‘Islamic Banking’ May Expand In a New International System

by Paolo Raimondi

The author attended the conference as President of the International Civil Rights Solidarity Movement, and representative of Lyndon LaRouche in Italy. His quotations from presentations have been translated from Italian into English.

Over 200 economic, banking, and government representatives attended an important conference on “Islamic Banking,” in Rome on Dec. 19, co-sponsored by the Italian Banking Association (ABI), the Islamic Development Bank, the Islamic Research and Training Institute, and the Italian-Arab Chamber of Commerce of Rome. Besides introducing the concepts which govern Islamic banking methods to a European audience, the conference assumed a more strategic importance in the context of the ongoing international financial crash, and the effort particularly in Italy’s Parliament, to formulate solutions to it by moving to a new and stable world monetary and financial system.

Opening the event, Prof. Sergio Marini, President of the Italian-Arab Chamber, emphasized the importance of banking cooperation for economic development between Western and Islamic finance, as one of the most important ways out of the present war danger in the Mideast region. ABI President Maurizio Sella, General Director of the Italian Foreign Ministry Antonio Badini, and Saudi Arabia’s Ambassador Prince Mohammed Bin Nawaf Al Saud stressed both the importance of such “dialogue,” and the much-needed moral orientation in banking and economic affairs which characterizes Islamic banking methods at their best.

What Is ‘Islamic Banking’?

Dr. Ahmad Mohamed Ali, President of the Islamic Development Bank based in Jedda, Saudi Arabia, introduced the audience to the methodological concepts of Islamic banking. Western customers think of two types of banks: investment banks, which function as financial intermediaries, collecting interest on behalf of creditors and lending this money to others, receiving interest as payment; and universal banks which accept general deposits, and can also participate in business activities directly as lenders or shareholders. “In both models the interest rate is the center of the banking activities,” Dr. Ali explained. “In Islam, it is prohibited to take and pay interest. The same prohibition exists also in all the religions, including the Christian and Jewish religions. To obey the prohibition, Islamic bankers have developed a number of alternative instruments.

“An Islamic bank is an institution which gathers deposits and undertakes all the normal banking activities, but without using the interest rate. On the passive side, Islamic banks mobilize funds on the basis of profit-sharing. They lend funds on the basis of profit- and loss-sharing, and . . . invest based on sales, which implies the purchase of goods paid in cash and their sale to clients for credit, with a fixed rate of profit which is the difference between the sale price and the purchase price. The participation in the capital and the commercialization of the goods and merchandise are the integral part of the Islamic banking activities.”

Dr. Ali cited a 1970 book by a European expert, *Partnership and Profit in Medieval Islam,* which describes how Islamic financial methods have been used for many centuries to finance intra-Mediterranean trade. He presented his own judgment: “In conventional banking activity, the bank is concerned mainly that its principal and the relevant interest be punctually paid. Thus in extending credits, one looks essentially at the creditworthiness of the debtor. This leads to the concentration of credit and wealth in the hands of a few. Today, we see that 15% of the world population controls 80% of the wealth, while 23% of the world population survives on less than $1 per day. These persons have de facto no access to credit.

“In Islamic banking activities, based on sharing of profits and losses, the bank receives a profit only if the project is successful. . . . For this reason, the Islamic bank will consider primarily the solidity of the project and the trade and management competence of the entrepreneur. . . . The creation of debt in Islamic finance is not possible without a correspondence of goods and services, and the means of debt are tradable only against goods and services. The monetary flows have a direct link with the flows of goods. The financial and real activities are strictly linked. Therefore, there is no room for sudden and massive movements of such funds as, on the contrary, happens with the flows of short-term interest-based funds. In this way, destabilizing speculation becomes strongly limited. In a world afflicted by financial crises, this offers new hope.”

The total capital of Islamic banking institutions is about $150-180 billion. Among them, a special role is played by the

Islamic Development Bank (IDB), with a nominal capital of $18.82 billion, which counts 54 member nations and promotes economic and social development of Islamic countries and communities.

'No Risk, No Profit'

Dr. M. Umer Chapra, adviser to the Islamic Research and Training Institute and to the IDB, spoke in more detail about the Islamic financing principle of "risk co-participation," (sharing profit and loss) under the motto "No risk, no profit," and presented two of the most frequently used Islamic financial models or contracts: the *mudarabah* and the *musharakah.* The first is an agreement between two or more persons, in which one or more provide the financing, and the rest the managing and entrepreneurial capability in any economic, trade, industry, or service sector, with the aim of realizing a profit to be shared according to the contract specifications. Losses are sustained only by the investors, while the management loss is the lack of gain for his services. The *musharakah* contract is a financial model in which all the participants contribute in the capital investment and the management.

Dr. Chapra asked, "Why the Islamic banking system?" and developed an interesting answer. "The difficulties in introducing a new model of financial intermediation raise the question of why we should substitute for the dominant system, which has existed for two centuries. It would not be needed if the conventional system functioned well. But it is not so. In the past two decades it has seen numerous crises. No area of the world has been spared. Then there is the disturbing feeling that something fundamental did not function. This has led to the request of a global reform of the financial system to help to prevent the explosion and the spreading of the financial crises, or at least to minimize their frequency and gravity. The demanded reform has been called 'the new architecture.' "

Dr. Chapra identified the causes of this crisis as financial liberalization in general, in floating exchange rates in particular; the explosion of the speculative bubble; and the lack of market discipline of the present financial system; which has resulted, he said, from the lack of an explicit risk participation in financial operations, and from the orientation toward very short-term investment. He detailed the dynamics of the three main financial crises of the recent period: the "Asian crisis" of 1997-98; the collapse of the Long Term Capital Management speculative fund in 1998; and the growing instability on foreign exchange markets. He concluded: "We see there is a strong logical basis behind the prohibition against interest expressed by the most important religions of the world. The moral basis is not simply to prevent the looting of the poor, but also to make the financial system more healthy and stable."

'Ethical Banks'

The prohibition in the Qoran was cited in another presentation by Gian Maria Piccinelli, Professor of Islamic Law at the Second University of Naples: "What you lend at usurious conditions to gain on the possessions of others, will not increase your standing before God. But what you give as charity, with the desire to see the visage of God, that will return to you double." Primarily, Professor Piccinelli also stressed that the real ethical question expressed is the active risk undertaken by a co-entrepreneur, as counterposed to the passive waiting of the creditor, who, with the support of the required guarantees, is sure of the return of his capital. Only in the middle of the 19th Century did Islamic experts begin to discuss how this injunction should actually be applied.

Piccinelli sees a vast area of banking and economic cooperation for the Islamic banks in the West, like the so-called "ethical banks" in Italy and Europe that are involved in what is known as social banking. Presently there is an intense debate on defining rules and procedures for a better cooperation.

Dr. Munawar Iqbal, head of the financial division of the Islamic Development Bank, presented in some detail the experiences of national Islamic banking in states such as Pakistan, Iran, Sudan and Malaysia beginning from 1979 and more effectively since 1983. In addition to these nations, there are about 90 Islamic banks and financial institutions worldwide.

Mr. Iqbal Khan, manager of the Amanah Finance of Dubai, recalled how, historically, Islamic notions of economic operations and activity have exerted a very important influence. For example, the original Arabic term for "representative paper" or obligation, was *sakk,* from which "cheque" or "check" derives. The concept of "fiduciary fund" comes from *waqf* or donation. The practice of *waqf* has been greatly used in the Islamic world for many centuries, and the concept of fiduciary fund was introduced into Europe by the Franciscan order in the 12th Century. St. Francis had relations with the Islamic world both in Egypt and in Islamic Spain.

Participation in New Monetary System

The activities of Islamic banking, as conference participants made clear, have a greater strategic importance than the simple question of how Islamic banks directly are integrated in the *existing* monetary and financial system. Financial responsibles from Islamic nations and organizations used the event to express a strong demand for a fundamental reform and reorganization of the global financial system itself.

Ideas and proposals like Lyndon LaRouche's New Bretton Woods—already called for by a resolution of the Italian Chamber of Deputies on Sept. 25, 2002—and the realization of the infrastructure development projects of the Eurasian Land-Bridge, could become the ground for a strategic cooperation and solution to the collapsing, speculation-based international monetary and financial system dominated by the International Monetary Fund. Its bankruptcy is provoking crises, poverty and wars.

Discussions in these directions will also give the right response to the search of Islamic finance for new rules, methods and participation in a productive new economic order for the nations of the world.