevalent alternative method of financier remuneration (i.e. Mudarabah) will, under certain conditions, lead to an enhanced level of capital investment on account of the ability of Mudarabah to act as an efficient revelation device."[10]

I may also add a succinct observation by the leading German economist, Professor Hans Alba'ah:

"They (the Islamic banks) supply equity in the form of venture capital to investors whose share is their ingenuity and their labour. Secondly, they supply equity in the form of equity capital as participants in the type of project which in general has a majority of shareholders. They may be ideally suited to meet the needs for equity capital in developing countries where the business risk is particularly high as well as in the industrialised countries where the development of new process and new projects involve high risk and requires large amount of venture capital."[11]

CHALLENGES AND ODDS

Islamic banking, if properly developed on the fundamental principles expounded by Islam, is destined to play a crucial role in reconstructing the economy in the 21st century on very sound foundations. However, it may be observed that Islamic banking, despite a promising beginning, is only in its larval stage. The real concept in its comprehensiveness is yet to be fully translated into reality. The movement has a long way to go to become truly representative of the original concept. The efforts that are being made with seriousness and dexterity to eliminate *riba* from financial dealings, however welcome, have a long mileage to achieve. It is a fact that these experiments are being made in a climate – both domestic and external – which is anything but congenial. The moral fibre of the society is weak. The legal framework is antagonistic. The tax system is partial towards the interest system and almost inimical to a profit-sharing system. The state of competition between Islamic and traditional banking systems is such that most of the odds are against the Islamic system.

In this context whatever progress has been made is path-breaking. Yet it deserves to be acknowledged that these efforts represent only first steps toward the direction of Islamic banking. The present-day interest-free banks have relied rather too heavily on those permissible instruments of financing which are closest to the traditional system like Murabah (mark-up) and Ijara (leasing). Almost 80 to 90 per cent lending has been done through these instruments. The real alternate instruments Mudaraba (trustee-financing) and Musharika (profit-sharing) have been resorted to only to a very limited extent. Other ethico-social objectives have also not received the importance they deserved. Greater success has been achieved in the field of deposit-mobilisation, particularly many untapped sources have been drawn upon. But the socially beneficial and development and welfare oriented utilisation of these resources has left much to be desired. Employment generation and flow of resources towards the lower and middle classes of the society, particularly in the rural sector, where great potential as well as greater challenges exist, has not taken place. So is the question of efficient utilisation of funds. That is why it would be unfair to judge the success or otherwise of the Islamic banking scheme mainly on the basis of the limited and partial experiment that is presently being made. The experiment is not even halfway through. The mileage yet to be covered is crucial. The distinctive character of the system is yet to unfold. Then and then alone the scope and extent of the experiment could be fully and realistically appreciated.

However, looking at the actual experience, at least in some countries, the rate of return offered by the Islamic banks has been generally lower than that offered by the traditional banks before the Islamic banking was introduced.

The investment portfolio held by the Islamic banks has generally favoured trade-related over production-related activities, short-term profitability over long-term profitability, and private profitability over social profitability. The heavy concentration in few assets of short-term duration has typically lowered the stability of the Islamic banks' portfolios and has increased the degree of their risk.

In practice, there has been an overwhelming preference by the users of loanable funds for the mark-up instruments over the PLS instruments, which have been overshadowed in the bank's portfolios.

The real rate of return (adjusted for the inflation rate) has been generally lower, if not negative, while that on the bank loan it is strictly positive.

FUTURE AGENDA

In view of these challenges from within and the major difficulties and bottlenecks from without, the Islamic banks have to undertake the herculean task of implementing Islamic financial norms in such a manner that efficiency, profitability and equity are achieved simultaneously.

It is therefore submitted that the system of auditing of bank accounts must be upgraded to determine their legitimate operating expenses and the monitoring of the case of bank default or other derivations from the norm. This should be an integral part of Islamic banking (indeed, of any responsible banking). In their words, the information basis of Islamic bank must be widened and made readily available with the help of modern computer-based technologies - which allow the storage, the processing and the dissemination of relevant information in a very short time and at the least cost. This is basic, because the information cost typically rises when Islamic banking is introduced. For instance, the depositors will have to evaluate the relative performance of competing banks to reach a decision about where to invest their funds. On the other hand, the bank will have to seek greater and timely information about the use of the funds it makes available to the entrepreneurs.

The cases of loan default must be dealt with severely in Islamic banks as they amount to *khiyanat*, which is a great sin in Islam. In general any misappropriation of bank fund should be declared a social crime.

To satisfy the equity requirement, the difference between the rate of return on bank deposits and that on bank advances should be as small as possible – making due allowance for the bank's operation expenses, as determined by authorised auditors.

To be preferred over the traditional banks, the Islamic banks should be made to offer a real rate of return, ranging from zero to a reasonable positive value, depending on the length of time for which the deposits are held. The reason is that in times of inflation the rate of return on bank advances typically rises by more than the inflation rate. This should enable the Islamic banks to do inflation adjustment at the rate of return offered on their deposits as well.

The Islamic banks should evolve innovative portfolios to suit the risk preferences of different classes of savers. It would be morally indefensible to make all classes of savers to bear the same degree of risk – irrespective of their capacity to take risk (which depends on the size of their respective incomes, savings, and so on). The Islamic banks should also show enterprising spirit by funding projects of a longer-term nature and where the social profitability of investment is higher than their private profitability – which typically covers all areas where external economies are large (health, education, infrastructure investment, and others).

To lower the incidence of risk and uncertainty, a system of deposit insurance may have to be instituted. On the side of bank advances, the legal structure governing private property rights should be clarified and strengthened. The evolution of effective supervisory mechanisms at different levels, horizontal and vertical also poor a critical challenge into moral be not unsuccessfully. This writer firmly believes that the Islamic banking can come of age only in an economy and society that is committed to total Islamisation and where real transformation is produced as a result of comprehensive movement, consisting of Islamically oriented behaviour of the individual and socioeconomic reform based on Islamic values. He supports that group of economists who regard the contemporary Islamic-banking movement, despite all its weaknesses, as a positive development which bears great promise for the future. Despite fundamental differences with the traditional banking there is a vast area of co-operation between the two streams. After all, venture capital has played a very important role in the development of the world economy.

Investment banking has been an integral part of banking more prominently in German and French traditions of banking. Unit trusts and investment houses are operating as major financial institutions in the world today. IFC as against IMF and World Bank, has gone with equity financing as part of international developmental effort. Western bankers may not be averse to the idea of developing new modes of co-operation with the Islamic banks and financial institutions if they are presented with economically viable projects. If Bosphores bridge – a billion dollar projects – could be financed through venture capital, why not thousands of other such projects. Once this new commonality of interest, based not on traditional "interest" but some form of equity-sharing – is built, I am sure new avenues of co-operation can be explored.

Huge untapped resources exist in the Muslim world and one of the reasons why they remain untapped is Muslim reluctance to go for interest-based financial institutions. Recent surveys have shown that even in Saudi Arabia, between 40–60 per cent of the households that have a relatively high per capita income do not have account. A large number of those who keep deposits have refused to take interest.[12] The situation is not different in other Muslim countries and even with the Muslim communities in many Western countries. This potential is yet to be tapped fully.

UNIVERSAL APPLICABILITY

Moreover, Islamic banking principles and instruments are not relevant to the Muslims only. They have universal applicability. Some recent trends in world capital movements show clear shift towards equity investment and venture capital. Net private capital flows (direct investment, net portfolio investment and other longer and short-term net investment flows to developing countries) were $ 10.1 billion on the average during 1973–1977, which increased to $ 27.4 billion during 1978–82, and to $ 117.8 billion during 1989–95. The actual figure for 1995 is $ 166.5 billion. As against this net official flows, mainly debts, were $ 11.1 billion during 1973–77, $ 23.4 billion during 1978–82, declined to $ 16.4 billion, average during 1989–95. The amount of venture capital in funding in Ames has risen by 27% during recent years.[13] If these trends provide some clue to the future, they suggest greater scope for equity-investment in the coming decades. This, among others, sets the ground for greater co-operation as well as healthy competition between Islamic and traditional banks not in the next century. Let the Islamic and traditional banking look upon each other necessarily as rivals, despite their differing perspectives and idealisms. They can still be partners in building a brighter future for mankind – both in the Muslim and the Western worlds. ◆

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