The Idea of Islamic Economic Cooperation in Contemporary Perspectives

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This paper examines the theoretical and contemporary aspects of Islamic economic cooperation based on the main principles and policy instruments of the Islamic economic system. From these theoretical foundations the paper shows that the idea of Islamic economic cooperation revolves around the central role played by profit-sharing and abolition of interest in the Islamic economic order. The idea of profit-sharing under economic cooperation is then extended to the case of international trade and development in Islamic countries. The same theoretical basis and recent statistical information on financial and foreign trade operations in Islamic countries are used to evaluate the Islamic economic principles in internatinal economic cooperation.

I. Introduction

The idea of Islamic economic cooperation is based on a structural development concept in which the socio-economic policies of Islamic nation states and their development institutions inter-relate to create productive transformation. In this milieu, the attainment of distributive equity is made a central goal of these policy mixes. The essence of this approach lies on the nature and philosophical foundations of Islamic economics in general, in which economic cooperation at every level plays the central role as an institutional goal-oriented instrument.[1]

II. A Summary of Islamic Economic Principles and Instruments

To summarize the principles and instruments of the Islamic economic

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[1] See Choudhury (1986) Ch. 1.

order we need to focus on the goal of structural transformation as seen in terms of the objective of implementating Islamic Laws ('Shariat') in society for attaining distributive equity and economic efficiency in a fair balance. In respect to the 'Shariat,' the central principles are as follows:

(1) *The Principle of 'Tawheed' (Unity of God and human brother-hood):* This principle enunciates the conscious belief on the unity of God as the Creator, Absolute Owner and Sustainer of the universe, with man as just His vicegerent on earth, entrusted with the irrevocable duty to manage the resources righteously and in harmony with nature and his fellow human beings. It is this crowning principle that invokes the practical implemention of 'Shariat' in the social order.

(2) *The Principle of Work and Productivity:* The principle of righteously managing the resources according to the enunciation of 'Shariat,' necessitates appropriateness of production and man's participation in that production process. The righteous management of resources also requires that the participants in the production process must earn only their due shares. To claim anything over and above a due share is considered tantamount to an excess under 'Shariat.'

(3) *The Principle of Distributive Equity:* This principle states that because man is taken as the vicegerent of God on earth, entrusted with the just and righteous use of all types of resources, so the output of production must be distributed equitably among all in due proportions, and as transfer payments with a maximum avoidance of the free rider situation (due to Principle(2)).[2]

The above three principles of the Islamic economic order are mobilized by the following main policy instruments (also forms of institutions):

(1) The instrument and institution of profit-sharing under economic cooperation, known as 'Mudarabah': 'Mudarabah' is central to resource mobilization in the Islamic economic order, because through it cooperative ventures are generated between all forms of participants in the domestic real and financial sectors and the external sector.

In the domestic economy, 'Mudarabah' works on the basis of sharing the profits of a jont venture in proportion to contracted shares determined by shares of total capital input, value of the share of wages foregone in total investment and so on. Such shares are referred to as profit-sharing ratios.

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[2] See Choudhury (forthcoming).

In the external sector with regards to inter-regional economic coopera-tion, the term 'Murabaha' is used, meaning foreign trade financing under cooperation. Here, trading partners cooperate to buy each others tradables through the cooperative action of a middle financing institution, that takes part in the trade transaction between the countries on goods and charges a 'mark-up' on the buying price from the importer of the goods. The 'mark-up' is market determined, lower than the average world rate of interest, and is used to cover the administrative cost of the foreign trade operation, the administrative working capital of the monitoring develop-ment finance institution, and the residual is reimbursed to member coun-tries of the economic union in the form of development finance.

(2) Abolition of interest on loan capital. By being the most acceptable form of institution and instrument of transaction in the Islamic economic order, 'Mudarabah' is aimed at replacing interest transactions totally by profit-sharing rates and returns. Islamic Law prohibits interest charges of any kind in all economic transactions. The point of argument is that in-terest being a subjective cost of capital is not a real cost of production and, therefore, cannot be imputed in the prices of goods and cost of capital. Not being a real cost of capital, the rate of interest does not reflect the marginal efficiency of capital/investment. Consequently, to charge in-terest on the use of capital under these circumstances would be an economic excess. This is in contravention to the 'Shariat' and the main principles of the Islamic economic order.

(3) The institution and instrument of wealth tax, known as 'Zakat': The principle goal of 'Zakat' is re-distribution of wealth for purposes of distributive equity. In the static sense (but not in inter-temporal context) 'Zakat' and productive investment can be seen to be inversely related to each other (substitutable). This means that either resources are mobilized through 'Mudarabah' into joint ventures, or they are transferred to government collection to be spent in socially requisite investment and consumption expenditures.[3]

Apart from 'Zakat' there are other forms of developmental taxes in the Islamic economy, but these are of a residual nature and are levied after 'Zakat' is levied. The implication here is that the emphasis on the market economy in the Islamic system passes on the responsibility of development to the private sector, while the Islamic government retains supervisory powers in the market place and collects and disburses 'Zakat.' Cooperatives in this market economy milieu are promoted in both the private and public sectors.

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[3] See Quran Ch. II, vs. 177.

*(4) Abolition of waste in consumption and production, termed as aboli-
tion of 'Israf':* In order to have 'Mudarabah' working effectively in factor
utilization and production, the enterprises must generate economies of
scale. This requires leakages from the production system and in the
economy to be minimized. Next, abolition of wasteful consumption im-
plies a greater allocation of resources into real investment. Thus, although
both investment and consumption would be increasing over time under
the joint effect of 'Zakat' and productive investment, abolition of
wasteful consumption would imply a greater allocation of resources into
real investment inter-temporally.

III. The Institution of Profit Sharing as Central to Islamic Economic
Cooperation

The institution of 'Mudarabah' is central to the Islamic economic
order. This is because the institution of 'Mudarabah' is instrumental in
the abolition of interest and in replacing it by profit sharing. The argu-
ment runs as follows:[4] With an economy-wide spread of profit-sharing
enterprises under 'Mudarabah,' the prospect for earning a positive rate of
profit increases and this diversifies risk-bearing by any one entrepreneur in
a joint venture. The more extensive are the joint ventures with equity par-
ticipation among entrepreneurs, the greater is the degree of risk diver-
sification. The economy wide spread of 'Mudarabah' enterprises requires
mobilization of capital into real investments, which can happen with a
simultaneous decline in the rate of interest leading ultimately to its total
replacement by the profit-sharing rates. The inter-temporal efficiency of
capital/investment is now reflected in the rate of profit. It has been
argued in the literature on Islamic economics that this rate of profit is the
normal rate or a rate above and close to the normal rate in the short run.[5]

The instrument and institution of 'Mudarabah' is increasingly becom-
ing the basis of the financial transactions in some Islamic countries and in
the most of the operations launched by the Islamic Development Bank
and the commercial Islamic banks around the world. In a recent book,
Iqbal and Mirakhor (1987) point out the good performance of the profit-
and loss-sharing Islamic banks in Pakistan and Iran. Table 1 gives the
yields on such P.L.S. deposits in Pakistan which are utilized in
'Mudarabah' type ventures in the real sector to yield the profit rates as
shown in comparison to interest rates on non-P.L.S. deposits. In Iran, the

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[4] See Choudhury (1986) Ch. 6.
[5] See Choudhury (1986) Ch. 6.

Table 1

PAKISTAN: COMPARISONS OF INTERESTS RATES AND OF RETURN UNDER PROFIT-AND-LOSS-SHARING (PLS) DEPOSITS[1]

| | Notice Deposits | | | | Savings Deposits | | Six-Month Deposits | | One-Year Deposits | | Two-Year Deposits | | Three-Year Deposits | | Four-Year Deposits | | Five-Year and Long-Term Deposits | |
| | 7 days | | 30 days | | | | | | | | | | | | | | | |
	Non-PLS	PLS	Non-PLS	PLS	Non-PLS	PLS	Non-PLS	PLS	Non-PLS	PLS	Non-PLS	PLS	Non-PLS	PLS	Non-PLS	PLS	Non-PLS	PLS
1981 June	5.3	—	...	—	7.6	8.6	9.4	10.9	10.4	12.2	10.5	12.7	11.2	13.7	12.0	14.2	12.0	14.7
December	6.0	—	...	—	7.6	8.7	10.0	11.2	10.2	12.5	10.6	13.0	11.3	13.9	12.2	14.4	12.2	14.9
1982 June	5.8	—	...	—	7.6	8.6	9.8	10.8	10.3	12.0	11.1	12.7	12.0	13.6	12.3	14.1	12.4	14.6
December	6.4	—	...	—	7.6	8.2	9.9	10.5	10.6	11.5	11.0	12.1	12.0	13.1	12.2	14.0	12.5	14.3
1983 June	6.3	—	...	—	7.6	8.3	9.9	10.5	10.5	11.6	10.8	12.2	11.8	13.0	12.4	13.6	12.4	14.1
December	6.3	—	...	—	7.6	7.7	9.9	10.5	10.5	10.8	10.7	11.5	11.7	12.3	12.4	12.8	12.4	13.3
1984 June	5.5	—	6.5	—	7.6	7.5	9.9	9.5	10.5	10.5	11.1	11.0	11.8	11.8	12.5	12.5	12.5	13.5
December	5.5	5.9	6.5	6.9	7.5	8.0	9.5	10.1	10.5	11.2	11.0	11.8	11.8	12.5	12.3	13.1	12.8	13.6
1985 June	—	5.4	—	6.2	—	8.3	—	10.8	—	11.1	—	12.2	—	13.2	—	14.2	—	15.2

[1] Rates of return offered by the nationalized banks, which constitute about 95 percent of the banking sector.

Data: Pakistan authorities; State Bank of Pakistan, Monthly Bulletin, May 1985.
IMF Survey, March 9, 1987.

law for Usury-Free Banking, addresses mobilization of banking assets into the real asset sector. This in the Islamic economy is realized through 'Mudarabah' type joint ventures.

In recent times, the Islamic Development Bank and the world wide Islamic banks have cooperated to establish the Islamic Banks Portfolio.[6] This scheme is based on the subscribed capital amounting to 65 million US dollars in 1987, that would be placed under the management of IDB, and directed to financing of both inter-communal trade among Islamic countries, and foreign trade between Islamic and non-Islamic countries in general when this latter is considered to have definite developmental impact on the member country of IDB. This initial stage of use of the Islamic Banks Portfolio funds will, thereafter, be expaned to participation in the capital market as well. The prevailing profit shares in this scheme are as follows: (a) 5 percent to IDB; (b) 5 percent as retained earning in the scheme; (c) 90 percent distributed to certificate owners in proportion to their corresponding shares. Twenty-one Islamic banks and multilateral development organizations are presently participating in the Islamic Banks Portfolio.

IV. Principle of Islamic Economic Cooperation Seen in Foreign Trade Financing

As mentioned earlier, a prominent example of the use of 'Mudarabah' in economic cooperation is found in development financing. This is the instrument of foreign trade financing, known in Islamic terminology as 'Murabaha.' Under this arrangement, the subscribed capital of Islamic countries, say member countries of the Islamic Development Bank, when not used in financing a project, is placed in promoting trade between member countries. Now, to the extent that the IDB can pay off some of the foreign exchange costs of the importing member country in the inter-communal trade, a mark-up levied by IDB on tradables turns out to be lower than a tariff on the good. By buying at prices lower than tariffed prices on tradables and selling them to the importing country with a mark-up, this mark-up becomes a payment to the IDB for a service. The IDB uses this income to meet its transaction costs and finally channels it to further project financing. In turn, foreign trade arrangement liberalizes trade between member countries in an economic cooperation, with the resources for buying goods and meeting foreign exchange requirements of importing countries coming partly or wholly from a common fund in-

6 See The Islamic Development Bank (1986-87).

vested with the development finance institution in its foreign trade finan-
cing programme. The effect of foreign trade financing on the inter-
communal trade liberalization is explained with the help of the following
diagrams:

Let countries 1 and 2 trade in the two goods Q_1, Q_2, respectively in
quantities shown by the same symbols, of which country 1 specializes in
Q_1, country 2 specializes in Q_2. In a free trade regime E_1, E_2 are the
equilibrium points on the respective production possibility curves. The
trade triangles are given by $E_1 C_1{}^* M_1$ and $E_2 C_2{}^* M_2$ respectively, show-
ing that the export $M_1 E_1$ of country 1 equals the import $M_2 C_2{}^*$ of coun-
try 2, and the export $M_2 E_2$ of country 2 equals the import $M_1 C_1{}^*$ of
country 1.

Now when tariffs are imposed on the imports of each country, the
equilibrium points shifts from E_1 to D_1 and from E_2 to D_2. The new trade
triangles (not shown) shows a shrinking of production levels as a result of
E_1 moving to D_1 (thus a reduction in the production of Q_1) and E_2 mov-
ing to D_2 (thus a reduction in the production of Q_2). This would give rise
to decreasing levels of inter-country trade. This also causes increasing
relative prices for each other's imports as shown by the slopes of the price
lines, $D_1 C_1$ and $D_2 C_2$, leading to worsening of their terms of trade. This
point is borne out by the steepening of the slopes of the terms of trade

Figure 1

THE ECONOMIC BENEFITS OF FOREIGN TRADE FINANCING

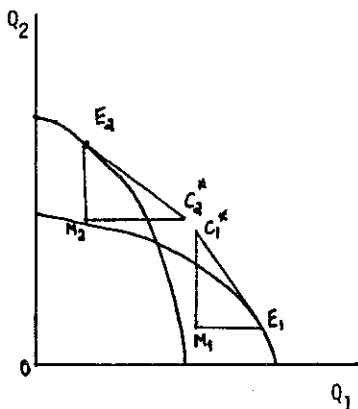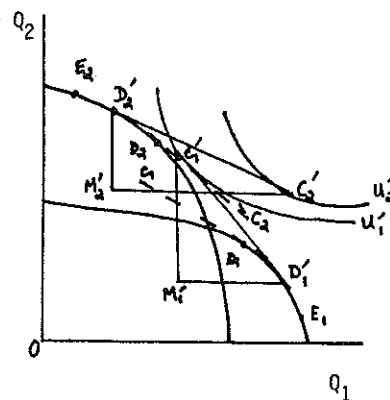| Figure 1a	Figure 1b
Initial Inter-Country	Inter-Country Situation
Situation in Free Trade	with Tariff and Foreign
	Trade Financing

line shown by D_2C_2 and the flattening of the terms of trade line shown by D_1C_1 in Figure 1b. The end result of all this is immiserizing growth for the trading partners.[7]

With the introduction of foreign trade financing, part of the foreign exchange cost of the import bill is covered by the sponsoring agency, in this case by the Islamic Development Bank or a similar Islamic development finance institution. The result is a better scope for trade and counteracting of the immiserizing growth effect of tariffs. Under foreign trade financing, points like D_1, D_2 thus shift to D_1' and D_2', respectively, as shown in Figure 1b. Subsequently, the terms of trade improve for the two countries. The trade triangles expand, satisfying enhanced levels of consumption in both countries of each other's imports (thus encouraging exports). This brings about improved economic welfare for the two countries over those existing in the case of tariffs with no foreign trade financing. These points are shown in Figure 1 by the indifference curves being higher in the case of trade with foreign trade financing scheme, i.e., U_1' being higher than the corresponding U_1 (for country 1); U_2' being higher than the corresponding U_2 (for country 2).

V. The Formalization of the Economic Benefit Derived from Foreign Trade Financing

The economic benefits of foreign trade financing in the presence of protectionist trade regime can be further studied with the help of the following formalization:

Let us say that country 1 puts a tariff t_2 on the import of Q_2 from country 2. Then,

(1) $P_2{}^1 = (1 + t_2)P_2{}^2$

where, $P_2{}^1$ denotes the price of Q_2 in country 1 after a nominal tariff imposition of t_2,

$P_2{}^2$ denotes the price of Q_2 in country 2 before tariff,

t_2 denotes the nominal tariff rate.

Likewise, if country 2 imposes a nominal tariff, t_1, on Q_1, then,

(2) $P_1{}^2 = (1 + t_1)P_1{}^1$

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[7] This methodology is well developed in Kenen (1985).

where, $P_1{}^2$ denotes the price of Q_1 in country 2 after tariff,

$P_1{}^1$ denotes the price of Q_1 in country 1 before tariff,

t_1 denotes the nominal tariff rate.

Now,

$$(3) \quad \frac{P_2{}^1}{P_2{}^2} = \frac{1 + t_2}{1 + t_1} \cdot \frac{P_1{}^2}{P_1{}^1}$$

That is, the price of Q_2 in country 1 relative to the price in country 2 = $\frac{1 + t_2}{1 + t_2} \times$ price of Q_1 in country 2 relative to the price in country 1.

It $t_2 > t_1$, country 2 needs to be helped in exporting its goods to country 1. The Islamic Development Bank would now purchase the quantity of Q_2 at a price, say $p_2{}^{2\prime}$ (close to $p_2{}^2$), add a 'mark-up' on this price in percentage vlaue less than the nominal tariff, t_2. It would then sell the good to country 1, but at a price level much less than the tariffed price. Similar is the case for the good Q_1 placed under a reciprocal trading scheme under foreign trade financing.

In the case where, $t_2 > t_1$, a greater preferential treatment would be given to country 2 in its export of good Q_2. Thus, $m_2 < m_1$ where,

m_1 denotes the mark-up on Q_1 bought at $p_1{}^{1\prime}$ (close to $p_1{}^1$),

m_2 denotes the mark-up on Q_2 bought at $p_2{}^{2\prime}$ (close to $p_2{}^2$).

Now,

$$(4) \quad p_1{}^{1\prime} = (1 + m_1)\, p_1{}^1; \qquad p_2{}^{2\prime} = (1 + m_2) p_2{}^2$$

Between equations (3) and (4) we obtain,

$$\frac{p_2{}^1}{p_1{}^2} = \frac{1 + t_2}{1 + t_1} \cdot \frac{1 + m_1}{1 + m_2} \cdot \frac{p_2{}^{2\prime}}{p_1{}^{1\prime}}$$

Since $t_2 > t_1$ and $m_2 < m_1$, therefore, $\alpha = \frac{1 + t_2}{1 + t_1} \cdot \frac{1 + m_1}{1 + m_2} > 1.$

Therefore,

(5) $\dfrac{P_2{}^1}{P_1{}^2} = \alpha \dfrac{P_2{}^{2'}}{p_1{}^{1'}}$; $|\alpha > 1$.

In expression (5), $\dfrac{P_2{}^1}{P_1{}^2}$ stands for the terms of trade of country 2, since $p_2{}^1$ stands for export price of Q_2, and $p_1{}^2$ stands for the import price of Q_1. Also, $p_2{}^{2'}/p_1{}^{1'}$ stands for the price of Q_2 relative to the price of Q_1 to the foreign trade financing body. In this sense, with an increase in the relative price of Q_2, m_2 would increase, because the profit-sharing mechanism of foreign trade financing must promise a good return to the financier of the program. Consequently, the export price of Q_2 will increase. This in turn will improve the terms of trade of country 2. With an improvement in the terms of trade will come about higher economic welfare and induced growth for country 2.

A similar process is taking place for good Q_1, but under the preferential treatment based on the levels of tariff imposition $(t_1 < t_2)$, the impact of foreign trade financing is to uplift the economic welfare and production effect in country 2 to the level of country 1. Note that, these results hold true even when there is free trade or negotiated tariffs with $t_2 = t_1 = $ common negotiated nominal tariff rate.

The improvement in economic welfare of country 2 over country 1 does not mean an absolute deterioration in the economic welfare of country 1. It is for establishing an equity-efficiency balance in resource allocation between the two countries that some adjustment is required through preferential treatment extended to country 2. While country 1 does not lose in absolute level of economic welfare, it ultimately gains from a redistribution of residual mark-up income earned by the Islamic Development Bank in foreign trade operation. This income is returned as development assistant both to country 1 and country 2 according to their respective development needs.

The system of differential mark-ups plays a critical role in development financing, the lower the mark-up the more vigorous will be the trade flow. Lower mark-up will depend upon the existence of competitive prices of tradables, a situation that can be realized with increasing trade liberalization. A final note is to the effect that the revenue from the mark-up in foreign rate financing is finally re-distributed to other development activities that benefit both countries 1 and 2 in this 2-country, 2-commodity trading world.

VI. Foreign Trade Financing as a Structural Development Instrument in Economic Operation

We now take up the topic of differential mark-up as an instrument in Islamic economic cooperation one step further. Here we shall look at foreign trade financing scheme as a development finance instrument. It is then necessary to elaborate how foreign trade financing program necessitates identification of the nature of the goods to be produced and traded. Such goods would then bring about structural change in the economies.

A. A Program for the Production of Capital Goods

The need for foreign trade financing of capital goods among member states of the Islamic Development Bank is a pressing issue of the time. This subject matter can be studied from two angles — one, as a study on the development of a program for the promotion of capital goods industries in member countries of IDB, and the other, as a study on the development of a scheme of foreign trade financing of capital goods. The end result of either of these undertaking should be to develop appropriate modalities for the financing of foreign trade in capital goods among member states of IDB.

The two approaches are interlinked. A study on the development of a program for the promotion of capital goods industries is a first and important stage, that would help unravel the problems and prospects of streamlining specific goods in given industries within the capital goods sector. The identification of the capital goods will then follow. Based on this, a financing scheme can be developed for possible financing of selected capital goods that are expected to yield developmental benefits.

On the other hand a *de facto* development of a scheme for foreign trade financing of capital goods would presume, either the prospects in the capital goods industries are proven to be good, or are taken for granted on the basis of other studies. An important one of such studies is entitled, *First Global Study on the Capital Goods Industry: Strategies for Development,* prepared by UNIDO.[8]

In 1982 UNIDO made an evaluation of the prospects for capital goods industries in Islamic countries and came up with the following specific conclusions:

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[8] See United Nations Industrial Development Organization (1981).

(a) Cooperation Among Islamic Countries in the Design of Capital Goods

   Within this area have been identified the needs for mastering certain engineering techniques; the choice of industrialized processes for manufacturing a given product; the choice of standards for the manufcture of equipments and their use; apprenticeship in the design of industrial equipments.

(b) Cooperation in the Production of Capital Goods

   Within this area are the needs for producing equipments for projects in basic industries; maximizing capacity of production; identifying productive and technological capacities in the capital goods sectors; exchange of experience among countries.

(c) Cooperation in the Sale of Goods

   Within this area, the marketing of capital goods, trade in capital goods and establishing inter-sectoral linkages among capital goods among member countries are important.

B. Differential Mark-Up System and Foreign Trade Financing of Capital Goods

The observations made by UNIDO on the potential for production of capital goods in Islamic countries show that considerations on foreign trade financing of capital goods must be linked to the prospects of these tradables generating economic development in the trading countries. Keeping this point in view, we now go on to develop here an alternative method of determining the mark-up and generating incomes under the foreign trade financing scheme for capital goods. The central approach in this alternative is to set up a differential mark-up system having the following characteristics:

During the time when the capital goods are being transferred by the Islamic Development Bank to an importing country, IDB would charge a nominal rate of mark-up of say, less than 3 percent on the f.o.b. price of exportables and would cover up to 100 percent of the c.i.f. cost of imports. After the transfer of capital goods, IDB will spread its mark-up percentage over several years in deferred payments from the importing country. This time distributed mark-up will be of a variable nature and will be inversely related to the import value added, that is to the value added in the final production of a capital good imparted by the imported good as an intermediate capital good. All other costs will be excluded in the determination of the mark-up, such as the f.o.b. price, the c.i.f. cost, which would be included in the determination of the mark-up during the

time of transfer. All other costs that involve the production of the inter-mediate capital goods in the exporting country in the first place will also be excluded in determining the differential mark-ups.

The inverse relationship between the differential mark-up and the value of production is expected on grounds that such a relationship will give incentives towards productivity and efficiency in the capital goods-using enterprises in the importing country. This will subsequently in-crease the export potential of this country, making it thus more self-reliant. There will, however, be an admissible range for the estimated dif-ferential mark-ups, say in the 3 percent to 8 percent range. Also, only a part, say 30 percent to 50 percent of the import value added would be ap-plied for computing the differential mark-up because this amount of value added would also result from the use of inputs other than the im-ported capital goods alone.

VII. Other Instruments of Islamic Economic Cooperation

Foreign trade financing is not the only instrument used in mobilizing the resources of the Islamic countries under economic cooperation. It is an important one as it applies the idea of profit-sharing ('Mudarabah') to the case of international trade, and then when used for the trading of capital goods, it also acts as a development finance instrument fostering struc-tural change in the trading countries.

Of late the Islamic Development Bank, to take as an example, found out that foreign trade financing is not adequate to mobilize all the resources it would need to finance development projects in the years ahead. Table 2 gives the resources needs and withdrawals from the foreign trade financing scheme of IDB expected to take place by the year 1990. It shows that after the funds devoted to foreign trade financing and the in-comes generated from it had increased significantly over the years, by the year 1986 this trend is expected to stabilize. The trends show that both the amount of funds in foreign trade financing as well as the mark-up rate (8 percent of FTF) will remain constant until 1990. Thus, the cash-flow position of the Bank will decline. Between the years 1983 and 1986 most of the income from operations was contributed by the mark-up in foreign trade financing. Thereafter, the contribution of foreign trade financing to total income from operations will decline, from 89 percent of net in-come in 1987 to 11 percent of net income in 1995. These trends thus point out the declining role of foreign trade financing in generating in-come for IDB and, consequently, in financing future development pro-jects in member countries unless significant resource replenishment is

undertaken. In these calculations no use of differential mark-ups has been made.[9]

Complementary Islamic financial instruments for fostering economic cooperation among member countries are equity financing; profit-sharing bonds such as Islamic Certificates of Deposits and Islamic Investment Certificates. Islamic Certificates of Deposit involve profit-sharing among Islamic banks and investors revolving around projects that the banks deem most profitable. Islamic Investment Certificate involves profit-sharing among Islamic banks and investors revolving around projects in which individual investors would also participate in the choice of projects and the related investment decison-making. Other kinds of financial profit-sharing instruments are found in the operation of leasing equipment with and without buy-back options of the leased out asset initially financed by the Islamic Development Bank (as one institution), the cost being then recouped through a deferred payment of rental value.[10] In all such cases, particularly those revolving around financing of capital goods projects, the discounted present value of returns must exceed the purchase price, otherwise the 'Mudarabah' scheme underlying the financing will not work out. In these discounting formulas while opportunity cost cannot be measured by the rate of interest and time-preference rates, there is always the altenative of using a range of expected profit rates on the project. This is then followed by close management and recurrent evaluation of the projects to ascertain the efficiency of the projects towards yielding the expected rate of profit. The 'Mudarabah' formula for a project yields an evaluative criterion, in which the rate of profit can never be negative, can be a certain percentage or an expected percentage (stochastic). This is unlike the case of the 'Mudarabah' formula for a firm's income statement wherein a loss can be shown.

Equity financing of projects is a cornerstone of 'Mudarabah' based profit-sharing, as it involves two related features-pooling of funds and risk and the need for active participation among the shareholders. A sleeping partnership cannot be entertained in this area of development financing. The Islamic capital market with its non-interest financial instruments particularly favours the growth of capital formation and yield of profitability. It is, therefore, not difficult to see why equity projects could flourish in this environment and why they should be so much emphasized. A recommended way of relating resource mobilization with three given modes of project financing for purposes of invigorating the formation of an Islamic capital market is shown in Figure 2.

9 See The Islamic Development Bank (1984-85).
10 See The Islamic Development Bank (1984-85).

Table 2

PROJECTIONS ON THE RESOURCE POSITION OF THE ISLAMIC DEVELOPMENT BANK AND THE RESULTING USE OF FOREIGN TRADE FINANCING FUNDS*

(Millions of US dollars)

|	FTF	Resources Required for Ordinary Operations	Resources Available	Resource Gap	Net FTF	Net Income	Mark-Up Income (8%)
1986	700	314	759	444	—	63	56
1987	700	346	566	219	—	63	56
1988	700	381	346	−35	665	56	53
1989	700	420	98	−320	378	49	30
1990	700	462	−189	−651	49	35	4

Note: *Columns 2, 5, & 7 are the author's estimate based on the source below. It is assumed in our estimates that foreign trade financing trends which are unused funds at any time will be the first ones to be mobilized in financing the ordinary operations.

Source: Islamic Development Bank, *Tenth Annual Report 1985* (Jeddah, Saudi Arabia, 1985).

In the process of evolution to an Islamic capital market, resource mobilization (point a_1) may start with loan financing (point b_1). But over time, loan financing takes decreasing importance in Islamic project financing and is next replaced by foreign trade financing and then by loan financing at time period t_2. This is shown by the points c_1, b_2 corresponding to a_2. Finally, the priorities of resource mobilization shift to foreign trade financing and equity financing in varied levels of weights placed on these. These are shown, first by points like a_3 corresponding with c_2 and d_1, followed by points like a_4 corresponding with d_2, c_3, etc.

The trends in the three modes of financing so recommended here are considered to be the appropriate ones for Islamic economic cooperation because they point out the central role of 'Mudarabah' type enterprises to be found in equity financing and foreign trade financing, and the declining reliance on interest based financing or inefficient loan financing based on service charges. It was pointed out earlier that be it loan financing or equity financing, all development financing in Islamic framework centers around 'Mudarabah' with expected returns on joint investment ventures. Now, loan financing plays a decreasingly important role in the long run.

Figure 2

THE ISLAMIC IMPLICATIONS ON RESOURCE
MOBILIZATION AND MODES OF PROJECT FINANCING
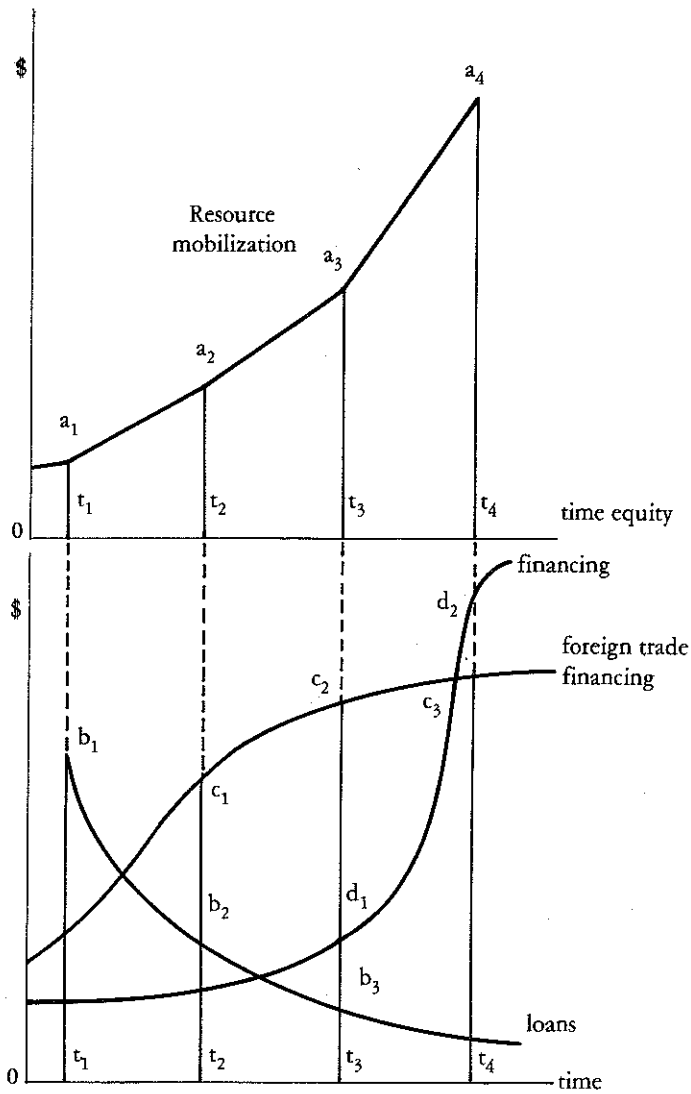
Likewise, with an increasing role of equity financing, these loanable
resources and resources in foreign trade operations are directed to equity
financing. The relationship among a's, b's, c's so emerges.

These are, however, not the types of trends in program financing in Islamic countries presently observed. Table 3 gives the trends that have actually occurred between the years 1980 and 1985. These are represented in Figure 3.

It was shown earlier that the commitments on project financing by the year 1990 will fall upon utilization of presently uncommitted funds that get utilized in foreign trade financing. Also, the Islamic Development Bank continues to be wary in future equity investments.[11] Such situations indicate that Islamic Certificates of Investments and other types of profit-sharing bonds cannot be made to revolve solely around foreign trade financing scheme and equity projects. A diversified portfolio of financial instruments must be developed. Some examples here are profit-sharing certificates revolving around co-financing of projects with other development finance institutions, floating of 'Mudarabah' bonds in the private sector of Islamic countries and co-operation with Islamic banks and national development banks in this area, and for the short run entering the existing secondary capital markets with 'Mudarabah' bonds. Another way to mobilize resources independently of the ordinary operations of IDB would be to call for an increase in subscriptions from selected member

Table 3

COMPARATIVE TRENDS IN PRINCIPAL MODES OF PROJECT FINANCING BY THE ISLAMIC DEVELOPMENT BANK IN VIEW OF THEIR POTENTIAL IN CREATING AN ISLAMIC CAPITAL MARKET
(Millions of U.S. dollars)

	Loans	Equity	Foreign Trade Financing
1980	71.12	41.72	634.99
1981	45.63	19.30	281.44
1982	63.15	13.43	494.70
1983	59.43	7.16	527.50
1984	79.32	8.31	778.36
1985	87.83	7.65	612.00

Source: Islamic Development Bank (Jeddah, Saudi Arabia, 1986), *Statistical Monograph No. 5.* Lines of equity have not been included as these are funds allocated to National Development Banks in member countries, who in turn invest it in equity projects.

[11] See The Islamic Development Bank (1983-84).

Figure 3

A DIAGRAMMATIC VIEW OF TRENDS IN PRICIPAL
MODES OF PROJECT FINANCING BY THE ISLAMIC
DEVELOPMENT BANK IN REGARDS TO THEIR
POTENTIAL FOR CREATING AN ISLAMIC CAPITAL MARKET
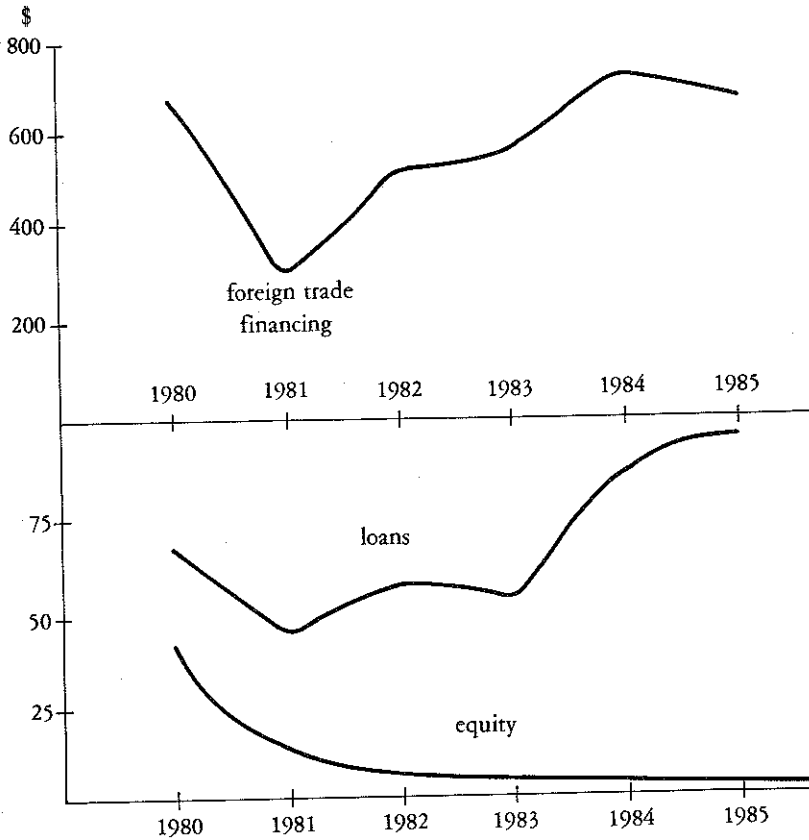
states and give these countries a proportionately higher share of returns on
the specific uses of their subscriptions in IDB's operations.

VIII. Conclusion: Future Prospects of Islamic Economic Cooperation

Islamic economic cooperation in contemporary times thus turns out to
be a multi-faceted endeavour. Within the Islamic community of nations
are the Islamic Development Bank and sister development finance

Table 4

TOTAL FINANCING FOR DEVELOPING COOPERATION
AMONG ISLAMIC COUNTRIES BY
MAJOR ISLAMIC DEVELOPMENT ORGANIZATIONS
(billions of US$ .... 1974-1986)

Names	Amount	No. of Projects
Abu Dhabi Fund for Arab Economic Development	1,094.6	88
Arab Bank for Economic Development in Africa	743.3	119
Arab Fund for Economic and Social Development	2,696.2	187
Iraqi Fund for External Development	1,733.1	69
Islamic Development Bank	5,255.6	454 [1]
Kuwait Fund for Arab Economic Development	5,039.5	314
OPEC Fund for International Development	2,075.0	409
Saudi Fund for Development	5,145.7	238
	23,782.9	1,878

Note: 1 This includes equity & profit-sharing 60, foreign trade 348, and other 46.
Source: Coordinating Secretariat of Arab National and Regional Development Institutions,
Arab Fund for Economic and Social Development, *Statement of Financing Opera-
tions* (up to Dec. 31, 1986).

organizations that mobilize funds for project financing through in-
struments like foreign trade financing, equity financing, leasing opera-
tions, loan financing and technical assistance. Then there are the capital
market operations based on 'Mudarabah' type investment certificates.
There are also inter-country institutional cooperation, like those between
the commercial Islamic banks, between Islamic banks, other financial
organizations, and the governments (National Development Banks).
Finally, the Islamic development finance institutions vigorously par-
ticipate in the South-South and North-South cooperations. These

establish cooperative channels to further mobilize the resources of the
Islamic world to development. It is well-known in this respect that the
petro-dollars deposited by Arab capital-surplus countries overseas provid-
ed substantial amounts of re-cycling development assistance to the Islamic
and other developing countries. In the North-South context, the IMF had
several times replenished its capital requirements by substantial borrowing
from the Saudi Arabian Monetary Agency.[12]

A wider financial perspective of development cooperation among
Islamic countries can be formed by looking at the total amount of financ-
ing done by Islamic development institutions majorly in Islamic countries.
In this regard, Table 4 gives the total accumulated amounts of develop-
ment financing by major Islamic multilateral development organizations
to be, US$23,782. 9 billion, between 1974 and 1986. A total of 1,878
projects were involved in this financing with a minimum of 408 in equity
and foreign trade operations.

The establishment of an Islamic capital market can proceed effectively
with greater cooperation in financial markets and development projects
with other groups. In this, the industrialized and developing regions must
be jointly considered. For instance, of late the capital surplus Islamic
countries had bought assets in the IMF, the returns from which could be
directed towards replenishing and establishing the Islamic capital market
in this sense of the South-South and the North-South cooperation. Unfor-
tunately, facts have shown that instead of proceeding in such directions,
the capital surplus Arab investors in IMF assets had become more wary on
their investment in Third World countries[13] in spite of their large
amounts of resource flows. This had some disabling effect on some key
development programs, such as the Common Fund compensatory finance
arrangement for commodity price stabilization in Third World countries
and the full blossoming of the New International Order.

12 See deVries (1987).
13 See Steward and Sengupta (1982).

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