

Comparative Analysis of Investment in Capitalistic and Islamic Systems under Certainty and Risk Conditions (1993)

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The roles of interest-based and interest-less banking systems in Investment has been both examined and compared in this rather lengthy paper.

Conventional banking is fundamentally based on loan from both depositor and customer sides. Loan, by definition, is temporary dispossession of a sum of money from lender to borrower irrespective of the outcome of the use of money. This would make such banks quite passive under certainty and risk conditions; furthermore, there is no guarantee that loan demanders would (in theory) necessarily invest, especially under risk conditions. Thus, these banks have properly been called Fund Intermediaries. However, acting as agents from depositors' side and as shareholders from financiers' side the Islamic bank plays a new role never considered by Western economists.

There seems to be no alternative for financees to use the funds provided by Islamic bank to purposes other than those indicated by several modes of contract prepared by these banks, in both certainty and risk conditions. Among these contracts PLS has the dominant role and other modes are auxiliary to PLS; hence, properly called PLS banking. Therefore, Islamic banks have quite an active role to play, contrary to conventional banking.

The author, based on above, has called conventional banks "monetary institutions", and Islamic banks "financial institutions", which follow monetary policy and financial policy, respectively. The ratio of bank's profit rate to that of the financee's, a new variable has been introduced which equilibrates saving and investment functions. By changing this ratio, Islamic bank would be able to either induce or discourage the financee, whichever appropriate. This would give an Islamic bank a powerful financial policy tool, especially under risk conditions. Conventional banks suffer from lack of such a tool, unless interfere in the money market and incurring considerable social cost.

Western economists are keen about the supply of money in interest-based banking system to the effect that it would often generate imbalance and inflation. PLS contract in Islamic banking would change the legal property of potential capital to actual capital before it leaves an Islamic bank; hence no reason to worry about the supply of money.