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NOTES ON CAPITAL MOVEMENTS, TRADE LIBERALISATION AND FINANCING ACTIVITIES OF ISLAMIC BANKS*

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1.
Industrialisation, Minimum Size of Markets, Protectionism and Collective Self-Reliance

It can be safely said that industrialisation is a set goal of the governments of most (if not all) Islamic countries. It is also widely accepted that an efficient or competitive production requires in many industries outputs which are beyond the absorptive capacities of the domestic markets. The smaller a country is, the more of its industrial output would need outlets abroad. In short, the **smaller developing countries** are more or less forced to adopt an **outward oriented industrialisation strategy**. A few newly industrialising countries (NICs) - esp. of the Asian region - have been quite successful with such a strategy in the past, and they became major suppliers of a number of goods on the world markets.

"World markets" means, more or less, the markets of the industrialised countries of the West. But for the NICs and some other developing countries who also adopted the outward oriented policy, problems arose in the last years as a consequence of the escalating protectionism in Western countries: The governments there were approached for **support** jointly by the entrepreneurs and workers unions of industries which had come under **competitive pressure from abroad** (incl. competitors from the NICs). The governments could hardly reject these joint claims for "structural adjustment support", but the budget deficits restricted their ability to pay direct subsidies to the pressed industries. What could be granted without a direct burden for the budgets were (non-tariff) **protective measures**. The costs of protectionism are borne by the consumers who have to pay higher prices.

Since the "political rationality" in Western democracies is, under the prevailing circumstances, more in favour of protectionsims than of free trade, protectionistic practices will not be just a short-term phenomenon but will continue to be imposed on foreign competitors, the outward oriented industrialisation strategy of developing countries needs a re-orientation.

If the access to the markets of the industrialised countries becomes increasingly restricted, the developing countries should look for new markets in the Third World. Such markets, however, do not yet exist in a large scale but still have to be developed. The creation and development of self-sustaining regional markets in the Third World was a major topic on the agenda of conferences concerned with economic cooperation among developing countries (ECDC) and regional integration. The basic underlying philosophy of collective self-reliance of the South - as it was elaborated by the Group of 77 in the second half of the 1970s - was verified and strengthened by the protectionism of the industrialised countries in the 1980s. The basic premise of **collective self-reliance** "is the determination of the developing countries to develop their economies in accordance with their own needs and problems and on the basis of their national aspirations and experiences. Its main vehicle is the fostering of economic co-operation among themselves".[1] In 1979 the Group of 77 adopted the **Arusha Programme for Collective Self-Reliance** and an action plan with ECDC priorities.[2]

The UNCTAD officially approved the collective self-reliance approach and made efforts to come to operational ECDC porgrammes. The UNCTAD was supported in this by other organisations of the UN system, for example the UNIDO which also - inter alia - had prepared a cooperation and integration programme in cooperation with non-UN organisations on a sub-global, regional level like the Organisation of African Unity (OAU).

The Islamic countries are members in the organisations of the UN system, and many of them are also represented in other relevant groupings like the Group of 77 or the OAU. Thus, the Islamic countries know quite well the general ECDC plans and efforts and the underlying basic economic rationales. It was probably this conceptional background in combination with an ideological element (concerned with the criterion for the group membership as well as with the justification of the integration) which led the Organisation of the Islamic Conference (OIC) and its subsidiary organs and associated bodies to the formulation of an "Islamic" variant of the ECDC approach. The **ideological element** was the idea of the **umma** - the community of all Muslims.

After the redress of the Ottoman Empire and the liquidation of the caliphate by the Turkish National Assembly in 1924, the last symbols of the unity of the Muslim world were removed. But when the Islamic countries gained their political independence after World War II, the idea of the umma was revitalized in the 1960s. In the discussions about the unity of the Muslim world, economic matters attracted wide attention. An often advanced argument was that the Islamic countries became independent only politically, but economically they still were under the domination of the strong industrial powers of the North. The Islamic countries, which are as a group well endowed with natural resources, should endeavour by joint action to remove these dependencies and to push ahead their economic development. National peculiarities cannot be denied, but it was argued that the common religion of Islam should be a strong enough foundation for the international solidarity within the Muslim world.

For many Muslim economists, the umma - translated into terms of international economics - requires the establishment of an **Islamic Common Market** or an **Islamic Economic Community** or even an **Islamic Economic Unity**.

2.
Non-Islamic Integration Experiences and the Heterogenity of the Muslim World

In 1957 the European Economic Community (EEC) was established, followed by the European Free Trade Association (EFTA) in 1960. The rapid economic development of the member countries of these European integration groupings inspired many governments of developing countries also to create free trade areas and customs unions and even to strive for common markets in the Third World. Those sectoral cooperation and (sub-)regional integration groupings where Islamic countries are members in are listed in **table 1**.

But in contrast to the European integrations, the overall record of experiences of these groupings of developing countries is not very impressive. The stimulation of the intra-group economic relations, leading to an increased volume of intra-group trade, was in most cases at best marginal. The main reason seems to be that governments very often are **not really willing to open their markets** for competitors from other integration countries. This view is supported by the following observations:

- Negotiations on trade liberalisation are, esp. in large groupings, lengthy and often delayed (see ECOWAS, PTA, CEEAC).

- Items which governments offer for tariff concessions can be large in number but negligible in relevance in the intra-group trade (see ASEAN).

- Intra-group tariffs can be formally abolished but factually are re-introduced by the adoption of a compensation-oriented tax system for goods produced and traded within the group (see UDEAC).

Table 1: Membership of OIC Countries in Economic Cooperations and Integration Groupings (February 1986)

Groupings

ACM = Arab Common Market
CAEU = Council of Arab Economic Unity
OIC = Organisation of the Islamic Conference
RCD = Regional Cooperation for Development
BEAC = Banque des Etats de l'Afrique Centrale
CEAO = Communauté Economique de l'Afrique de l'Ouest
CEEAC = Communauté Economique des Etats de l'Afrique Centrale
CILLS = Comité Permanent Inter-Etats de Lutte contre la Sécheresse dans le Sahel
CPCM = Comité Permanent Consultatif du Maghreb
ECOWAS = Economic Community of West African States
Entente = Conseil de l'Entente
LCBC = Lake Chad Basin Commission
MRU = Mano River Union
NBA = Niger Basin Authority
OAU = Organisation of African Unity
OMVG = Organisation pour la Mise en Valeur du Fleuve Gambie
OMVS = Organisation pour la Mise en Valeur du Fleuve Sénégal
PTA = Preferential Trade Area for Eastern and Southern Africa
UDEAC = Union Douanière et Economique de l'Afrique Centrale
UMOA = Union Monétaire Ouest Africaine
ASEAN = Association of South East Asian Nations
Bangkok = Bangkok-Agreement
GCC = Gulf Cooperation Council
SAARC = South Asian Association for Regional Cooperation

	inter-regional				Africa																Asia			
Group	ACM	CAEU	OIC	RCD	BEAC	CEAO	CEEAC	CILLS	CPCM	ECOWAS	Entente	LCBC	MRU	NBA	OAU	OMVG	OMVS	PTA	UDEAC	UMOA	ASEAN	Bangkok	GCC	SAARC
establ.	1964	1964	1972	1964	1972	1974	1983	1973	1964	1975	1959	1964	1973	1980	1963	1978	1972	1981	1966/73	1962/73	1967	1975	1981	1985
Afghanistan			●																					
Algeria			●						●						●									
Bahrain			●																				●	
Bangladesh			●																			●		●
Benin			●			●				●	●			●	●					●				
Brunei			●																		●			
Burkina Faso			●			●		●		●	●			●	●					●				
Cameroon			●		●		●					●		●	●				●					
Chad			●		●		●	●				●		●	●									
Comoros			●												●			●						
Djibouti			●												●			●						
Egypt	●	●	●												●									
Gabon			●		●		●								●				●					
Gambia			●					●		●					●									
Guinea			●							●			●	●	●	●								
Guinea-Bissau			●							●					●	●								
Indonesia			●																		●			
Iran			●	●																				
Iraq	●	●	●																					
Jordan	●	●	●																					
Kuwait		●	●																					
Lebanon			●																					
Libya	●	●	●																					
Malaysia			●																		●			
Maldives			●																					●
Mali			●			●		●		●				●	●		●			●				
Mauritania	●	●	●			●		●		●					●		●							
Morocco			●						●						●									
Niger			●			●		●		●	●	●		●	●					●				
Nigeria			●							●		●		●	●									
Oman			●																				●	
Pakistan			●	●																				●
Qatar			●																				●	
Saudi Arabia			●																				●	
Senegal			●			●		●		●					●	●	●			●				
Sierra Leone			●							●			●		●									
Somalia		●	●												●			●						
Sudan		●	●												●									
Syria	●	●	●																					
Tunisia			●						●						●									
Turkey			●	●																				
Uganda			●												●			●						
U.A.E.		●	●																				●	
Yemen A.R.		●	●																					
Yemen P.D.R.	●	●	●																					
Members: a - Islamic	7	13	46	3	3	6	3	7	4	11	3	4	2	5	24	1	3	4	2	5	3	1	6	3
b - non-Isl.					3	1	7	1		5	2		1	1	25	1		11	3	2	3	5		4

- When tariffs are abolished, governments can take recourse to non-tariff restrictions for the continued protection of (weak) national industries (see ACM and first signs in GCC).

- When economic policies are not harmonized, exchange rate manipulations, fiscal and other incentives can be utilized for a protection and/or pormotion of domestic industries (see GCC, CEAO).

The poor record of integration groupings of developing countries and the evasive tactics of many governments regarding a "real" intra-group trade liberalisation stand in contrast to the economic rationale for the formation of free trade areas and customs unions: It is usually argued that the national markets of most developing countries are too small for the establishment of industrial plants of efficient or optimum size. Hence the enlargement of the markets (and their protection) is seen as a prerequisite for a more rapid industrial development.

This economic argument pays attention to the welfare and development of the integration grouping as a whole, but it does not care much about the regional resp. national distribution of the costs and benefits of the market enlargement. But this is the main concern of national governments for whom the domestic industrial production and development is a major political goal. It has been observed, for example, that in terms of natural endowments the countries of West Africa are extremely complementary, but that in practice the resulting developmental potentials have not been exploited. This "lack of complementarity was created and maintained by nationalistic development policies for light, import-substituting industries. ... Manufactured products are similar and intended for the internal markets; agricultural and mineral raw materials are exported to Northern countries." [3]

If the tariff-protected industries of integration countries are very similar in their basic orientation but differ substantially in their levels of **efficiency** and **sophistication** - because, for example, some countries with larger national markets are generally more advanced in their economic development -, then some countries have to be in for a loss of industrial production. This implies a devaluation of invested capital and temporary unemployment. For most governments, this is politically not acceptable. "Frustration and conflicts arise when a country perceives that its markets have been flooded by its partners' products when it cannot make reciprocal gains on its own. Such fears are fully justified, for no country wishes to be a mere agricultural appendage to its more developed neighbours."[4]

The developing countries had to learn that in heterogenous integrations - i.e. integrations comprising countries of widely differing sizes, levels of development and industrialisation, etc. - the costs and benefits of the removal of the restrictions of trade and factor movements can be distributed very unevenly. The experience of many integrations is that the **intra-group liberalisation** can turn out to be **detrimental** for the industrial development of the **least advanced member countries**. Industries in these countries are often too inefficient to survive when they get exposed to the intra-group competition after the elimination of national protective tariffs. In addition, most new industries will choose locations in those integration countries which have already reached a higher level of development and offer some external agglomeration economies (e.g. due to better infrastructure in transport and communication or a better trained labour force). The least developed countries often complain that the **more advanced countries** have **gained** industrial capacities **at their expenses**, and they ask for a compensation of the losses caused by their accession to the integration.

"It may be useful to list the forces that may contribute to cumulative growth in one area at the expense of another. First, the strong region may attract factors of production from the weak region, leaving it with fewer resources for development. ... Secondly, there may be factors at work that lead to an unduly large proportion of any increase in the production in the weak area flowing to the strong area. ... (A) large portion of extra production may have to be remitted to the strong area in the form of profits, interest and repayment of loans ... Thirdly, the weak region may be prevented from setting up infant industries by the established firms in the strong region. (Fourthly:) As comparative advantages change, continual costs of adjustment are thrown upon the less progressive region, whilst only a small part of the gains from progress in the progressive region is passed on to the weaker region."[5]

Although highly aggregated and not very complete, the data in **table 2** give a rough idea of the economic heterogenity of the Muslim world.

- The share of the individual countries in the aggregated Gross Domestic Product (GDP) of the OIC ranges from 0 to 20 %; more than a quarter of the member countries have GDP shares near to nil, while the share of the three largest countries sum up to 43 %.

- The shares of the manufacturing industries in the national GDPs range from 2 to 24 %, the GDP shares of agriculture range from 1 to 50 %.

- The population of the largest country is more than 500 times that of the smallest one.

Table 2 : Population, GNP per capita, GDP and Structure of Production

(1) Population mid-1983 (in million)
(2) GDP 1983 (in million US$)
(3) GNP per capita 1983 (in US$)
(4) GNP per capita, annual growth rate 1965-1983 (in %)
(5) Contribution of agriculture to GDP 1983 (in %)
(6) Contribution of industry to GDP 1983 (in %)
(7) Contribution of manufacturing industry to GDP 1983 (in %)
(8) Contribution of services to GDP 1983 (in %)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Afghanistan	17.2	-	-	-	-	-	-	-
Algeria	20.6	47,200	2,320	3,6	6	54	13	40
Bahrain	0.4	4,920	10,510	-	-	-	-	-
Bangladesh	95.5	10,640	130	0.5	47	13	-	40
Benin	3.8	930	290	1.0	40	14	-	47
Brunei	0.2	-	21,140	-	-	-	-	-
Burkina Faso	6.5	900	180	1.4	41	19	-	40
Cameroon	9.6	7,220	820	2.7	24	32	11	45
Chad	4.8	320a	-	-	-	-	-	-
Comoros	0.4	-	-	-0.6	-	-	-	-
Djibouti	0.4	-	-	-3.6	-	-	-	-
Egypt	45.2	27,920	700	4.2	20	33	-	47
Gabon	0.7	-	3,950	3.2	-	-	-	-
Gambia	0.7	-	290	1.4	-	-	-	-
Guinea	5.8	1,910	300	1.1	38	23	2	39
Guinea-Bissau	0.9	-	180	-	-	-	-	-
Indonesia	155.7	78,320	560	5.0	26	29	13	35
Iran	42.5	-	-	-	-	-	-	-
Iraq	14.7	33,573*	-	-	-	-	-	-
Jordan	3.2	3,630	1,640	-	8	31	15	61
Kuwait	1.7	21,330	17,880	0.2	1	61	6	38
Lebanon	2.6	2,394	-	-	-	-	-	-
Libya	3.4	31,360	8,480	-0.9	2	64	4	34
Malaysia	14.9	29,280	1,860	4.5	21	35	19	44
Maldives	0.2	-	-	-	-	-	-	-
Mali	7.2	980	160	1.2	46	11	-	43
Mauritania	1.6	700	480	0.3	34	21	-	45
Morocco	20.8	12,300	760	2.9	17	32	17	51
Niger	6.1	1,340	240	-1.2	33	31	-	37
Nigeria	93.9	64,570	770	3.2	26	34	5	40
Oman	1.1	7,460	6,250	6.5	-	-	-	-
Pakistan	89.7	25,880	390	2.5	27	27	19	46
Qatar	0.3	6,419*	21,210	-7.0	-	-	-	-
Saudi Arabia	10.4	120,560	12,230	6.7	2	66	6	32
Sengal	6.2	2,570	440	-0.5	21	26	17	54
Sierra Leone	3.6	950	330	1.1	32	20	5	48
Somalia	5.1	1,540b	250	-	50b	11b	6b	39b
Sudan	20.8	6,850	400	1.3	34	15	8	51
Syria	9.6	16,850	1,760	4.9	19	25	-	55
Tunisia	6.9	7,020	1,290	5.0	14	36	14	50
Turkey	47.3	47,840	1,240	3.0	19	33	24	48
Uganda	13.9	3,360b	220	-	-	-	-	-
U.A.E.	1.2	27,520	22,870	-	1	65	10	34
Yemen AR	7.6	3,710	550	-	21	17	7	62
Yemen PDR	2.0	850	520	-	-	-	-	-

a) 1981, b) 1982, *) figures from AMF sources.
Sources: World Bank (1984, 1985), AMF (1984, 1985, 1985a).

- The per capita income ranges from 130 US$ to 22,870 US$, i.e. the per capita income of the richest country is more than 150 times that of the poorest one. This is the most extreme range of per capita income that can be found in any existing integration grouping worldwide.

- The average annual growth rates of the Gross National Product (GNP) per capita for 1965-1983 vary widely from -3.6 % to +5.0 % (not including the high-income oil exporters).

- The OIC states also differ widely with respect to their exchange rate regimes: By the end of 1985, 9 countries had tied their currencies to the US$, 9 to the French franc, 1 to the British pound, 4 to the Sepcial Drawing Rights of the IMF, and 8 to other currency baskets; a limited flexibility was practiced by 6 countries, a managed floating by 6 countries and a free floating by 2 countries.

Although highly aggregated, these figures indicate clearly the enormous economic differences between the member states of the OIC. The OIC includes the poorest as well as the richest countries of the world, countries with oil-based industries as well as agricultural economies, fast growing and (in real terms) contracting economies, countries with large and with small domestic markets, etc. The OIC is probably the **most heterogenous** of all groupings worldwide striving for economic integration.

3.
The OIC Integration Approach, the Investments Agreement, and the Need of a Trade Liberalisation Scheme

If the idea of an **Islamic Common Market** is taken seriously, the OIC cannot be content with the support of sectoral cooperation activities but must elaborate a more fundamental and comprehensive strategy for the liberalisation of the flows of goods and factors among the Islamic countries. A summary of various partial cooperation and more basic integration measures which have been put forward in important documents of the OIC system is given in **table 3**.

Considering the more basic integration measures in the OIC system, one finds that the first (and so far only) agreement (with a more concrete content than the General Agreement for Economic, Technical and Commercial Cooperation among OIC member states which was signed in 1977 and came into force in 1981) is the **Agreement for Promotion, Protection and Guarantee of Investments** among the OIC member states (Investments Agreement). This Investments Agreement was adopted in 1981 and has been signed by 12 states (by the end of 1985). But only 6 states also ratified the agreement which shall enter into force after the ratification by at least 10 OIC members (i.e. by less than a quarter of the 46 OIC members).

The Investments Agreement refers to the first article of the General Agreement (of 1977/1981) where "arrangements, guarantees and incentives to encourage the transfer of capital and investments" among OIC members were suggested. The main **regulations of the Investments Agreement** are as follows.[6]

Table 3: Systematic Summary of ECIC Approaches and Measures in High-Ranking OIC Documents

Approaches for economic co-operation and integration among Islamic countries		for the creation/enlargement of markets with main orientation towards		
		results of production (goods and services)	process of production (factors of production)	
			capital	labour
coordination of economic policies, cooperation (primarily) on the state level	general approaches directed to the design of a legal framework	trade on the basis of equal and non-discriminatory treatment among Islamic countries trade preferences for Islamic countries	liberalization of capital movements promotion of and protection for capital transfers and investments of Islamic countries	preferential treatment for manpower from Islamic countries model social security system
	specific approaches directed to particular preconditions for economic activities or to particular results	trade liberalization within the Muslim world clearing mechanisms and payments arrangements export credit guarantees and export insurance schemes	access of Islamic countries to the national capital markets of other Islamic countries improvement of agricultural infrastructure and transport facilities	exchange of experts, skilled manpower, etc. (technical cooperation)
cooperation (mainly) on the business level		food reserve stocks maritime transport export promotion by information systems, trade fairs, exhibitions, etc. cooperation among financial institutions	agro-based and agro-related industries achieving industrial complementarities by joint projects joint ventures in specific sectors (agriculture, industry, trade, energy, etc.) and/or for specific purposes (research, technology, etc.)	manpower education and training counteractions against the brain drain to developed countries

- "The contracting parties shall permit the transfer of capitals among them and its utilization ... in accordnace with their laws. The invested capital shall enjoy adequate protection and security". "The contracting parties shall endeavour to open up various fields and investment opportunities" which will foster the development of the host country and also achieve profitable returns for the investors. The contracting parties shall "offer various incentives and facilities for attracting capitals". The host country shall "encourage the local private sector to cooperate with and participate in investments" from other contracting countries.

- If no specific arrangements exist for a preferential treatment of investments between the host country and any other country, then "investors of any contracting party shall enjoy ... a treatment not less favourable than the treatment accorded to investors belonging to another State not party to this Agreement" (and not party to another agreement granting better treatment to investors of that particular state in the host country). This rule is similar to the most favoured nation clause in trade arrangements, but in its effects it is restricted to cases where no special arrangements exist.

- Investment guarantees shall ensure that the host country will not "affect ownership of the investor's capital or investment by depriving him ... of his ownership or of ... his basic rights or the exercise of his authority on the ownership, possession or utilization of his capital, or of his actual control over the investment, its management, making use out of it, enjoying its utilities, the realization of its benefits". The host state shall "guarantee the free transfer ... of the capitals and its net proceeds in cash ... without any taxes or charges on the transfer. ... The repatriation of the original capital shall be effected on the termination of the investment ... or after five years ... (and) in the currency in which the investment was made or in any other convertible currency".

- "The investor shall be entitled to compensation for any damage resulting from ... [inter alia] violation of any of the rights or guarantees accorded to the investor under this Agreement". The OIC shall - through the Islamic Development Bank (IDB) - establish "an Islamic Institution for the Guarantee of Investments".

The Investments Agreement can be assessed as a first step towards a **free intra-group movement of capital**. It deals with the **inflow** of capital and with the profitable employment of funds from investors of other OIC countries. It does not touch the question of free capital outflows. This is understandable since there is hardly any chance to get sufficient support for an agreement that would allow the free export of capital: Most (if not all) less developed Islamic countries are short of funds for the financing of the domestic investments and depend more or less on capital imports. Capital exports are the concern only of a very small number of oil exporting countries.

As a kind of supplement to the (not yet effective) Investments Agreement, the IDB and the Islamic Chambe of Commerce, Industry and Commodity Exchange (ICCICE) paid much attention to the promotion of **industrial cooperation through Islamic joint ventures**. The ICCICE had called for project proposals in 1981, and after a first evaluation of more than 70 proposals, it submitted them to the IDB and other financial institutions. The IDB found six projects to be financially viable which amount to 123 million US$. The ICCICE is now looking for project partners who could supply most of the financial means needed for the implementation of the viable joint venture projects.[7]

The usual pattern of integration starts with the reduction and abolition of intra-group tariffs, accompanied or followed by the introduction of a common external tariff, while free factor movements are postponed to a (rather distant or indeterminate) future date. Seemingly, the OIC has somehow reversed this usual pattern and starts with a liberalisation of factor movements. One of the reasons probably is the recognition that a trade liberalisation would have - under given circumstances - no substantial impact: The trade among Islamic countries is, on the average and also for most individual countries, rather insignificant in quantity, highly concentrated with respect to both the number of traded goods (mainly raw materials) and the importance of particular countries in intra-Islamic trade, considerable polarised (i.e. directed mainly to only a few importing countries in the Muslim world), and growing at a slower rate than the total trade of the Islamic countries. It is an experience of many existing integrations of developing countries that the trade liberalisation is rather ineffective and that the initially low level of intra-group trade did not increase substantially after the reduction or abolition of tariffs. The main reason is that the outward oriented sectors of the developing economies produce goods which find their outlets in the markets esp. of the industrialised countries but do not meet the import demand of the other group members. There is a lack of tradable goods within the group. Before the intra-group trade could increase, the export industries need some restructuring with regard to the intra-group demand. This requires investments which could be facilitated by the inflow of capital from other group members. In this perspective, a liberalisation of capital movements is seen as a prerequisite for an adjustment of the export industries and for an increasing intra-group trade.

The OIC integration approach with the emphasis on capital movements and joint ventures has some similarities with the re-designed integration efforts of the Council of Arab Economic

Unity (CAEU): The disappointing results of the trade liberalisation in the Arab Common Market led to a shift of emphasis form trade liberalisation towards the promotion of Arab joint ventures. The rationale behind this new approach was the idea that the joint venture formula could facilitate the establishment of new industries supplying the regional market and enhancing the industrial potential of the Arab Common Market (ACM).

But there is one important difference between the Investments Agreement of the OIC and the joint venture promotion of Islamic institutions on the one hand, and the efforts of the CAEU on the other hand: Arab joint ventures have - at least in principle - free access to the national markets of all ACM member countries since tariffs were abolished among ACM members; but as long as no multilateral agreement on a preferential or free trade among Islamic countries is concluded, the outlets for Islamic joint ventures are basically confined to the national markets of the location countries. The consequence is that the (partial) liberalisation of capital movements would operate in favour of the industrially more developed Islamic countries with large national markets, while the least developed and small Islamic countries would have even less chances to attract investors and to be chosen as a country of location for new industries than they would have in a conventional free trade area or customs union (without capital movements) Without appropriate trade liberalisation measures, the Islamic Investments Agreement would be conducive first and foremost to the interests of a few 'capital surplus' countries (i.e. mainly the oil exporters of the Arab Guld region) and the more advanced and/or relatively large countries esp. in Asia and the Middle East. The considerably large number of small und least developed Islamic countries in Africa could hardly draw much benefit from the Investments Agreement.

The set goal of an Islamic Common Market as well as the developmental interests of the least developed and small member countries of the OIC demand for a supplementation of the Investments Agreement by an approporiate scheme for trade liberalisation: For the small countries it is often seen as a prerequisite for their industrial development that they can enlarge their too small domestic markets and find outlets for the output of their industries in other Islamic countries. But in a conventional free trade area or customs union the danger is that their industries (of small scale and less efficiency) would be overthrown in the arising intra-group competition so that they would end up with a reduced level of industrial production. Therefore, an 'appropriate' trade liberalisation scheme would be an arrangement which could bring about an enlargement of the markets for the small and least developed countries but at the same time gives them some form of protection or support which shall ensure that the efficiency-improving intra-group competition will not result in a reduction of their level of industrialisation.

The outline of such an 'approporiate' scheme for trade liberalisation has been given elsewhere and should not be discussed in details here.[8] What deserves attention in the present context, is the fact that additional and supplementary measures of trade promotion would also - in the last instance - contribute to the restructuring and promotion of new intra-group industries. But a general trade promotion without trade liberalisation may lead to a support and continuation of a distorted trade structure where the so far existing and then intensified trade relations are less based on intra-group comparative advantages but on different national export promotion strategies of the group members.

Among the most important measures for the promotion of intra-Islamic trade is a recently established long-term trade financing facility of the IDB with an initial capital of approx. 300 million US$.

The respective decision was taken by the 10th Annual Meeting of the Board of Governors which was held in Qatar in April 1986. The IDB was heavily engaged in (short-term) trade financing already before that decision was taken, but this activity was not fully in accordance with the statutes and the set objectives of the bank (so that the establishment of the trade financing facility now looks somewhat like a belated approval of a long established practice): Trade financing is not explicitly mentioned in the first chapter of the Articles of Agreement where the purpose, functions and powers of the bank are laid down. According to this, the IDB ought to employ its funds primarily in project financing by using techniques like equity participation, profit sharing or leasing. Funds not immediately needed for this purpose could be used for short-term trade financing. But the proportion of trade financing in total financing of the IDB increased substantially from 30 % in 1977 to 67 % in 1985, while the share of project financing decreased accordingly. From the opening of the bank until 1985, 241 foreign trade operations were financed with an average amount of 15,000 US$ for 29 importing countries. About 80 % of the financed imports originated from other OIC countries. This is a remarkably high percentage, but a closer look at the composition of this trade discloses some structural shortcomings: About 60 % of the financed trade were imports of crude oil and petroleum products; thus, about 50 % of the total financings of the IDB facilitated exports of Islamic oil countries (esp. of Saudi Arabia, Iraq and Kuwait). Further % of the trade financing were made for imports from non-Islamic countries. Therefore, only about 10 to 15 % of the total resp. the foreign trade financing of the IDB were used for non-oil imports from Islamic countries, and only this relatively small percentage may have had some impacts for the industrial development of the Islamic countries.

If one does assume that there are no quantitative limitations to the availability of funds for the Islamic financial institutions in total, then the mobilisation and earmarking of additional funds for trade financing means that only a smaller pool of mobilisable funds is left for the financing of industrial projects. Looking at the practice of Islamic banks, one can see that the Islamic commercial banks employ most of their funds in trade financing, but - for a number of conceptional and operational reasons - they hardly provide funds for the medium or long term financing of industrial projects. But when the economic relations among the countries of the Muslim world should be re-structured according to the intra-group comparative advantages (in order to create a self-reliant and self-sustained regional market), then is would be more important to support the provision of funds for the financing of investments for the adjustment of old and the establishment of new industries than to provide for funds for additional trade (prior to the efficiency-improving re-structuring of the industries of the Islamic countries).

From this point of view, the wisdom of the decision to set up a new trade financing facility can be challenged: For the - individual as well as collective - development of the Islamic countries in a medium and long term perspective, it is more important to make available additional financial means for the financing of industrial ventures than for the financing of intra-group trade. The Islamic commercial banks have strong economic incentives to provide financial means for the financing of trade and to enlarge the volume of funds which they can offer to exporters and importers in Islamic countries. If there would be a large unsatisfied (commercial) demand for funds for the financing of intra-group trade, then the Islamic commercial banks should be willing (out of their microeconomic interests) to provide the needed funds (at terms favourable to their profit situation) by mobilising additional funds from their depositors and by channelling more of the available funds into trade activities.

Compared with a (hypothetical) 'industrial projects financing facility', it can be summarized

- that the more pressing need for support through the IDB is on the industrial investment but not on the trading side,

- that the Islamic (and, of course, also the non-Islamic) commercial banks should be able to provide sufficient means for the financing of intra-Islamic trade, and

- that the IDB as an intergovernmental development bank had better set up an industrial venture financing scheme (which would also bring the IDB activities back in line with what was originally intended).

If the IDB once would try to get more involved in the promotion of industries, it is plausible to expect that it would concentrate its financial support on newly established Islamic joint ventures. Although this would be preferable to additional trade financing, some reservations should be voiced: As trade **promotion** is not the same as trade **liberalisation**, the promotion of industrial joint ventures is not yet a liberalisation of capital movements. But - as already mentioned - only a **liberalisation** of the movement of goods **and/or factors** would pave the way a 'real' efficiency-improving reallocation of industrial activities between the Islamic countries in accordance with resp. based on intra-group comparative advantages. What could result from trade and investment **promotion** programms without liberalisation elements might be, in the worst case, a corrobation and perpetuation of extisting distortions in the intra-group economic relations. This neither can be a stable equilibrium, nor does it help much to mobilise the own forces and development potentials of the Muslim world; quite contrary, many political disputes and quarrels may be caused by the distorted and biassed economic relations and absorb much or most of the intellectual and creative capacities which should better be used for developmental activities. Therefore, the Islamic countries must look for appropriate liberalisation strategies and not only concentrate of trade and investment promotion. Entrepreneurs then may find new profitable investment opportunities in the re-structuring industrial sectors, and Islamic banks may find it attractive to finance these promising new industrial ventures. But even if the Islamic banks would hold to their trade financing preference: under liberalised conditions this trade would have a more 'economic' basis than at present, and therefore also the trade financing would foster (indirectly) the industrial development of the Muslim world.

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1) Group of 77 (1976), p. 10.
2) See Group of 77 (1979).
3) Diouf (1984), p. 20.
4) Ibid., p. 27.
5) Streeten (1964), pp. 54-55.
6) See OIC (1981).
7) See ICCICE (1984, 1985).
8) See Nienhaus (1985, 1985a).

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