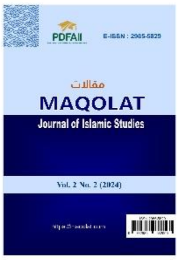

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Research Article

Islamic Finance in the Globalized World with Special Reference to Equity Over Debt Financing

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Abstract. The Islamic finance industry has significantly established itself in the global financial landscape since the latter half of the 20th century. Its constant substantial growth has surprised even those, not assured of its success earlier. In the economic recession of 2008, Islamic finance was termed as a safe, ethical, and vibrant alternative to the conventional financial system. In 2023, the global financial landscape faced several tough challenges characterized by geopolitical tensions, inflation and excessive debt. Despite these high challenges, the Islamic Financial Service Industry has continuously demonstrated remarkable growth. Approximately, 3.38trillion dollars of the United States is estimated to be engaged in this experiment. It has garnered attention from top global financial institutions like the International Monetary Fund, World Bank, and many other reputed financial institutions and it has equally received warm attention from global academic centers like Harvard University, Rice University, London School of Economics, and many other top universities of the world. It is currently operational in more than 75 countries via 550 Islamic financial institutions. Emerging concepts in conventional economics, such as green funds and ethical financing, constitute fundamental elements inherent in the Islamic financial system, which has consequently expanded the scope of the Islamic financial industry. Therefore, the present study explores the scope and viability of Islamic finance in the context of globalization, emphasizing equity financing as a preferable alternative to debt financing. It takes into account, how Islamic financing can help developed and developing countries to build a new world order that would be based on tranquility, cooperation, mutual help, sharing, and caring by relying more on equity financing than on debt financing. The present study discusses the repercussions of interest based debt on global economy and the need of Islamic finance to bloom economies of developed and developing countries at global level by avoiding channels of exploitative practices like interest, debt-trap, in-equality of wealth, etc. which eventually leads nations into poverty, debt, abject hunger, and un-employment. The study also examines why the debt relief packages provided to under-developing countries by developed nations have not successfully helped to address the issues of debt trap and in equality of wealth. Furthermore, the study reviews, whether Islamic finance exclusively serves the interests of Muslims only or benefits the whole humanity without any discrimination of caste creed, color, region and religion.

Keywords: Islamic Finance, Globalization, Debt and Equity Financing.

INTRODUCTION

Over the last few decades, the Islamic financial industry has evolved from a nascent industry to a global industry and is gaining momentum in both Muslim and non-Muslim countries. Its presence has been seen in various sectors, such as the capital market, takaful (insurance), and the banking sector of the global economy. According to the Islamic Financial Service Industry Stability Report 2024, the Islamic Financial Industry has constantly achieved positive growth and has successfully witnessed worth about 3.38 trillion United States dollars[i] despite facing various serious issues such as geopolitical tensions, inflation, and global debt. In the latter half of the 20th century, the forces of globalization and liberalization culminated in the integration of economies of the world that have eventually uplifted certain economies, but simultaneously, it is being argued that it has pushed economies of some countries, such as sub-Saharan Africa and Middle Eastern countries, to backwardness and vulnerability. These countries visualize globalization as a new form of imperialism, primarily due to debt-based lending practices that involve fixed interest rates. This has resulted in a "debt trap," which engulfed various economies and devastated their financial systems. Therefore, in the framework of globalization, if debt-based financing is replaced by equity financing, as emphasized in the Islamic financial paradigm, it may proliferate the vulnerable economies of the world, which understand globalization as a curse and an old slavery in a new form. Therefore, in the present study, it is discussed that the Islamic financial system, which relies more on equity financing than debt financing, may act as a viable tool in the framework of globalization to immune the global economies from debt traps and inequality of wealth, and would bring efficiency in the allocation of resources.

RESEARCH METHODOLOGY

The present study adopts a literature based of qualitative research in which historical, descriptive cum analytical methodology has been used.

Debt and Equity Financing from an Islamic Perspective

Debt and equity are two key financing components. However, in the Islamic financial system, debt has always remained an integral part of financing, which can easily be found in the balance sheets of Islamic financial institutions, created mostly via ijarah (trading) instruments. This is elucidated from the fact that Prophet Muhammad (saw) had borrowed loans for his personal needs and, at times, for the benefit of the Islamic state. In Islamic finance, the concept of debt is treated with caution and ethical considerations. If debt is incurred, it should not increase. However, in a conventional economic system, charging interest on debts/loans is a fundamental aspect of financial activities. In the Islamic financial system, any addition over and above the principal of a loan is entailed as riba, and charging interest on loans is viewed as hurting the spirit of loaning. Majority of the scholars in Islamic finance argue that the main intention behind advancing loans or debt is to provide eudemon to borrowers. This perspective emphasizes that lending is a virtuous act aimed at promoting mutual closeness and kindness among individuals and communities. Islamic finance seeks to cultivate a sense of social responsibility and compassion in financial transactions. This understanding reinforces the idea that financial assistance should be grounded in ethical principles, ultimately fostering stronger relationships and support systems in society. It is also noted from the following famous traditions of Prophet Muhammad (saw):

Qard (loan) is equal to half of the Sadaqah (charity) though it is being paid fully.[ii]

In another place, the Prophet (SAW) is reported to have said:

Offering loans without charging any addition is more pleasing to Allah (SWT) than giving largesse.[iii]

Thus, in Islam, the issue is not debt financing versus equity financing; however, it is worth noting that equity financing is more recognized than debt financing. The Islamic financial system tends to strike a healthy balance between debt and equity financing to foster economic growth and success. It also aimed to transform the debtor/creditor relationship into a partnership relationship that encourages investment in productive sectors, which adds considerably to the overall gross domestic product (GDP) of countries. Islamic finance not only facilitates economic development but also ensures that financial practices align with ethical considerations, fostering a more equitable economic landscape that addresses the needs of all stakeholders. On the other hand, the conventional financial system focuses more on the interest model and promotes debt financing, in which not only consumers and entrepreneurs but also the government find themselves heavily indebted to creditors who have adverse economic, social, political, and psychological consequences.[iv] The burden of debt halts economic growth, creates social tension, and nourishes a sense of insecurity among individuals and institutions. As debt accumulates, the focus shifts towards repayment rather than investment in development, resulting in a cycle that can potentially stop overall progress and well-being.

In addition, under the debt-based model, the creditor is focused to lend his money only to credit-worthy borrowers, on the condition of the prefixed interest rate and not to those who lack collateral to secure loans, despite the borrowers possessing entrepreneurial skills and innovative ideas. Furthermore, in the debt-centric model, the creditor is not bothered about the debtor and his enterprise; rather, he only looks for his profit. Therefore, interest-based debt financing opens doors for injustice and leads to instability of wealth and income in society. For instance, if an entrepreneur incurs a loss, he is bound to absorb the loss and repay the capital along with interest to the lender, which is unjust for the creditor to order the debtor to pay full capital along with interest. Now, if the entrepreneur has earned a substantial profit, he is only required to pay a part of that profit as interest to the creditor, which is also unjust on the part of the debtor, to return merely a portion of the profit towards the creditor without which his profit might not have materialized. Thus, interest-cum-debt-based financing gradually deteriorates the entrepreneurial culture, because when people are rewarded for money without being entitled to risk, they would prefer to indulge in business activities where there is a risk of loss. Therefore, in this system, the creditor often becomes rich in a very short period at the expense of a debtor or entrepreneur who struggles to recover from losses and utilizes his skill and time.[v]

It always assists in grooming the renter and lender classes; however, the entrepreneurial or debtor class often faces significant challenges. By contrast, the Islamic financial system prohibits risk-transferring mechanisms and focuses on risk sharing, which inherently supports the entrepreneurial culture in a society. This system helps individuals who possess the skills and innovative vision, but are unable to fetch funds in the prevailing conventional financial frameworks, because of their inability to demonstrate creditworthiness.[vi]

In the current globalized economy, the dynamics between developed and developing nations concerning public debt demands critical and thorough scrutiny. Developed countries frequently extend loans to developing nations under the assumption that such financial assistance will stimulate their production capabilities, thereby enabling them to fulfill their repayment obligations through anticipated surplus. However, this assumption is often not realistic. A large portion of borrowed funds is routinely allocated to immediate consumption needs rather than productive investments. This includes addressing urgent financial challenges, balancing budgets, and meeting essential expenditures, all of which fail to enhance the overall economic productivity. As a result, instead of bolstering economic advancement, such debts can lead to a situation where countries find themselves entrapped in a cycle of financial burden. The fixed interest rates, in turn, exacerbate this situation as the resulting debt accumulates without corresponding economic growth. Consequently, many nations find themselves ensnared in a "debt trap" rendering them increasingly vulnerable and unable to relieve themselves from cycles of indebtedness and stagnation. As observed by Siddiqi, the conventional debt financing model not only acts as a constraint in the disposal of economic justice and freedom but also proves injurious to ensure the efficient use of investible funds in productivity ways and hurt expected profit, mostly because of the terms and conditions on which these funds are advanced to the borrower.[vii] Thus, reconsidering the financing models applied in these contexts, particularly advocating for equity-based financing, as proposed by Islamic finance, may offer a more sustainable path for development.

Transitioning from debt to equity financing can significantly enhance economic growth, promote equitable development, and foster the entrepreneurial environment through risk-sharing and not risk-shifting, which is highly recognized in Islamic finance. It may also enable the lender (bank) to thoroughly scrutinize the projects they choose to finance. By carefully examining potential investments, they can acquire a clearer understanding of the associated risks, while simultaneously contributing to the growth of those projects. This dynamic benefits both developed and developing countries by cultivating a more sustainable financial system that prioritizes mutual growth and stability over exploitative practices.

Any economy of the globe, developed or developing economy dependent highly on interest based debt, can be more fatal and risky, which shall be dealt with in-depth in the following sections:

The Interest and Debt Trap in the Global World and its Consequences

In the current landscape of globalization, the global economic and financial forces are predominantly shaped by Western economic theories that advocate interest-based financing and lending practices. Globalization has spurred economic growth in certain regions; however, it has simultaneously constrained the development of others. Top global financial intermediaries, such as the International Monetary Fund (IMF), World Trade Organization, World Bank, and certain rich European nations, have leveraged the advantages of economic integration resulting from globalization. They often resort to lending their surplus funds to developing countries in the form of interest-bearing loans and debts, and capitalize on the poverty of these nations.[viii] It is essential to recognize that the motivations behind such lending practices often involve political consideration. To serve the interests of developed Western countries, these nations frequently engage in lending activities that may aim to exploit and, in some cases, topple the governments of vulnerable countries.

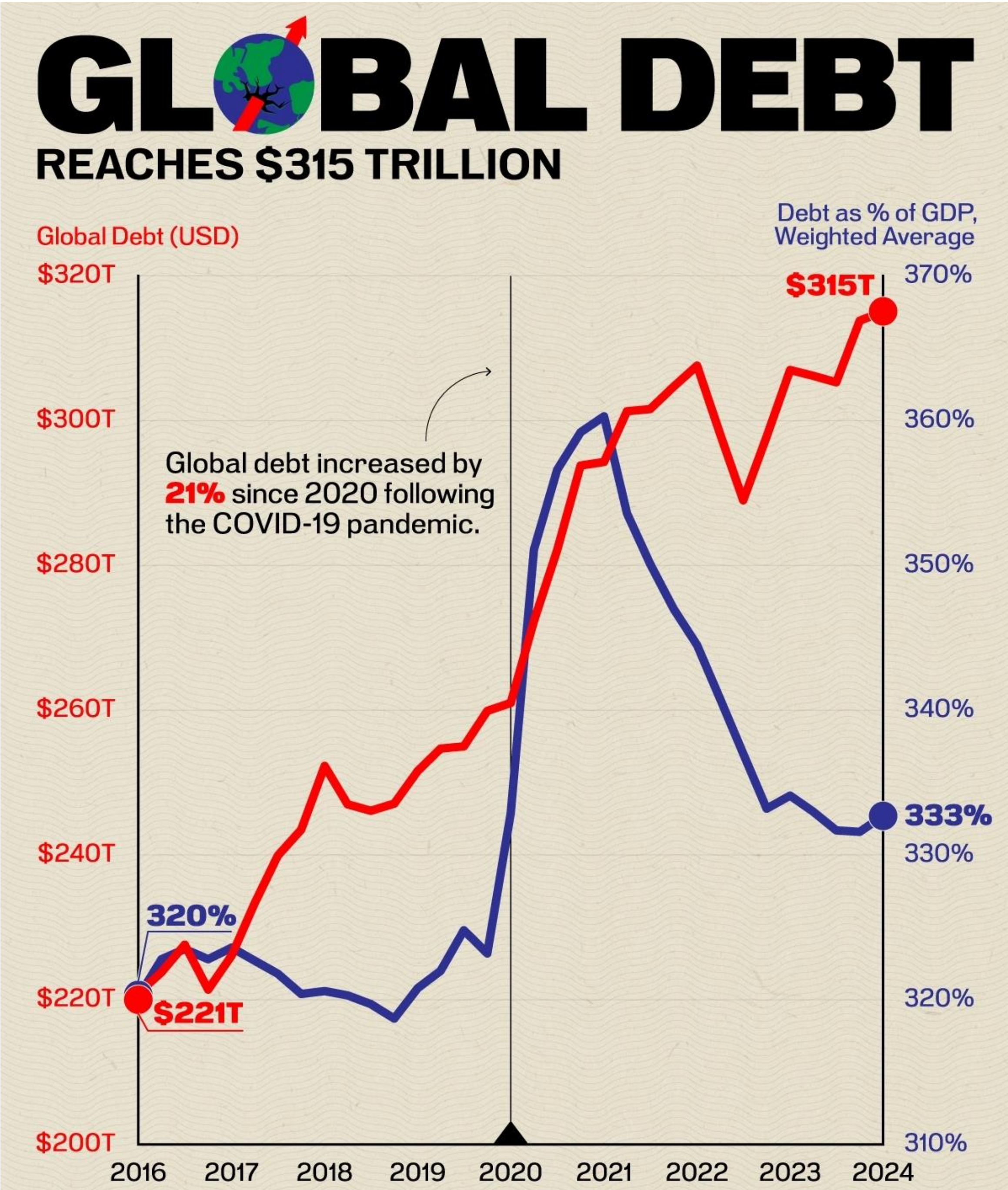
The conventional interest-bearing financial system has created an un-repayable debt burden, often referred to as the "debt trap," which serves as a tool for the exploitation of indebted nations by wealthier countries. Historical examples, such as the control exerted by European nations over the Ottoman Sultanate through interest-based debt,[ix] illustrate this dynamic. Recently, the Sri Lankan economy went bankrupt due to similar excessive interest-based lending. This system acts as an impediment to the development process and yields destructive consequences comparable to the impacts of war, as noted by scholars such as Dr. Adabayo Adedeji. It can be seen as a modern form of slavery, stiffer, and harsher than the historical slave trade. The most downtrodden section of society suffers immensely and is unable to enjoy the benefits typically associated with loans from developed nations because they struggle to meet debt obligations.

The cyclical nature of debt alleviation is troubling, as yesterday debt is often met by accruing additional debt today, thus worsening the country's financial position. It is notable that developing nations often receive \$1 in aid, yet they are required to repay an estimated \$2.30 to manage their debt obligations.[x]

This reality illustrates why the debt relief packages provided to under-developing countries by developed nations have not successfully helped them relieve themselves from the debt trap. To service their debts, many developing countries are compelled to increase taxes and reduce expenditures on vital developmental projects, such as health, education, and food. This approach results in extreme poverty, which leads to hunger, malnutrition, and disease. It further triggers failures in businesses, rising unemployment, inflation, and declining savings and investment, and ultimately diminishes both gross domestic product and national income, culminating in failure at the macro-economic level. For instance, in sub-Saharan Africa, approximately 7000 people die every day due to inadequate funds for critical human capital and infrastructure development, as they are overwhelmed by a debt trap that requires them to pay $13 billion in debt service.[xi] The current state of indebtedness, particularly in developing nations, warrants significant attention. A powerful statement from the African Council of Churches aptly encapsulates this reality: "Every child, including newborn babies, is born with a financial burden that he cannot remediate even through their lifelong labor. The debt is a new form of slavery and is as rancorous as the slave trade. Debt has turned into a more vicious form as some multinational financial institutions have transferred the debts of poorer countries to vulture funds, facilitated by judicial systems in the United States and Europe.[xii]

Paul Wolfowitz[xiii] has aptly noted the troubling dynamics of debt being traded in open markets, which subsequently forces debtor nations to repay multiple times their debt obligations.

The excessive dependency on debt is not only detrimental to the economies of developing and under-developing countries but also poses serious risks to the economies of developed nations. Global debt is indeed alarming, reaching 315 trillion USD in 2024, the highest in history[xiv] which is evident from the following graph 1.0.



Source: IIF Global Debt Monitor

After analysing the above data which has been taken from the official data base of Institute of International Finance, it elucidates that the current wave of global financial fragility, accompanied by interest based-debt, is concerning. It mirrors the Great Depression's instability, with increasing private debt, public poverty, and recurring crises threatening both developing and advanced economies. Take, for instance, the United States, which faces its own burgeoning public and personal debt, an issue that threatens economic stability. Their public and personal debt has reached a level at which it has become problematic for their economies to maintain stability.

However, because of its unique ability to print the dollar, which serves as an eminent global reserve currency, it maintains a semblance of stability. Furthermore, they were also supplemented by mega financial institutions of the world, such as the World Trade Organization, International Monetary Fund, and World Bank, which provide regulatory frameworks that potentially support their economy at the cost of the world economy.[xv] However, if any lender of the United States like Japan or China calls for the return of their debt, then the situation may topple the global economy.

The need for Islamic Finance at the Global Level

The challenge of alleviating excessive debt, poverty, and income inequality in underdeveloped countries is a complicated issue that does not offer short-term solutions. However, it is essential to recognize that certain issues such as severe poverty and debt traps are often artificial and can be addressed through careful analysis and reform. Economists such as Muhammad Yunus[xvi] have uttered advocates for these changes. Organizations such as the Jubilee USA Network, Action Aid, and Oxfam constantly take initiatives to advocate for debt cancellation from traditional financial institutions. Their initiatives have influenced major global entities, including the World Bank, the International Monetary Fund (IMF), and the G8 nations, which together canceled approximately $40 billion in debt for impoverished countries in 2005.

Despite these efforts and substantial government investments in debt relief and aid packages, many impoverished nations continue to find themselves engulfed by a cycle of debt. This predicament is largely attributable to the enduring exploitative practices associated with interest and excessive reliance on traditional debt financing, which tilts wealth in unidirectional rather than equitable distribution. Scholars, such as Climent M. Henry,[xvii] aptly assert that many developing countries visualize globalization as a modern form of imperialism. Therefore, there is a pressing need to adopt and explore alternative systems, particularly Islamic finance, which emphasizes interest-free lending, risk sharing, and prioritizing equity financing over traditional debt financing. Embracing Islamic finance could poverty, avoid debt traps, and address the inequitable distribution of wealth and income. Such a system facilitates a more balanced flow of wealth, thus benefiting society as a whole.

In the context of globalization, Islamic finance has the potential to play a pivotal role in developed, developing, and underdeveloped countries. It offers a safeguard against the scourge of exploitative instruments, such as interest and debt traps, by stressing equity instruments more than debt instruments. Unique to Islamic finance is the prohibition of interest (riba), replaced with profit-and-loss sharing mechanisms, which have been beneficial to the growth of developing nations. Professor Horst Albach, in his book, *Risk, Capital, Business Investment and Economic Cooperation,* aptly points out the challenges faced by the Western German economy due to a decline in equity capital, which has led to an overreliance on debt.[xviii] He argued that Islamic finance which focuses primarily on risk sharing could channel surplus petro-dollars into Western economies as equity capital, for the mutual benefit of both sides.[xix] It would supplement the developing countries to make mobilization of funds from the developed countries and other International financial institutions on an equity basis in which actual return is tied up with the profit which results only after the invested project will get fruitful results. In other words, it calls for both developed and developing countries to act as partners in progress and to share risk with foreign investors instead of transferring risk solely to the host country. It will attach their concern only and only toward the success of the project which ultimately facilitates the proliferation of economic growth and development. It will result in foreign exchange of outflow only when the investment earns a positive return and acts as an efficient alternative to conceal interest-bearing financing which leads the flow of wealth in a unidirectional way without making any productivity activity.

This framework encourages developing countries to mobilize funds from developed countries and certain international financial institutions on an equity basis, ensuring that returns are tied to the success of the projects they invest in and fostering a sense of partnership between nations. It encourages developed and developing nations to collaborate as partners and share the risks involved with foreign investments, rather than shifting the burden solely on host countries. Such collaboration enhances a vested interest in ensuring project success, thereby fostering economic growth and development. Ultimately, funds would only leave the country when investments generate positive returns, making Islamic finance a promising alternative to traditional interest-bearing financing, which often leads to a unidirectional flow of wealth without promoting productive activities.

In the era of globalization, Islamic finance offers constructive viability and potentiality to promote cooperation and integration between Western economies and Muslim oil countries. Western nations are equipped with advanced technology and management expertise, which are less developed in many emerging economies. Conversely, developing and underdeveloped countries possess vast resources and significant markets that require a cooperative approach rather than traditional interest-based lending, which often leads to debt traps. Equity financing, a cornerstone of Islamic finance, can stimulate economic growth in both developed and developing nations.

No economy in the world can thrive in isolation. Economies of both developed and developing countries should integrate and share their technology, management, and resources which would accelerate the growth of their economies. When the countries resort to investing in risk and profit sharing while avoiding borrowing on interest, it will help to develop the feeling of cooperation, love, sympathy, and tranquility across the countries. This approach foresees world, free from debt traps and exploitative practices that contribute to various socio-economic issues. As a result, globalization is often viewed by debt-ridden countries, particularly countries of the Middle East and North Africa, as a new form of colonialism and imperialism. These countries are often reluctant to accept the new global forces of economic and political change.[xx] It will also change their attitude towards globalization and they may understand it as a blessing and not a new face of imperialism. It is a proven fact that the world has always benefitted from the integration of civilizations and not from desegregation. Thus Islamic finance demands that we should make keen use of forces of globalization and economic liberalization for the advantage, progress, and well-being of all countries.

Is Islamic Financing a Sectarian Financing or Not?

Several myths are occupying the minds of the masses which require initial attention. It is a challenging task for Islamic economists, bankers, and stakeholders to deconstruct the myths surrounding the arena of Islamic finance. For instance, some scholars like Timur Kuran, argued that Islamic finance is based on sectarianism and is being designed by its propounders for the protection and identity of Muslims. But when we are making an in-depth study of the literature on Islamic economics and finance his assertion seems baseless and needs correction as rightly pointed out by reputed Islamic economists like Azim Ahsan Islahi. Right from its very inception Islamic economists, jurists, and bankers have written various articles, and books to determine the objectives of the Islamic financial system and concluded, that one of the fundamental objectives of Islamic economics and finance is to provide human welfare (falah) and good life (hayat tayyibah) to all mankind. It is interesting to highlight that in the 7th International Conference on Islamic Economics in 2008, held at Jeddah it was clearly stated that Islamic economics is for the whole of humanity, stating their problems to be its problems and its main aim is to ensure the wellbeing of all and to work for the cause of humanity. In addition, Shaikh Mahmud Ahmad, in the preface of his book titled "Economics of Islam, a Comparative Study" also argued that if Muslims can practice the Islamic economic system today, they should recommend it equally to the people of other faiths, because the economic issues are almost same to both Muslims and non-Muslims.

Islamic finance was warmly welcomed in non-Muslim countries like the United Kingdom, the United States, etc., and its demand and popularity have increased not only in Muslim-majority countries but also in non-Muslim countries. It is worth highlighting that the first person who opened his account in the Islamic Bank of Britain was a non-Muslim who traveled miles and showed his dedication and love toward Islamic finance.[xxi] In addition, Gordon Brown[xxii] states that he wants to see Landon as a global hub for Islamic finance and in this regard he made flexible policies, regulations, and tax regimes in favor of it. This depicts the enthusiasm of people from other faiths towards Islamic finance.[xxiii] Besides, there are numerous conventional commercial banks in the Western world like HSBC Amanah, Alburaq, Clifford Chance, European Islamic investment bank, European Finance House, Lloyds TSB, Norton Rose, ABC International Bank Bristol, Norton Rose, KPMG are engaged in offering Islamic banking products and financial services to their clients and mostly these financial services are being provided via windows called "Islamic windows".[xxiv] It acts as a platform on which both Muslims and non-Muslims are participating and are engaging in offering financial products and services on Islamic lines. It transpires from the above discussion that it is not true to relate Islamic finance with sectarianism rather it encompasses the whole of humanity.

CONCLUSION

Summing up the discussion, it reveals that a debt-reliant economy accompanied by interest proves to be more detrimental to the growth and development of economies in both developing and developed countries, acting as a constraint on the equitable distribution of wealth and income. This economic model engenders various socio-economic issues, including debt traps, economic instability, extreme poverty, inflation, unemployment, and infrastructure deterioration. To address these socio-economic challenges and improve global conditions, it is imperative to transition to an alternative financing method (Islamic financing) that stresses equity over debt financing. Consequently, in the current era of globalization, Islamic finance demonstrates viability and potential to establish new avenues of cooperation and integration between Western economies and Muslim oil-producing nations. It offers a comprehensive package of financial services to the entire community, irrespective of religion or region, while simultaneously eschewing exploitative mechanisms such as interest, debt traps, and wealth inequality, which often lead to extreme poverty, indebtedness, hunger, and unemployment. However, Western countries possess advanced technology, skills, and management capabilities that are less prevalent in developing countries. Conversely, developing countries hold substantial resources and expansive markets, necessitating a novel approach to financing based on equity rather than interest-based lending, which ultimately results in debt traps and wealth inequality. Consequently, globalization may perceived by developing and underdeveloped countries as advantageous rather than a new form of imperialism, as understood by Middle Eastern and North African nations.

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[x] Jubilee USA 2007, Debt, Poverty and the MDGS, Debt and Millennium Development Goals, p. 23.

[xi] Khan, M. Mansoor & Bhatti, M. Ishaq, op.cit. 2008, p. 25.

[xii] *Ibid,* p. 25.

[xiii] Paul Wolfowitz was the 10th president of the World Bank and an American political diplomat who was a former United States ambassador to Indonesia.

[xiv] Firsanova, V., Statistical Analysis of Global Debt in the World Economy, (2024) *Technology Audit and Production Reserves*, 4(4(78), 38–42. https://doi.org/10.15587/2706-5448.2024.310351.

[xv] M. Ayoub, op. cit, 2007, p. 86.

[xvi] Muhammad Younis is a Bangladeshi economist and social entrepreneur. He was awarded the Nobel Prize for promoting microfinance and founded Grameen Bank.

[xvii] Climent M. Henry is a reputed professor and a prolific author of various works such as the Political Economy of the Middle East and North Africa, Globalization in the Middle East and North Africa, etc.

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[xxi] M. Ayoub, op. cit. 2007, p. 16.

[xxii] Gordon Brown is a former president of the United Kingdom and a British Politician.

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