Resource Mobilization and Development Goals for Islamic Banks

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ABSTRACT

A critical evaluative study of Islamic economic thought that has gone into the theory of money, finance, and market exchange is undertaken. Such economic reasoning influences the operations and financial perspectives of Islamic banks and financial institutions. Yet it has remained oblivious to the paradigmatic substance of Islamic political economy, wherein human futures incorporating markets, money, finance, institutions, and the economy are studied via an interactive process-based worldview that makes institutions, policies, and preferences endogenous entities. The epistemology of Divine Unity that generates unification of knowledge in a web of systemic complementarity and diversity becomes the essential foundation of the new paradigmatic shift. Viewed in this light, the corresponding goal of social well being, substantively explained, is presented for Islamic banks and financial institutions. An empirical study of Islamic banks points out that such a *Shari'ah*-based worldview remains to be realized. Policy directions are thereby suggested.

I. OBJECTIVES

This paper has three objectives. First is to critically assess whether the type of resource mobilization that Islamic banks throughout the world presently undertake can eventually lead to the formation of a viable Islamic capital market and the Islamic socioeconomic transformation. Second, along with major questions and perspectives appearing in global political economy and on the threshold of new thought, it is also time now to evaluate whether the evolution of Islamic banks and their future prospects points to a substantive contribution in these directions during the new millennium. Together with these questions, one must also examine the philosophy behind Islamic financing and money in their relationships to the Islamization process, particularly of the Islamic political economy. An alternative worldview on paradigmatic shift is provided. Third, an empirical analysis is done to evaluate the performance of Islamic banks and financial institutions during the last decade. This is followed by recommendations to standardize the scope of Islamic banks and financial institutions globally, in light of the analysis in the first and second objectives of this paper.

II. REVIEW OF LITERATURE

A. Keynesian and Neoclassical Orientations

A brief review of the literature on Islamic finance, money, and macroeconomics shows that one or the other of the received economic doctrines, particularly of the Keynesian and neoclassical genre, has been thoroughly rationalized and used. Within these main areas, the models of Tobin and Brainard (Khan and Mirakhor, 1989), moral hazard and information asymmetry (Khan, 1985), and risk aversion and the principal-agent game (Bashir, 1990) are the main ones adopted. The neoclassical doctrine of optimality, marginal analysis, the existence of exogenous preferences, and the derivation of financial rules with the tradeoff between money and goods, all of which are found in consumer utility analysis, have become the building blocks of Islamic economists in treating decision-making with altruistic values in them, and in making money an exogenous instrument of exchange and valuation (Metwally, 1990; Khan, 1991). Even where various cooperative instruments of financing joint ventures have been invoked and interdependent utility functions used, as in the case of explaining the principal-agent problem, the preferences of agents are held to be exogenous.

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Social decision-making that should truly configure the cooperative venue in the sense of interactions, organizational behavior, and the process of dynamic change within systems are treated non-substantively. Thus a Beckerian neoclassical analysis of altruism, with risk aversion and the marginal substitution hypothesis entrenched in the prescribed utilitarian behavior of agents, is used to explain the nature of altruism in the Islamic economic attitude toward risk and return by individuals and collectives (Becker, 1989; Khan, 1992). There is an endorsement of such neoclassical methodological approaches in the understanding of the relationship between money and goods and the risk-return behavior behind financing and resource mobilization in the neoclassical economic framework (Naqvi, 1994).

There are at least two problems with both the Keynesian macroeconomic orientation and the Tobin-type neoclassical treatment of the liquidity preference theory of the relationship between money and goods. First, a macroeconomic approach to this relationship hides the ethical and moral nature of the relation between money and goods, institutions and preference formation—essentially a matter of microeconomics. Thus a macroeconomic policy analysis on the quantity of money is methodologically carried out in the absence of the intrinsic nature of microeconomic interrelationships (Thurow, 1983). Here, for example, one can think of information sharing, which configures the decision-making relating to a relationship between money, goods, prices, and factors of production. The Keynesian theory cannot offer such perspectives.

Second, Tobin's liquidity preference theory of money and goods in utility analysis assumes agent-specific preferences to be exogenously given (Tobin, 1958). A utility maximum and an optimal allocation of resources are assumed to be attainable. Optima that are attained by a cogent realization of the first-order conditions of the utility maximization problem are of the long-run type. The implication is that the assumed optimal relationship, and with it the underlying equilibrium resource allocation, are permanent structural conditions of the model and methodology. Given exogenous consumer preferences, targeted utility-maximization problems, and the steady state equilibrium methodology, any substantive issue of interactive, cooperative decision-making under the continuous impact of an evolutionary process of information flows (learning) loses relevance. The importance of novelty is subdued by inert learning states (Shackle, 1971; Simon, 1960).

B. Non-Neoclassical Evolutionary Approaches

Islamic economists have sparingly ventured in the direction of the rational expectations hypothesis, which tries to lay a microeconomic foundation for macroeconomics (Lucas, 1983). Few works in this area of methodology applying to Islamic political economy have looked at the social contractarian issues with economy/institution interrelationships (Choudhury, 1993a; Mehmet, 1990). The missing methodological area for explaining the dynamic nature of interrelationships between monetary issues (seen as an institutional category) and goods (seen as a market phenomenon) has resulted in the absence of an explanation of endogenous interrelationship in such economy/institution interlinkages. Contrarily, the methodological and applied understanding of the inhering interactive and evolutionary interrelationships within a consensual framework of economy/institution social contracts becomes central to the microeconomic (i.e. market-based) preference formation in concert with the flow of information from public authority (polity).

Even in the case of the rational expectations hypothesis (REH), such a dynamic concept has not been possible. Expectations based on an existing stock of knowledge are assumed to be adaptive. Hence, despite the REH's introducing probabilistic processes, the adaptive nature of information flows assumes a linear history and its exogenous influence on present and future preference formation. This is nothing but a property of linearity in models of behavior and change. Indeed, if we apply such Markovian models to the stock market volatility of recent times, the result would be chaotic to investors' well being (Kolb, 1994; Yong, 1994). In essence, the moral dimensions of money, finance, and their relations to the market exchange, through an endogenous treatment of institutions, policy, and interrelations in the political economy, cannot depend upon time-forecasting models for directives. Instead, structural models of behavior are used to guide prediction and change. Such models are simulated by information flows using evolutionary knowledge, not by sheer dependence on linear time.

In earlier works on money and finance in Islam, certain instruments were invoked under the claim of the *Shari'ah* (Siddiqi, 1985; Chapra, 1985). Most prominent among such instruments, in the absence of interest transactions, are *mudaraba* (profit sharing) and *musharaka* (equity participation). Thereafter, other forms, such as trade financing, *murabaha* (cost-plus pricing), and secondary-market financial instruments

(e.g., unit trusts, co-financing, and Islamic bank portfolios), are linked with joint ventures. Financial loans are treated as grants having no interest rate attached (*qard hasana*) (IDB, 1997).

While such financial instruments are at face value *Shari'ah*-based, there remains the deeper question whether the way they are currently used helps interlink the goods and money markets (i.e. economy and institutions, as mentioned above). In fact, a prime objective of the *Shari'ah* (*maqasid as-Shari'ah*) is to attain social well being through complementarity among opportunities that the moral law allows. Such a complementarity rule attained by means of *Shari'ah* rules (*ahkam as-Shari'ah*) emanates from the Qur'an: "Of every kind He made in pairs, two and two … Behold, verily in these things there are signs for those who consider" (Qur'an 13:3). The principle of complementarity is causally related to the diversity of the creative order: "And in the earth are tracts diverse through" (Qur'an 13:4). Such universally causal relations are shown as the medium of dynamically evolving creative processes: "It is He who begins the process of creation, and repeats it" (Qur'an 10:4). These principles, taken together, bestow social well being that is reflected by the Divine attributes of balance and justice: "that He may reward with justice those who believe and work righteousness"(Qur'an 10:4). There are many other Quranic verses to establish this inference (Choudhury, 1994). The precepts of universal complementarity, diversity, and the creative evolution of opportunities therefrom become the permanent characteristic of the Islamic worldview, with its epistemological premise of Divine Unity. The creative actualization of Divine Unity is found in the emergent unification of knowledge within Islamic world systems, in the present case of money and markets, institutions, and the economy. The unification of knowledge is the manifest essence of the principle of complementarity.

The issues of economy and institution, and hence of the causal relationship between money and markets, and all the methodological ramifications of these concepts are thus premised on the overarching implication of the *Shari'ah*. From our Quranic derivation it follows that the *Shari'ah* is based on systemic complementarity among the diversity of permissible possibilities evolved by the creative synergy of human presence. Besides, the complementary essence is seen by the Qur'an to be endowed in nature. Its observation is open to discovery through human effort, discourse, and interactions.

Complementarity among the diversity of *Shari'ah*-based opportunities is discovered as the basis of the goal of attaining social well being. When money, markets, and financing instruments are taken up within such a systemic methodology, their *Shari'ah* relevance cannot be limited to isolated segments of the society or its sectors, markets, agents, and enterprises. In other words, the *Shari'ah*-based money, markets, and financing instruments, with endogenous interactions and preferences, novelty and discovery, must evolve ever new possibilities for dynamic expansion. Besides, the ever-increasing sets of interactive instruments and methodology enable such systemic expansions to occur and be sustained. The implication here is not that *Shari'ah*-based possibilities are to link up with those inimical to Islam. *Shari'ah*-based opportunities must replace the latter, not merge with them.

In the end, we find that the treatment of money, goods, markets, and their causal interrelations has not been advanced in Islamic economics in a strictly Quranic view of such politico-economic realities. The undue reliance of the Islamic economic methodological approaches in this area is one of several mainstream adaptations and has crried with it the epistemology of such other systems. The substantive methodology of endogenously incorporating the Divine Unity worldview, along with its precepts of complementarity, diversity, and the evolutionary model of unification of knowledge could not be incorporated. This debility has partly been because of the very ethically neutral or ethically exogenous nature of the economic theory on which Islamic economic methodology and methods have been premised. The new methodology to explain causal relations among money, markets, and financing, and thereby among institutions and markets, will now be briefly expounded (Choudhury, 1997).

III. METHODOLOGY

We commence this section by noting the premise of Divine Unity that endogenously establishes a knowledge-induced process worldview of interactions among diverse *Shari'ah*-based opportunities with complementarity and creative evolution as the essence. These processes take place in the human world in institutional and organizational forms. The Qur'an refers to them as the systemically pervasive consultative organization called *shura*. Consensual evolution of such organizational behavior implies the unification of knowledge based on the tenets of the *Shari'ah*. In the physical world including markets, the worldview arises from inherently complementary interlinkages. Such is the attribute of unification realized by means of the essence of Divine Unity (*tawhid*) in the order of things (Choudhury, 1991; Faruqi, 1982).

A. Social Well Being Criterion

With the two complementary sides of social reality—the human world and the natural world—we now define the social well being function as the evaluative criterion of complementarity and balance reflected by institutional rules and market preferences and between them. Complementarity thus becomes pervasive. It annuls both the tradeoff nature of marginalism and the concept of limited complementarity in neoclassical economic theory. It also replaces the Keynesian concept of macroeconomic aggregation, the neoclassical microeconomic foundations of macroeconomics, and social contacts based on public choice theory (Buchanan, 1971) by the criterion of social well being. From this criterion are then derived the interrelationships between money and goods, prices, financing instruments, and factors of production, and economy-wide linkages among real economic activities. The *Shari'ah* rule of interest-free financing eliminates financial speculation and promissory monetary notes from capital markets.

The concept of such a social well being criterion that captures the overarching precept of complementarity and thereby unifies diverse *Shari'ah*-based opportunities is similar to the precept of a public purpose based on *Shari'ah* rules. Imam Shatibi formulated one such theory as *al-Maslaha wa l-Istihsan* (Shatibi, undated; Masud, 1984; Choudhury, 1993a).

The attributes of social well being in *Shari'ah* terms are:

1. upholding the law of Divine Unity (*tawhid*);
2. just balance (*mizan*);
3. dispensing equality with justice (*'adl*). This attribute comprises the Divine purpose of justice in the *Shari'ah*;
4. protecting property rights, entitlements, security from insolvency, and guaranteeing the basic needs of all. This comprises the attribute of certainty, or *haqq al-yaqin* in the social domain;
5. and dynamic reproduction of knowledge of the Divine Unity (*khalaqa thumma yu'id*).

These attributes are entrenched in Islamic political economy by injunctions of the Qur'an. They are not initiated by human "rationalism." The great Islamic philosopher Fakhruddin Razi thought of such attributes of the *Shari'ah* in his epistemological works (Noor, 1998).

For instance, money in the social well being function becomes a complementary entity with real economic transactions. The monetary authority creates it as a quantity equivalent to the value of transactions of real goods and services in market exchange. The link between exchange prices and the quantity of money occurs primarily from the market side to money, not vice versa.

In the first round of interactions, money responds to the exchange value of real goods and services. This marks the market determination of value and its monetary assignment. With this direction of relation from goods to money, prices determine the quantity of money required for the valuation of real transactions. We note that the discursive process underlying *Shari'ah* modes of financing and of establishing permissible enterprises initially determines the nature of exchange transactions. The consumption preferences and production and distribution menus, changed by interactive knowledge induction through discourse, give social legitimacy to the *Shari'ah*. Goods thus affect the quantity of money. Money then responds for purposes of valuation to the real exchange.

In the second round of interaction, when an existing quantity of money from a previous time period (i.e., the moment of shuratic discourse) has already entered the markets and has valued a market exchange in process, there comes about a simultaneous income multiplier caused by such a valuation. Money affects a second round of economic activity. This is the reverse of the first round of interaction, in which goods determined the quantity of money for exchange valuation. Yet such an effect of money on goods, incomes, and thereby prices occurs by the continuing organizational interactive process of market-institution *shura*. It is this form of interrelationship at every stage of choices that determines where money is to be mobilized and by what instruments in order to make the creation and use of money acceptable in *Shari'ah* perspectives and link it with real transactions.

On both sides of the above-mentioned interrelationship between money and real economic transactions permissible under *Shari'ah*, knowledge formed through the underlying shuratic (of the essence of *shura*) process becomes the only determining factor. In the absence of such a primacy of knowledge formation in the interrelationship between money and exchange value, speculative transactions would enter exchange. Promissory monetary notes would be supplied. These would cause interest rates to become endemic in transactions. All *Shari'ah* rules would be annulled. The circularity of interrelationships

between money and goods in rounds of creative evolution between institutions and markets being determined by the primacy of knowledge formation based on *Shari'ah* rules makes the models of knowledge-based dynamics among money, output, value, prices, costs, and factors of production to be determinate. The problem of logical tautology in a circular dialectical process, found in Marx (Carchedi, 1991), and of non-convergence of decisions, in Rawls' infinite social games (Wolff, 1977), are resolved by the presence of endogenous knowledge derived in the specific issue from the epistemology of fundamental Unity.

The type of money in Islam we have defined here is endogenous with respect to its knowledge-based interactive, complementary, and dynamic interrelationships with real sectoral transactions. Its valuation is carried out through financial instruments. All these are determined by *Shari'ah* rules. Consequently, because both financial speculation and promissory monetary notes become irrelevant in and by the above interrelationships, interest rates cannot have any bearing on such real economic transactions. Exchange value is measured by market-driven prices. Consequently, price instability is reduced. Thereby, costs of production and factor payments remain stable as well.

In case market imperfections inevitably appear in such processes of Islamically ethicizing market transformations, probabilistically expected interrelationships would be generated. But such expected values are simulated by means of knowledge-based rules and directions emanating from interactions. They are therefore not based on time-dynamic forecasting and predictive methods alone. The evolution of complementarity opportunities based on the realization of rich diversities among goods and services achieves product and risk diversification continuously. In the evolutionary framework of analysis of Islamic political economy of money and goods, institutions, and markets, such incompleteness of information flows must always exist and be improved on. Consequently, imperfections in market-institutional and money-goods interrelationships must always exist. By simulation of the social well being function, we have replaced optimal methods of analysis in neoclassical economic theory in relation to knowledge-based socioeconomic variables, including money, output, prices, costs, and factors of production with *Shari'ah*-based policies (*ahkam as-Shari'ah*).

IV. A SIMPLE FORMULATION

A simple formulation of the knowledge-induced social well being function, SW, and its subsidiary relations is:

$$SW \quad = \quad SW(M, X, p, F, P(r)) \tag{1}$$

The social well being function is simulated in terms of its inherent knowledge production by interactions among the following relations:

$$M \quad = \quad f_1(X, F, p, P(r)) \tag{2}$$
$$X \quad = \quad f_2(M, F, p, P(r)) \tag{3}$$
$$F \quad = \quad f_3(M, X, p, P(r)) \tag{4}$$
$$p \quad = \quad f_4(M, X, F, P(r)) \tag{5}$$
$$P \quad = \quad f_5(M, X, F, p) \tag{6}$$
$$r \quad = \quad f_5(M, X, F, p, P) \tag{7}$$

SW, the social well being function, is based on complementarity among the following variables:

M: quantity of money
X: output
F: services of factors of production
p: exchange price
P(r):   *Shari'ah*-based policy, as indicated by its dependence on the profit-sharing rate r in *Shari'ah*-approved opportunities
P.:   previous policy impact on r in a recursive sense

Furthermore, as the circular causation of interrelationships among markets and institutions, and among socioeconomic variables, as explained earlier, continues, attained levels of (M, X, F, P(r)) determine

SW, which in turn determines simulated values (denoted by +) of (M, X, F, P(r))₊, and so on. Each time, the continuous evolution of underlying knowledge values (implicitly implied here) causes the evolutionary causation to occur. See Figure 1.

Next, we can explain the nature of the above forms of interrelations among (M, X, F, P(r)). Note that the principle of complementarity implies that with respect to the simulation of the underlying knowledge variable realized in the interactive process, we obtain dSW > 0. This implies that all the knowledge-induced variables change together and in the same direction.

Expression (1) means that in the knowledge-induced sense, as money increases (or decreases) with market transactions, X increases (or decreases). This relationship automatically stabilizes prices from the demand and supply sides. Now increased mobilization of M across increasing X stabilizes the growth rate of the quantity of money. Since the existing quantity of money assigns values to goods in exchange, therefore, the rates of change in money and prices remain equal. Thereby, inflation is avoided; price stability is maintained.

With the attainment of increased output (X), factor use (F) increases as well. But since p remains stable, factor payments are also stabilized. Consequently, the yield on profit-sharing ventures, denoted by r, increases in the midst of such stability and productivity growth. Such yields manage to augment the factor payments with dividends. In the developmental sense across the economy, markets in the microeconomic sense generate the aggregate quantity of money for circulation among complementary activities, as explained here.

The endogenous effect of prices and output on the quantity of money is transmitted essentially by knowledge formation through interactions. This is instrumental in causing the stability of the relationship (1). Otherwise, any other effect of prices on the quantity of money can be inflationary. Besides, with the neoclassical marginal substitution among factors of production, F, the stability of incomes by such factors would not be maintained. This would adversely affect income distribution, which would show up on the profit-sharing side. The marginal substitution between factors as a cause and effect of the inequitable distribution of incomes now becomes a de-link in the otherwise complementary chain required in the Islamic economy.

The implication of such differences between Friedman's (1989) concept and ours, regarding the "quantity equation" relating to money, income and prices, as in (1), is that the knowledge-centric institutional relations cause stabilization in (1). However, leaving this same expression to Friedman's quantity equation of exchange can cause speculation and inflationary pressures to occur randomly (Laidler, 1989).

Expressions (2) through (7) give the reverse relationship in the circular causation between money and socioeconomic variables, as we explained earlier. In such a circular causation evolutionary process, the implications of stability among the variables are maintained by the presence of knowledge formation in the interactive processes that ensue (i.e. P(r)). In their absence, any other form of increase in money creation will inflate prices and destroy the balance of interrelationships among the variables as shown.

The implication of stability is also in accord with the dynamic basic needs regimes (X, F) of change that essentially characterize development in Islamic political economy (Huq, 1997). Here price stability (p) keeps unison between moderation in income (X) and in spending (money). Moderate factor payments are thereafter augmented by profit-sharing (r).

In the end, social well being improves along a stable trajectory of complementary variables, all being induced by knowledge formation in the underlying interactive process. Such a social well being function must then have multiplicative and non-linear variable types. Since the social well being function now becomes a non-linear aggregation of the microeconomic social well being indices, as implied by group-specific, enterprise-specific, and economy/institution-specific interactive preferences, we have the implication of a microeconomic foundation of politico-economic interrelationships. Here, preferences and policies become endogenous due to continuously generated knowledge and their circular cause-effect interrelationships among the socioeconomic variables.

V. ISLAMIC BANKS AND ENDOGENOUS MONEY

The implication of expressions (1)-(7) for Islamic banks is that such financial institutions are now intertwined with socioeconomic development issues in Islamic political economy. Their objective criterion, as guided by the social well being function, is to generate and sustain intersectoral linkages among real transactions as prescribed by the *Shari'ah* and using *Shari'ah*-based financing instruments. The

focus on such intersectoral linkages, while they are based on P(r), increases resource mobilization and reduces all kinds of speculative financial transactions. In an Islamizing political economy with the role of Islamic banks as development institutions, the ratio (interest rate (i) /profit-sharing rate (r)) thereby progressively decreases to zero. Risk diversification, followed by increasing r and decreasing i, is complemented by product diversification, indicated by an increase in real output (X), along with stability in the growth rates of M and p.

As Islamic banks get increasingly coordinated in an Islamic political economy, a positive Islamic capital market can arise. This is an evolutionary process of the type explained above. Islamization of the financial sector is meant here to evolve even from an initially a non-*Shari'ah* venue to increasing acceptance and application of the *Shari'ah* in society. In such an evolutionary process, banks and financial institutions would increasingly cease to issue promissory monetary notes. The quantity of money created would be determined in concert with representatives of the commercial enterprises, clients, their Islamic banks, and the central bank. The central bank would then create and constrain the quantity of money in accordance with the direct transaction needs of the agents. Any excess money, apart from the requirement to service loans and debts outstanding with interest-bearing sectors, would be neutralized.

Clients hold vouchers, just like checks, which they can fractionally liquidate across the bank counter after spending in direct transaction needs, just as bonds are liquidated. They would then hold vouchers of residual value. The unused monetary holding would be neutralized. A transformation to 100% reserve requirements at the central bank would be engendered in such monetary regimes.

In a 100% reserve requirement monetary regime, the central bank does not "supply" money. It simply produces money at a cost, like any other commodities created in real economic transactions. It then lets commercial banks, entrepreneurs, and clients hold it on the basis of a widely systemic form of cooperative ventures. In these ventures, the central bank, commercial banks, entrepreneurs, and households (represented, say, by consumer guilds) all become participants.

This is precisely the idea of the economy-wide and globally interlinked participatory ventures in light of *Shari'ah* rules, wherein profit sharing, equity-participation, and other instruments cease to be restricted to narrow domains of actions. Systemic expansions of intersectoral and global linkages are generated and sustained. Once again, the central principles of complementarity, diversity, and creative evolution function in such interrelationships between money and real transactions.

It is no wonder that after World War II, the demise of the gold standard and the fixed exchange-rate regime were caused by the cunning of capitalist financiers to monetize the post-war debts of many countries. The Bretton Woods agreements institutionalized the holding of the U.S. dollar or the British pound as paper money. Such holding of paper money caused hyperinflation around the world and ended the stability that the gold standard stood for and realized. Today, the same game of supplying paper money (promissory notes) has caused speculation and an excess supply of dollar-denominated money to be held by entrepreneurs at high risk of uncertainty in capital markets. The Southeast Asian stock market crashes proved the volatile and uncertain consequences of currency swaps and derivative markets, where money as promissory notes held in convertibility to U.S. dollars did not link with real sectoral transactions.

A. Loanable Funds

In the case of loan capital, the usually accepted notion of lending as grants—because interest-based transactions are avoided—raises questions relating to the sharing of participatory costs and benefits. Risk must be equally shared in appropriate ways among partners. A borrower of money is indeed a partner with other risk takers, though with a different mode of financing.

We suggest that the cost of loanable funds in an Islamic participatory joint-venture scheme be computed by holding it against a productive venture. For example, if an Islamic bank makes a loan on a car, the cost of the loan is not an interest charge on it. Rather, it is a payment equivalent to a proportion of the market value of the car, over a period of time, as the loan is progressively liquidated. The payment would be against the period-wise income accrued, in the production of which the car was an intermediate input. The payment of the decreasing proportion of the loan outstanding continues until the liquidation of the loan by market valuation. Such a market valuation helps avoid an interest capitalization of the loan.

In the case of a loan to a poor or asset-less person, the focus must be on the productive use of such loans, rather than on issuance of loans for sheer consumption purposes. For example, cooperative joint ventures by the poor in an economy-wide sense and their effective product selection and development must become the target. Loanable capital would then be linked with a productive return on such enterprises. Only in adverse cases can loanable capital be financed as a grant from developmental funds held by

financial institutions. But here, too, the loanable funds would be combined with the 2.5% mandatory Islamic wealth tax on the accrual of the fund to meet the immediate consumption needs of the poor and needy. This Islamic charitable outlay is called *zakat*. *Zakat* is not to be repaid by its recipients.

Boulding and Wilson's theory of the grant economy points out that a good deal of resource mobilization can be integrated with the productive economy (Boulding and Wilson, 1978). For example, homemakers generate an impressive informal economy by responding to flyers and catalogues distributed free. Such ads bring forth a substantial amount of spending. Similarly, at the grassroots levels of the Islamic political economy, the interface among interest groups, Islamic banks as development institutions, market opportunities, and the *Shari'ah* polity can generate wide intersectoral linkages. In such situations, any loanable capital should be linked with returns on the productive outlets for which the loan will be used in direct or indirect ways.

At the end, we see that whether it is for investment or consumption purposes, resource mobilization becomes the target for Islamic bank portfolios. Loans are converted into resources if they pay returns in the absence of interest rates. The very absence of interest rates or its progressive phase-out increases the speed of resource mobilization and spending capacities of the Islamic economy. *Shari'ah* institutions launch their efforts in this direction by being catalysts for knowledge generation, that is, interactions and guidance. It is only in the interest-based loanable system that the poor are adversely affected, spending remains costly, joint ventures are limited by the constraint on spending; and productive returns remain low due to the presence of high or uncertain commercial interest rates and financial collateral.

VI. ISLAMIC FINANCIAL INDEX

From our discussions on the nature and modus operandi of Islamic financial instruments, it is clear that participatory joint ventures stand out as the singular aspect of Islamic enterprise. This acquires its significance in the midst of the universally interconnected epistemological worldview of unity and unification afforded by the *Shari'ah*. The complementary and interactive perspective is holds on matters of money and real transactions in ethical markets and between the economy and institutions on the side of polity, organization, and social contracts. The narrow concept of participatory instrumentation has thus been extended to the overarching case of systemic interlinkages in the economy-wide and global sense. We will now formulate the index of Islamic financial instruments that can effectively realize such extensive systemic interlinkages among real sectoral activities permissible under the *Shari'ah*.

A. Definition of an Islamic Financial Instrument

What then is the idea of an Islamic financial instrument, I, in the above sense? "I" is an index of ways to realize the monetary goal of valuation in the sense of extensive linkages among *Shari'ah*-based enterprises. Formally we proceed as follows:

Note the relationship that holds in the Islamic political economy,
$$\text{Commerce} \xrightarrow{}_I \text{Valuation} \xrightarrow{}_{I'} \text{Commerce} \tag{8}$$

(as opposed to the M-C-M cycle of the capitalist order) (Heilbroner, 1985).

We write I(Commerce) = Valuation, and I'(Valuation) = Commerce. This comprises a pair of recursive relationships. Interrelationships of this type were shown by expressions (1) through (7).

Next, we will specify some specific kinds of "I" that could be candidates in expression (8). For reasons of space, only *mudaraba*, *musharaka*, unity trust, and foreign trade financing will be considered in formulating the index. *Mudaraba* is profit sharing under economic cooperation; *musharaka* is equity participation. We will generalize for secondary financial instruments.

B. *Mudaraba-Musharaka*

For the valuation of intertemporally and intersectorally linked profit sharing and risk sharing in participatory cooperative joint ventures, we can write:

$$\text{valuation of } [(p_{ij,t}.X_{ij,t} - C_{ij,t}).\rho_{ij,t}] = \text{monetary value of returns.} \tag{9}$$

Here, i and j denote sectors, i,j=1, 2, …, n. C denotes the cost of production allayed in productive factors. ρ denotes the profit and loss shared over time t. The suffixes denote sectoral interlinkages over time.

$$(p_{ij,t}.X_{ij,t} - C_{ij,t})\rho_{ij,t} = \pi_{ij,t}, \qquad (10)$$

is the usual profit-share function that is intersectorally linked and intertemporally valued. In each case, the underlying knowledge value affecting all variables is implicit. The nature of the exact model of valuation remains to be answered in an important component of the nature of the Islamic financial indices developed below. In this regard, we have rejected the time-discounting method of valuation because of its neoclassical leaning on intertemporal costing and marginal substitution of resources (Choudhury, 1993).

But in the perspective of the simulative social well being function with money in it (the one proposed here), the following expression holds: $\pi_{ij,t} = \alpha_{ij,t} . \pi_{ij,t-1} . \alpha_{ij,t} = (1 +$ the rate of change in $\pi_{ij,t-1})$. Underlying this adjustment relation is the interactive process of simulation of knowledge values. The important attribute of the re-contracting possibility in participatory joint ventures will be reflected in $\rho_{ij,t}$. In this way, over T time periods the net valuation of shares will be:

$$M = \Pi_{t=1}^{T} \pi_{ij,t}, \quad i,j=1, 2, …, n, \qquad (11)$$

with cumulative information flows in the system arising from interactions, complementarity, and evolution. The yield rates in this case are never predetermined. It is the simulated value of yields at a given point of time that evaluates the shares. If, for instance, the profit shares were declared at the end of "s" periods of time, then the stored-value of money in the economy according to this instrument is M_t. Given such money creation, since the shareholder can opt to liquidate or fractionally hold shares, no additional money enters the economy beyond what is required for actual transactions. Thus there can be no multiple creation of money through deposits, as would be the case with promissory notes. Each M_t attains its value at specific time periods through simulation and not through additive cumulating.

The important point to note here is the extensively intersectorally linked characteristics of the profit-sharing instrument. Such an approach to participatory joint venture is quite different from the way *mudaraba* and *musharaka* are treated in Islamic economics. There, the view of these instruments is one of a sleeping partnership between the contracting partners, with no particular attention paid to intersectoral linkages. In our case, the "I" instrument is seen to be linked with a vastly cooperative joint venture financing system, with profit sharing replacing the interest rate, and endogenous money in 100% reserve requirement prevailing.

In this extended sense, the above-mentioned adjustment expression can be spread out intersectorally as follows, for a given time period t:

j \ i	1	2	3	…	n	Averages*	
1	π_{11}'	π_{12}'	π_{13}'	…	π_{1n}'	$\Sigma_j \pi_{1j}' \rho_{1j} / \Sigma_j \rho_{1j} = \pi_{1.}'$	
2	π_{21}'	π_{22}'	π_{23}'	…	π_{2n}'	$\pi_{2.}'$	(12)
3	π_{31}'	π_{32}'	π_{33}'	…	π_{3n}'	$\pi_{3.}'$	
.	.	.	.	…	.	.	
n	π_{n1}'	π_{n2}'	π_{n3}'	…	π_{nn}'	$\pi_{n.}'$	
Averages	$\pi_{.1}'$	$\pi_{.2}'$	$\pi_{.3}'$	…	$\pi_{.n}'$	$\pi_{..}'$ = economy-wide weighted profit-rate	

*Here, $\pi_{1j}' = (p_{1j}.X_{1j} - C_{1j})$; $\rho_{1.} = \Sigma_j \rho_{1j} < 1$. Likewise, for all i, j = 1, 2, …, n, horizontally and vertically. This suggests that average amounts of profit sharing equal the intersectoral profits.

The above formalism importantly points out that the overall profit rate, $\pi_{..}'$, can be used as the equivalent of macroeconomic policy developed from the microeconomic roots of profit sharing. That is,

$$\pi_{..}' = \Sigma_i\Sigma_j\ \pi_{ij}'.\ \rho_{ij}\ /\ \Sigma_i\Sigma_j\ \rho_{ij} = \Sigma_i\Sigma_j\ \pi_{ij}'.\ \rho_{ij},\ \text{since}\ \Sigma_i\Sigma_j\ \rho_{ij} = 1. \tag{13}$$

Hence the profit rate equals the aggregate profit-sharing rate, both being taken up with respect to a change in knowledge values rather than time. This is due to the complexity of the knowledge-induced processual system of Islamic political economy, as opposed to the linearity of a sheer time-dependent system.

Islamic financial intermediaries, microenterprises at the grassroots, the private sector, and governments all cooperate to develop appropriate policies of the types mentioned in order to make intersectoral linkages possible in a profit-sharing system. Such linkages establish endogenous money and realize endogenous economic growth through a vast web of socioeconomic participation. Siddiqi (1983) mentions such a transformation process. Vanek (1971) gives a serious theory of the participatory economy.

The above results mark important departures in theory. They transform the instruments of *mudaraba* and *musharaka* into sectorally interactive and integrated dynamic forms of participatory joint ventures for mobilizing resources directly into (X, p, F, P(r)) toward realizing higher levels of social well being. Simultaneously, M appears as the store of value of transactions for purposes of valuation of exchange. Money thereby has no intrinsic exchange value; it simply reflects the exchange value of real socioeconomic activities. Hence, we again return to the expression M = I(X, p, F, P(r)).

C. Unit Trust (*Amana Saham*)

The next financial instrument to examine in light of endogenous money in Islam and the 100% reserve requirement monetary system is the unit trust. Unit trusts can provide an easy and well-diversified portfolio for investments by small-scale shareholders (Wilson, 1993). They thereby becomes an avenue through which microenterprises can access established stock markets. Large investors can count on a large amount of public shares being bought and floated in stock markets with a minimum of management problems, as might otherwise arise in the case of preferred shares. In this way, several of the important attributes of appropriate financial instruments to back up a progressive transformation to endogenous money in a 100% reserve requirement monetary system are present in a unit trust financing instrument. These comprise the special focus that unit trusts can give to microenterprise development. They diversify risk by expanding the portfolio base and focus on specifically integrated markets where stability of yields can be maintained, as must be the case with microenterprises governed by *Shari'ah* rules on interest-free financing and specific outlets.

The foregoing formalism gives a general framework for analyzing all kinds of Islamic financial instruments in light of the attributes of the interactive worldview applied to money, output, intersectoral linkages, prices, and social well being. The study of unit trusts in an Islamic framework would therefore invoke all the attributes of the model so far propounded.

Yet we find today that unit trusts, such as the *Amana Saham* in Malaysia, have run into the problem of floatation in risky ventures with high yield volatility. For example, the legitimization of derivatives as *Shari'ah* instruments among many Islamic economists has caused unit trusts to be mobilized in this direction. The result has been an utter liquidation of the unit trust shares during the recent stock market crashes in Southeast Asia.

Furthermore, in the absence of any evident and planned Islamization process of the Malaysian political economy, taken up within the nation's development plan, the systemic framework of financial mobilization could not be done. Consequently, risk diversification remained low, and the otherwise intersectoral linkages of unit trusts for generating real economic activities also remained low. In Malaysia, money creation has mostly remained the domain of commercial banks. Consequently, the holding of unit trusts meant buying bonds rathr than participatory shares. The extent of the decision-making process was thus removed by a capitalistic managerial presence. Interest rates could not be phased out of the economy in the process of creating an increasingly healthy equities market. Integrated markets of diverse products, on which Islamically financed microenterprises could flourish, could not be secured. Hence, they failed to compete in global capital markets.

It is therefore suggested that a combination of *Amana Saham* and *mudaraba*/*musharaka* forms of joint venture financing, in the economy-wide participatory sense that was explained earlier, should become mutually reinforcing instruments. These instruments would complement each other toward gaining product and risk diversification and widely productive linkages intersectorally. All other policy instruments

necessary for backing up a conscious Islamization of Malaysian political economy must be addressed, as in the case of realizing endogenous money in Islam.

A joint index of the two instruments, rather than a dissociate way of using them, is essential. This is because the capital and goods markets financed by the instruments must not compete with each other if they are to be integrated. Such a compound index would be premised on the principle of universal complementarity and the diversity of possibilities in real economic activities. Once again, knowledge induction plays the central role in all such dynamic evolutions.

One form of such an integrated index, II, is,

$$II = I_m^{\ a} \cdot I_u^{\ b}, \tag{14}$$

where I_m denotes the *mudaraba*/*musharaka* instrument in the sense we have re-defined it with respect to economy-wide participatory joint ventures. I_u denotes the unit trust instrument. The "a" and "b" coefficients denote the intensity (elasticity) of interlinkages among these instruments by the force of the inherent knowledge values derived from the underlying discourse within and among institutional, organizational, and policy frameworks, as explained by the interactive worldview.

Thus, through such universal complementarity, all the knowledge-induced socioeconomic and policy variables and preferences become interactive, complementary, and evolutionary between the indices, $I_m^{\ a}$, $I_u^{\ b}$, and II. The neoclassical notion of marginal substitution is totally replaced by the principle of universal complementarity, signified by economy-wide intersectoral and capital-goods market linkages. The usual conclusion on productivity, price stability, and the endogenous relationship between money and goods is reinforced.

D. Foreign Trade Financing

In this case, the index "II" is extended to include foreign trade financing (FTF) for establishing extended complementarity among the individual indices. FTF has a strong potential to interlink microenterprises and other businesses and groups through low-risk trade-related ventures and thereby to establish appropriate market and sectoral linkages. For this to be effective, policy and institutional support and good coordination of the instrument with others within a national development plan and integrated markets are essential. Such steps can make FTF a positive instrument of Islamic change (Choudhury, 1989). The very international trade feature of the instrument has the potential to generate extended market linkages, risk and product diversification, and a regime of improved terms of trade and export revenues in terms of the role that endogenous money can play in Islamic economic integration (*umma*).

Thus, all the arguments made earlier respecting money and economy-wide real sectoral activities are now extended to the international economy, keeping fixed the objective target of Islamizing the monetary and financial sectors toward a 100% reserve requirement with endogenous money in Islam. FTF plays a catalytic role in such an ummatic globalization process.

The compounded international integrated index, III, is given by:

$$III = I_m^{\ a} \cdot I_u^{\ b} \cdot I_f^{\ c}. \tag{15}$$

The various results obtained with respect to "II" are now extended to the case with FTF. But this should not be viewed as a mechanical step, even after the institutional, policy, organizational, and developmental perspectives are linked up with FTF.

The thesis on universal complementarity and diversity of possibilities characterizes the FTF markup in the following way:

Let $X_{ij}(r_{ij})$ denote the export of the ith country to the jth country under FTF with a markup of r_{ij}.
Let $X_{ji}(r_{ji})$ denote the export of the jth country to the ith country under FTF with a markup of r_{ji}.

Total trade between the countries with endogenous economies of scale—say, those caused by a cooperative development fund established from the proceeds of the markups and concessional financing goodwill between the countries—will be given by the compound function

$$X = X_{ij}(r_{ij})^{e1} \cdot X_{ji}(r_{ji})^{e2}. \tag{16}$$

The implications of such a geometric aggregation on factor markets are based on endogenous economies of scale. The coefficients e1 and e2 are of types "a" and "b", earlier analyzed with respect to the underlying knowledge values that primarily cause endogenous benefits and interlinkages to occur.

Since the X's are complementary to each other between the trading countries in the product and risk diversification cases of goods and services, the r's will move in the same direction—once from the demand side (imports) and next from the supply side (exports). In a regime of trade and capital market liberalization within ummatic globalization, the markup rates (r's) will tend to decline and stabilize. Accordingly, the X's will increase. This establishes an inverse relationship between markup and trade and capital flows. The profitability of participatory joint ventures that emanate from transactions in goods and services will move in tandem and stabilize. This marks a trend of the profit rate toward a normal profit rate, wherein all revenues are distributed to productive factors. Such a state of distribution of output implies that no surpluses can exist, as all resources are mobilized into productive directions away from saving as a leakage.

The concept of profit sharing and profit rate as the microeconomic foundation of macroeconomic policy in an Islamic participatory joint venture system is now generalized to inter-country sectors and partners in the *umma*. If "r" is a rate developed as a geometric average from a spectrum of similar rates by projects, then the return on X is positively related to r (Choudhury, 1993b). In other words, with increased trade and capital flows in the *umma*, r_{ij} and r_{ji} tend to have a positive relationship with r, which then dominates. Over collective discourse in the interactive framework, as the knowledge-centered worldview promotes the limiting value, say r' of the r's, the markup in FTF is estimated from the limiting value of profitability derived in inter-country and intersectoral real transactions. Thus, $r'=f(r)$ is the estimating expression for the markup in the midst of a development financing perspective of FTF. Together with this, all other institutional concessional factors can coexist.

It is evident that in the case of capital flows, the returns to them are reflected in the r's, and the markup on these are reflective of the same profit-rate. Finally, the unit trust discussed above becomes an important instrument to productively utilize the capital resources flowing through FTF. In perspective, the important implication of the Kuala Lumpur Stock Exchange as a financial institution that can articulate a definite Islamizing agenda with unit trusts, participatory joint ventures, and ummatic trade and capital flow linkages using FTF becomes pronounced.
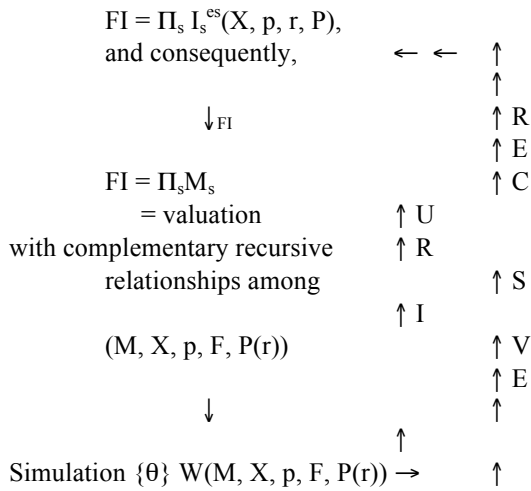
E. Islamic Secondary Financial Instruments in General

Unit trusts and the various issues revolving around participatory kinds of joint ventures in the absence of interest rates and with the use of FTF are one kind of secondary financial instrument. Just as the creation of markets with diversity is important for product diversification, the development of secondary capital markets where a diverse range of complementary instruments can be issued to link up with integrated markets of goods and services is necessary for risk diversification. Product and risk diversification are essential for achieving stability, security, and distributive equity in the milieu of interest-free financing. They are also those that promote participatory enterprises, particularly at the grassroots.

Yet the temptations of derivatives, bonds, and speculative financial outlets must be avoided. Even shares issued must be of the participatory type and should be causally connected with economy-wide and ummatic (of the essence of the *umma*) interactions, integration, and evolution in them. The shares at the grassroots must be complemented by those issued by more mature enterprises and corporations. While ummatic cooperation in these will of course be the logical priority, it need not exclude other joint venturers, provided the essence of the Islamic contracts and objectives are preserved. In all kinds of financing with a large diversity of secondary instruments, complementarity among them and with integrated markets must prevail. Hence, an index of secondary financial institutions should be the guiding light for the direction and valuation of capital resources.

With these points in view, the overall financial index of capital market instruments ("FI") is given by Figure 1:

FIGURE 1: THE OVERALL ISLAMIC FINANCIAL INDEX FOR ATTAINING SOCIAL WELL BEING IN THE *UMMA*

$$FI = \Pi_s \, I_s^{es}(X, p, r, P),$$

and consequently,   ←   ←   ↑

                                        ↑

$\downarrow_{FI}$ ↑ R

                                     ↑ E

$$FI = \Pi_s M_s$$ ↑ C

    = valuation   ↑ U

with complementary recursive   ↑ R

    relationships among   ↑ S

                      ↑ I

$(M, X, p, F, P(r))$ ↑ V

                                     ↑ E

    ↓   ↑

                       ↑

Simulation $\{\theta\}$ $W(M, X, p, F, P(r)) \rightarrow$ ↑

VII. EMPIRICAL ANALYSIS

It now remains to examine to what extent Islamic banks have performed their task as developmental financial institutions in the perspective of complementary across *Shari'ah*-based intersectoral activities and in the global sense across the Muslim world. Tthe consolidated balance sheets and resource mobilization of Islamic banks will be used in this study. The cases of some Islamic banks will be used sparingly. Data are available for 1988 and 1996, and as an average between 1985 and 1996. This time span enables examination of how, if at all, the direction of Islamic banks in resource mobilization and socioeconomic development has changed.

Table 1 shows sectoral investment for selected Islamic banks in 1988. Table 2 provides data on sectoral investment for the aggregate of all Islamic banks in 1996. Between the two, note that the declining trend in the financing of sector projects has been reinforced. The notable exception is the case of the Islamic Bank of Sudan, whose portfolio appears to be well balanced across sectors. It is noted elsewhere that despite the overly agricultural nature of Bangladesh economy, the Islamic Bank Bangladesh has overly financed manufacturing projects, particularly of garments (Hassan, 1997). The same picture appears in the case of Islamic Bank Malaysia. This proves to be in tandem with the general substitution of the industrial sector for the agricultural sector in Malaysia by the Government Development Policy (Alias and Choudhury, 1996; Bank Islam Malaysia Berhad, 1994).

TABLE 1. SECTORAL ALLOCATION OF INVESTMENT BY ISLAMIC BANKS, 1988

1. Faisal Islamic Bank of Egypt

Industry	30.6
Trade	30.4
Agriculture	3.0
Other Sectors	36.0
Total	*100.0*

2. Dubai Islamic Bank

Trade	90.6
Service and Family	7.6
Other Sectors	1.8
Total	*100.0*

3. Sudanese Islamic Bank

Agriculture	34.0
Industry	23.5
Trade	10.8
Transportation	10.0
Other Sectors	21.7
Total	100.*0*

4. Faisal Finance Institution Inc. (Turkey)

Metal Industry	26.3
Chemical and Petrol	17.8
Clothing	16.7
Food	7.9
Tools	5.7
Paper Printing	5.3
Agriculture	16.9
Contracting	3.4
Total	*100.0*

Source: *The Aggregate Balance Sheet of the International Association of Islamic Banks*, 1988 (Cairo, Egypt: International Association of Islamic Banks)

TABLE 2. ISLAMIC BANKS AND FINANCIAL INVESTMENT, SECTORAL ALLOCATION, 1996

Region	Trading	Agriculture	Industry	Services	Real Estate	Others
S. Asia	13.68	8.69	48.26	9.79	2.00	17.58
Africa	29.91	19.56	17.04	8.02	5.79	19.68
S.E. Asia	45.13	5.54	6.30	24.26	2.53	16.24
Mideast	27.50	9.85	28.80	5.00	21.95	6.90
G.C.C.	38.30	0.30	11.50	10.60	21.30	18.00
Euro./Amer.	32.60	0.60	1.31	21.54	16.74	27.21
Accumulated Avg. Rate	31.17	7.50	18.82	13.17	11.67	17.67

Sector	Trading	Agriculture	Industry	Services	Real Estate	Others
Average	31.17	7.50	18.82	13.17	11.67	17.67

Source: *Directory of Islamic Banks and Financial Institutions*, 1997 (Cairo, Egypt: International Association of Islamic Banks)

These overall trends point out that in view of the developmental needs of the predominantly agricultural economies of the Muslim world, the Islamic banks have either moved away from this focus, or in the hope of raising profitability have moved into secondary manufacturing. A neoclassical picture of sectoral tradeoff, instead of the much-needed intersectoral balance and linkages in development financing, appears in such shifts away from agriculture. With such substitutions, many of the variables in (M, X, p, F, P(r)), and hence in SW, would be adversely affected.

The financial figures for 1996 also point out a high degree of concentration in FTF. This would adversely affect the value of a compound financial index by substituting the elasticity of financing in this instrument for particular goods, most often petroleum and commodities in FTF. The development consequences of a resulting lack of product and risk diversification are lost by such a concentration of a few financing instruments.

The underlying high elasticity of FTF can also be seen by the concentration on *murabaha* (cost-plus pricing) for 1996 (Table 3), as opposed to the more important mode of financing by means of a combination of *murabaha* in FTF and equity participation (*musharaka*/*mudaraba*). In this combined form, a good deal of intersectoral linkages could be obtained. On the other hand, by a long-standing indication in other Islamic banking statistics (IDB, 1997), financing in profit-sharing ventures (*mudaraba*) is found to remain very low. This too points to weak performance on the side of essential Islamic financing instruments and the resulting weak intersectoral linkages among *Shari'ah*-approved outlets. It is then logical to conclude that product and risk diversification remained weak within the given pattern of financial instrumentation across Islamic banks globally.

The picture on the portfolio mix of financing instruments was similar in 1988 (Table 4). Islamic banks were found to focus overly on short-term investments as opposed to long-term investments. The latter are badly needed for socioeconomic development and sustained growth of incomes and entrepreneurial profits. It is clear that FTF, and thereby *murabaha*, would have played the major role in short-term investments. Besides, social spending and *zakat* funds remained unusually low (despite the low 2.5% rate of *zakat*).

It is conspicuous that a large proportion of the portfolio is in savings. This goes against the spending propensity that should exist in an Islamic economy. The implication is that Islamization, as a transformation of markets and development processes through mobilization of savings in *Shari'ah*-based directions, was not being realized, either in the Muslim world or through the role of Islamic banks as development financing institutions.

TABLE 3. ISLAMIC BANKS AND FINANCING INSTITUTIONS: MODES OF FINANCING, 1996

Region	*Murabaha*	*Musharaka*	*Mudaraba*	*Ijara*	**Others**
S. Asia	34.00	5.70	5.50	10.30	44.50
Africa	56.90	22.30	4.00	3.40	13.40
S.E. Asia	25.30	3.40	15.50	10.30	45.50
Mideast	42.00	28.30	5.40	7.80	16.50
G.C.C.	49.30	3.40	10.30	15.00	22.00
Euro./Amer.	34.30	13.30	1.80	22.40	28.20
Accumulated Avg. Rate	40.30	12.70	7.20	11.50	28.30

Region	*Murabaha*	*Musharaka*	*Mudaraba*	*Ijara*	**Others**
Average	40.30	12.70	7.20	11.50	28.30

Source: *Directory of Islamic Banks and Financial Institutions*, 1997 (Cairo, Egypt: International Association of Islamic Banks)

TABLE 4. INVESTMENT PORTFOLIO OF ISLAMIC BANKS, CONSOLIDATED BALANCE SHEETS, 1988

1988 (millions of U.S. dollars)

Short-Term Investment	4909.8
Medium-Term Investment	453.1
Long-Term Investment	141.4
Real Estate Investment	1498.2
Social Spending	64.2
Zakat Fund	3.1
Current Accounts	1044.3
Credit Accounts	114.7
Investment Savings Accounts	6811.1
Total Shareholders' Equity	427.3
Participation in Other Banks and Companies (mainly for Kuwait Finance House, Faisal Islamic Bank of Egypt, Nasser Social Bank, Dubai Islamic Bank, and International Islamic Bank; zero for all others)	113.2

Source: *The Aggregate Balance Sheet of the International Association of Islamic Banks*, 1988 (Cairo, Egypt: International Association of Islamic Banks)

The Directory of Islamic Banks and Financial Institutions (1996) states that between 1985 and 1996, total capital subscriptions of the consolidated body of Islamic banks increased by 26 times, total assets by 18 times, total deposits by 17 times. But the 1996 figures also point out that the net profit rate (net profits divided by deposits) equaled only 1.66%. Clearly, the mobilization of funds toward productive and profitable ventures was not effective enough. Combined with the picture on the lack of sectoral interlinkages and the balanced extension of a diversity of financial instruments, there appears to have been the resulting lack of product and risk diversification, which otherwise could have increased resource mobilization and realized higher levels of profitability according to *Shari'ah* norms. Another contributing factor to the low profit rate could have been the high administrative cost experienced, particularly with the increased and expensive technological induction of Islamic banks.

In conclusion, it can be said that Islamic banks in general did not achieve real profitability, real income growth, and long-term investment benefits for development planning, which complement each other in the goal of realizing social well being. The picture in individual cases may have been different. For instance, there is the pioneering case of the Islamic Bank of Sudan. Indeed, all banks in Sudan have been Islamized.

With the impact of *Shari'ah*-based development financing remaining unproven by Islamic, banks taken as a whole across the world, the process of Islamization remained causally related to this low financial performance. On the one hand, the failure of the Muslim world to Islamize itself could have contributed to Islamic banks' difficulties. On the other hand, Islamic banks themselves may have sought avenues of resource mobilization (deposits) mainly in short-run investments. Here, risk remains high in terms of the limited scope of investments (and thus a heavy concentration on *murabaha*) and lack of diversification. Volatility in prices and currency values then adversely affects share values.

Relating these results to the expressions (1) through (7) given earlier, we note the following consequences with respect to profitability, socioeconomic development, and monetary matters. In the vector, (M, X, p, F, P(r)), the *Shari'ah*-based policy variable, P(r), remained weak, with r being low. This is reflected in the weak intersectoral linkages and in the inference of the weak degree of product and risk diversification. These caused high administrative costs. Consequently, the mobilization of resources in real economic transactions, generating X, remained low. This caused the development effect of Islamic capital markets and the Islamic economic transformation to remain ineffective. The prices, p, of real transactions in goods and services of Islamic banks remained high. Factor utilization, human resource development, and production costs remained expensive. The result was expected to be gross substitution among these possibilities. Thus, all the ramifications of neoclassical economic states were upheld. No new economic reasoning, institutional development, or social actions came forth to cause a paradigmatic shift toward an authentically Islamic way of thinking and doing business. Social well being also could not be attained in its essentially *Shari'ah* perspectives.

VIII. CONCLUSION: TOWARD STANDARDIZING THE ROLES AND GOALS OF ISLAMIC BANKS

The problems of Islamic banks and financial institutions, when viewed in light of the *Shari'ah*-based worldview of complementarity and creative evolution realized through interactive processes, necessitates a degree of standardization of goals, institutions, and policies in light of the *Shari'ah*. This paper has pointed out such directions to be premised on the epistemology of Divine Unity (*tawhid*). Such an Islamic worldview needs to be intellectualized and fed into the interrelationships among money, finance, and real economic transactions. At the level of development financing, the paradigmatic worldview is translated into a social well being criterion that describes market, institutional, and behavioral interactions among agents, variables, and their relations, in terms of the principle of complementarity and diversity of *Shari'ah*-based opportunities.

At the pragmatic level, the appropriate policies for transforming Islamic money into 100% reserve requirement would require the formation of Islamic capital markets and an Islamic economic union. Here Islamic banks must serve as catalysts toward realizing flows of goods and capital in segmented markets governed specifically by the *Shari'ah*.

When we study the present state of Islamic banks and their parent countries in the Muslim world, it is realistic to infer that the above paradigmatic shift remains a target that can at best be attained only over the long run. To initiate the process of positive change in that direction, it would be useful to adopt the following directions toward reorganization.

One, the need for establishing the specifically *Shari'ah* aspects of business in the national and global order requires that Islamic banks carry out business in selected areas that can be segmented and protected in their own right. This would take the form of transactions in specific kinds of goods, services, businesses, and instruments according to *Shari'ah* rules. The implication here is of effective regulation to open up market opportunities for Islamic banks in and with *Shari'ah*-specific markets and financial instruments.

Two, the markets for these items will accordingly be specific to themselves. Hence interlinkages among markets for goods, services, and capital within these segmented markets must intensify.

Three, in a globalizing environment, such markets, institutions, policies, and instruments must interconnect with other ones, but with selectivity in such foreign items in view of *Shari'ah* rulings and in light of the Muslim interest to diversify and develop interlinkages among their own specific kinds.

Four, cost-effective methods of technological change and mobilization of funds should be tapped more actively. The establishment and financing of microenterprises that promise productivity at the grassroots levels of society and have the potential to generate intersectoral linkages through production and marketing are to be encouraged (Akhtar, 1997). This has been the case with the Islamic Bank of Sudan. In the case of the Islamic Bank of Malaysia, the many unit trusts that were floated at the Kuala Lumpur Stock Exchange were openly traded with conventional shares. Sufficient protection was not accorded to them and the unit trusts were not used to develop and finance specific kinds of *Shari'ah*-based markets.

Five, *Shari'ah*-based rules, policies, and agent-specific preferences are to be specifically addressed at the national and Islamic global (*umma*) development perspectives. This would involve delineating the organizational, developmental, training, and resource mobilization roles of Islamic banks in an Islamic market transformation. Inter-institutional linkages, between both Islamic banks and financial institutions and with enterprises and governments, must increase. Microeconomic policy targets, such as trade and financing instruments to realize segmented market linkages, must apply. There must be a vigorous dialogue about microeconomic policy matters and a dynamic perspective on national development policies. In this way, intersectoral development balance can be realized. It is encouraging to note that the World Development Report (1997) gave full coverage to such an approach of the state, institutional, and market interface within an increasingly private-sector climate of change.

Six, Islamic banks and financial institutions should establish an autonomous center of advanced socioscientific research and policy analysis in the private sector. It would pursue research and action programs to implement findings in the area of paradigmatic shifts based on the roots of Divine Unity and its actualization in commerce, money, markets, and institutions. The methodology and methods of attaining elaborate goals of social well being of the *umma* should guide the center's vision. Human resource development in *Shari'ah*-based fields for financial and socioeconomic change would be pursued at this center. Institutions and enterprises from the public and private sectors throughout the Muslim world would collaborate at it. Other participation would be welcome.

Seven, such a center of advanced learning would become the pivot of collective discourse and policy formulation at the national, global, and micro-entrepreneurial levels.

Eight, with the assistance of sister Islamic organizations, such as the Islamic Development Bank, Islamic banks are to convincingly call for Islamic institutional and monetary changes in Muslim countries to enable them to realize the endogenous monetary system and its targets as explained in this paper. Even the incentive of earning sustained profits would motivate Islamic financial institutions on this front.

Nine, cost-effective and easily accessible databanks and networks on Islamic financial and socioeconomic data need to be established. This can be pursued with the existing ones at the Statistical, Economic, and Social Research and Training Center for Islamic Countries, the Harvard Islamic Finance Information Program, and the International Association of Islamic Banks. The data depository can be incorporated at the proposed center for advanced learning and policy analysis.

The standardization of goals, activities, and policies of Islamic banks and financial institutions are thus to be taken up in terms of harmonizing the targets of operations and development financing in the private sector at the micro-level of attaining social well being. Then, through vigorous dialogue with the intellectual and grassroots agencies of change, Islamic banks must learn about and implement feasible *Shari'ah*-based policies and programs to interlink among themselves through segmented markets, trade, and financing. It is assuring to learn that the World Bank is presently promoting such ideas of state-sponsored guidance and regulation with states, institutions, and private-sector interactions involving the extended public sector that comprises non-governmental organizations and the grassroots (World Bank, 1997).

From these initial stages onward, the dynamic synergy of progress by Islamic banks and financial institutions would be carried out incessantly into the global order. Islamic capital markets and an Islamic common market, with the specific role of Islamic banks and financial institutions and the move to endogenous money in Islam, should offer bold and visionary programs for the new millennium.

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