

OIL IN THE VORTEX OF THE CORONAVIRUS

"The architect of politics is...
a man on a tightrope: only by
advancing, can he avoid a
precipitous fall"

H. Kissinger
Memories, 1979 p.62

Dr. Dr. Kasim Asker Hasan

**Institutional Affiliation: Postgraduate in Research and Development
Management – Central University of Venezuela (UCV)**

**Ambassador of the Republic of Iraq in Caracas and Ph.D. in Economics from UCV and
Ph.D. in Engineering at Aachen-Germany University**

August 2020

SUMMARY

By the seventh decade of the twentieth century, the world was divided into two major blocs: the West, which supplemented the satisfaction of its energy needs with imports mainly from the Middle East; subject to the tensions between the hegemonic pretensions of the socialist world and the predominance of the financial system centered on the Bretton Woods agreements, creators of the IMF and the World Bank.

The increase of oil prices, in the eighth decade, due to the appetite of China and the desire to improve the material welfare of the countries of the Middle East, created incentives and pressures to introduce modifications in the world monetary order and in its basic political components: the National States; situations whose preliminary analysis is the purpose of this essay.

1) Introduction: Global Changes and the Oil World

In political terms, in the seventh decade of the 20th century, the world was divided into three major blocs, which emerged from the Second World War and the events of political-economic reconstruction after 1945.

The first of these, the so-called Western Bloc, made up of the countries bordering the North Atlantic, continued its industrialization process, with a commercial network and domestic bank financing; aided in the payments of the exchange with the third block, by an International Monetary Fund (IMF) supported by the US dollar.

The second block was made up of the economies of the Russia/China alliance (1950), which resorted to centralized planning or the Socialist Bloc, without participating in international trade with the Western Bloc and without the assistance of the IMF. The third block, or Third World or Third Way, was made up of the economies whose process of industrialization was reduced to consumer goods, supported by their process of payment in the foreign currency provided by the export of raw materials to the Western Bloc and by support, ultimately from the IMF, in interaction with a domestic central bank and with a pre-fixed exchange rate¹.

From the energy angle, the Western Bloc complemented the satisfaction of its needs with the import of hydrocarbons from the third block, with the intermediation of private international companies, which worked under the figure of concessions granted by the Third World States; while, the Socialist Bloc obtained its energy resources with public companies that exploited its domestic deposits.

Thus, although metaphorically speaking of a global energy market, supply and demand were divided, approximately 71% in the Western world and 29% in the socialist world, according to L. Mata Mollejas (2018 b 14).

But since 1980, China's appetite for hydrocarbons has forced it to join the West's energy trade, which has driven up crude oil prices, which are transformed into demand shocks for dollars (Yergin, 2012) and globalizes financial interaction, with a nerve center in the West.

The economic, energy and financial world is thus structurally modified; this, together with the political situation: the tensions in the USSR and the formation of blocks of economic integration in Europe and the Third World, obliges us,

¹It should be noted that in the case of Islamic countries, a different financial monetary system was created; this is called Islamic banking; the description of which is given in Appendix No. 3.

as the purpose of this essay, to refer to the subsequent geopolitical and geoeconomic changes, including the impact of the Covid 19 pandemic, in order to understand and establish the objective reference bases (diagnostic impression) and to carry out a first exploration of the future, limiting ourselves to a short-term time horizon of 2020-2021.

2) Political and economic interests in the world of hydrocarbons

The economic activity of human societies, as it is well known, is multidimensional, since it interrelates the individual, his diverse groupings and nature; which, in synthesis allows to conceptualize it as a subsystem of the biosphere, with becoming framed within the energy flows that define it.

Hence, the use of the different energies marks the history of societies, in relation to the processes of transformation of natural resources or industrial-commercial activity; that still, in this beginning of the XXI century (AD) depends, in high degree, on the efficient use of the energy resources called fossils, although there has been progress in the use of other options, as the nuclear source; because the use of that source, by its catastrophic derivations, is limited by geopolitics.

It should be highlighted:

1. That the production and distribution of energy, like any economic activity, is conditioned by monetary and financial agreements, which cancel out real transactions, including those of an international nature;

2. That economic and political interests are different for importers and exporters of energy (L. Mata Mollejas 2018:43), since exporters focus their attention on the use of monetary value as capital, while the importer considers it relevant to have security of supply at low cost, being evident that, between both agents, conflicts will arise from the valuation, while the implications for geopolitical strategies should be clarified (L. Mata Mollejas, 2016 a:74, note 33).

3. That, since 1945, the political conjunctural circumstances have defined the international monetary pattern and its influence on global financial affairs, including the incidences of hydrocarbon trade: double restriction or conditioning that Mata Mollejas, L. (2016 a: 74) specifies, following F. Miterrand (1981) as Tenaza dollar petróleo; matter whose details (the so-called recycling) we present as Appendix No. 1.

The corollaries of the above are:

i. That after the collapse of the Bretton Woods agreements and the beginning of the floating of the dollar (1973-74), significant increases in international capital flows have been present; accentuating the volatility of relative financial prices (interest rates, exchange rates, stock market returns) and the frequency of financial crises (breaks in timely payments) with the subsequent depressive impact on production and employment. In other words, affecting the functionality of the various domestic monetary banking systems.

ii. That, in industrialized economies with large domestic markets, the impacts of foreign trade are minimized; the authorities should be concerned about the performance of the interest rate (under the influence of the treasury). While in small and open economies (such as net oil exporters) the authorities should be concerned about the progress of the exchange rate; this is to take care of the strict surveillance of the amount of international reserves and their proportion with the external debt... Without forgetting that, in the countries of the Middle East there are particular conditions that have produced monetary surpluses, a matter that we discuss in Appendix No. 1.

Hence, it is relevant to remind the interactive march between the situation of the hydrocarbon market and the financial monetary conditions within the periods 1970-2000 and 2001-2019.

3) The political and economic situation in 1970-2000

As we stated in the previous section, until 1970 the so-called world oil market was centred on factors associated with development. The United States of America had to attend to the needs of its allies; therefore, after 1945, they directed their efforts to boosting the economy during the period 1945-1975 (the Glorious Thirties), while the private companies engaged in the oil business: "the seven sisters": Exxon, Mobil,

Chevron, Gulf, Texaco, Shell and British Petroleum, coordinated the extraction and commercialization, maintaining the prices of crude oil with little variation \$b 3. 6 until 1973.

From then on, the desire of Middle Eastern and Latin American exporters to obtain a greater share of the monetary benefits took advantage of political tensions: the Arab-Israeli conflict to put pressure on the United States and the Netherlands by limiting the volume exported; this triggered the price of crude oil to \$b 12.0 in 1974. For the 1974-78 period, OPEC production was established at an average of 30 million barrels, with prices ranging from \$12.5 to \$14.0.

The overthrow of the Shah of Iran (1979), pivot of the American geopolitics in the Middle East, reduced the Iranian production from 6 Mbd to 4 Mbd, taking the price to \$b 25. The subsequent war between Iraq and Iran (1st Gulf War)² brought the price to \$b 37 in 1981. This rise stimulated the growth of production in the North Sea, successively reducing prices: \$b 31 in 1982; \$b 29 in 1983; \$b 28 in 1984; \$b 25 in 1985; and \$b 14 in 1986.

It should be noted that, between 1985 and 1986, the London Stock Exchange, under the direction of N. Goodison, promoted reforms that increased futures³ sales, facilitating the fall in prices indicated.

The final consequence was the reduction of OPEC's offer to 15.8 Mbd... and a slow recovery of prices to \$b 18 in the period 1987-89, with an elevation to \$b 23 due to the Iraq-Kuwait conflict (1990), reaching an average of \$b 20 including the year 1995. The subsequent recession of the so-called Asian

²The territory in the south of the Anatolian peninsula (Turkey), washed by the Euphrates and Tigris rivers, a place of multiethnic-cultural contact since ancient times, borders to the north on Russian Central Asia, separating it from Africa, a sea language of the Indian Ocean called the Persian Gulf or Arabian Gulf. This territory is shared by Syria, Iraq and Iran, states that have been in conflict over the fate of the Kurdish ethnic group, which has not been able to form an autonomous state. The sympathies between Teheran and Washington were opposed to those of Baghdad for the unruliest Arab leaderships, randomly linked to Moscow, to counteract the transfer of British interests (in the region) to the United States.

³These reforms allow banks and insurance companies to act as brokers (intermediaries and advisors) and the offerors of securities and jobbers' options to cede them through bank credits.

Tigers (1997) caused prices in the period 1998-1999 to average \$b 28.0 despite slight increases in OPEC supply.

Thus, table No. 1 (See Annexes), shows the situation in the year 2000, once the financial conditions described had crystallized; the figures indicated there serve as a starting point for obtaining the diagnostic impression that L. Mata Mollejas (2018: 100) recommends establishing from the factors of real politics.

4) The 2000-2019 period: The Real Politik in Action

The episteme for the elaboration of the diagnostic impression, includes the consideration of:

- I. The political constraints at the beginning of the 21st century, which include, summarily: *the reduction of carbon emissions to counteract global warming; the preference for the use of renewable energies: hydro, wind and solar, rather than nuclear sources;*
- II. Microeconomic restrictions (minimizing costs) and financial macroeconomic conditions; that is, ensuring the cancellation of global financial flows, as a dominant condition, over the cancellation of monetary balances with domestic currency;
- III. The increase in the demand for fuels, due to the increase in the middle-income strata in the ex-socialist world and, in general, in the countries with medium industrial status; and
- IV. IV. The willingness of net oil exporters to become exporters of refined products (naphtha and lubricants) and petrochemicals.

These factors are reflected in the oil flow statistics for 2010, 2016 and 2018, which show that inventory management is a way of offsetting global supply and demand figures; At the same time, OPEC tries to coordinate 40% of the real supply of crude oil, in the face of demand that follows, approximately, the contribution to the world GDP of the various

economies; it must be understood that the other conglomerates, roughly speaking, bring together the demands and offers of the Russian, Chinese, Indian, and Southeast Asian economies, as well as those of Africa and Latin America not institutionally associated with OPEC⁴. This is reflected in table 2 (see annexes).

5) New World Oil Order?

History, when it is interested in the birth, rise and fall of the planetary⁵ political leadership, shows that the transcendental economic and political changes are negotiated and decided in conciliation of the high spheres, to fulfill the old task of making compatible politically, the objectives and the national⁶ economic means.

Thus, the British predominance in the nineteenth century, combined the invention of the parliamentary regime, with antecedents from the eighteenth century with the Magna Carta; the industrial and banking revolutions during the seventeenth and eighteenth centuries, while the predominance or order under the United States of America, required the establishment of the dollar as the international monetary standard (Bretton Woods Agreements in 1945) and the intensive use, for its low relative cost, of fossil energy of hydrocarbons, initiated by England during the Crimean War in the period 1854-1856.

A global order that has withstood the onslaught of financial exuberance, including London's central role in the whirlwind of international capital movements; a circumstance that makes England a very close ally of Washington; having left behind, until now, the radical challenge presented by the Moscow-Beijing alliance, during the so-called Cold War, acting under socialist ideology.

Could this world order be changing?

In January 2017, a total of 24 oil-exporting countries, comprising the 14 members of OPEC and 10 non-OPEC countries (including Russia under

⁴See, D. Priestland (2012).

⁵See, among other authors, P. Kennedy (2006).

⁶Operating as an invisible government, according to the principle: we think and decide without you, about you, but without you, paraphrasing M. Rogalski (1994).

Putin) agreed to reduce their joint supply by 1.8 million barrels in order to gradually reduce the surpluses or inventories accumulated in the OECD countries.

This procedure was reiterated in successive agreements in May, July, and November 2017. But the OECD supply continued to grow, on average by 0.87 million dollars, and as a result, the average prices for 2017-2018 recovered moderately.

The compensatory measure handled by the OECD countries, in order to boost the economy, was the reduction of the central banks' interest rates; without causing substantial changes in the internal tensions of the EU, caused by the conversations with London, associated to the Brexit; a small matter for the EU, next to the previous refusal of London (1992) to join the Maastricht Treaty that established the operation of the euro as a regional currency, supervised by a community central bank.

In short, the slow rate of reduction of inventories was associated with moderate movements in the prices of crude oil, according to its technical characteristics (sweet/acid), affecting, marginally, the trade of the different producing countries; without it being possible to say that with this a new world oil order has been entered; since the substantive change was the increase in US production, making the United States the world's largest producer; which diminished OPEC's influence on the level of prices, by increasing the influence of inventory management under the guidance of the OECD's high finance managers.

Let us say, then, that the agreement of April 12, 2020 between OPEC, the IEA and the G-20, to carry out open negotiations for the adjustment of the global offer, is healthy... as an operative mutation that preserves the established order... we can remember what H. Kissinger (1979: 62) expressed when commenting on the fundamental teachings of the history of the 20th century, on the requirements to establish a new world order; namely

1) that material progress is not a sufficient guarantee for achieving political harmony, and

2°) that if the search for peace (or harmony) is the only objective of politics, fear becomes the key weapon of the most ruthless...

And, accompanying what has been said with one of the conclusions of the book of Change (I Ching), one of those that synthesize the millenary Chinese experience (wisdom), it will be necessary to agree that only ideological dissent seems a necessary cause to produce substantive changes; since the complement or requirement of sufficiency is the order in action.

However, the decisions referred to, from January 2017 to April 2020, do not constitute ideological dispensations... and may contrast with the conditions experienced since the beginning of 2020, regarding the deadly coronavirus pandemic, an issue that represents a major challenge for all countries of the world, since the almost unanimous consensus on the basic measure of the fight: staying at home, in globalized isolation, borders on ideological dissent, given the more than evident disorder in the productive-distributive processes of the material sustenance of human life... being able to evidence that overcoming the threat of death today... in order to live in misery tomorrow, introduces the psychological factor of fear, in the discussion to select a strategy on objective bases.

6) Conclusions

Let us conclude by saying that a new global governance order, including the financial monetary order, would have to consider the tensions between:

(i) The increasing globalization or unification of financial markets, forming a single circuit of capital mobility, influenced by productive and financial corporations with different national bases,

(ii) The difficulties of testing "regional integration" of actual production,

(iii) The existence of a global problem such as: the ecological deterioration of the planet, the socio-economic and political backwardness or marginalization of part of the world's population

Future analyses should then answer the questions: Will it be functional to preserve the political construct of the nation state?

A matter which, because of its obvious political/economic complexities, is beyond the scope of this essay

As has been the case since the end of the 19th century, it is now accepted that the framework conditions of the economy, in which private actors act, in the productive-distributive processes, recognizing also that the State can intervene with particular political objectives; having, consequently, to negotiate with the Civil Society.

In that regard, it must be said that the financial monetary system created in the first half of the 20th century, as economic support of the international political order has shown, as of the seventh decade of said century, substantive tensions when presenting in the economic sphere, speculative elements, which operate as restrictions for the achievement of national purposes of increasing material welfare.

In effect, the administrative financial modifications undertaken as of the eighth decade of the XX century, led by the reforms of the London Stock Exchange, allowed credit to be used to acquire titles in the stock exchanges, making the central banks see their capacity to orient the intermediary bank (with the management of the interest rate and of its counterpart the exchange rate) towards the support of the reproductive investment that creates jobs... presenting political tensions in the international and domestic ambit of the different countries.

Hence, in proposing to describe and analyze the complex interaction between the energy determinants of material progress and the functionality of the Financial Monetary System, we have introduced ourselves into the general framework of the dynamics of the order of States.

Being, the first conclusion, that such dynamics is slow and develops in long temporary horizons... and that, its evident corollary, as confirmed by the analysis made, is that the present order, led by the United States, will continue in force at least, in a short and medium term horizon; therefore, the present tensions are not sufficient condition for a substantive change.

Within this framework, the deterioration of the international monetary system (SMI) created in 1944, supposed to maintain relatively stable exchange rates, when evolving to a fiduciary dollar pattern in 1971, made the monetary authority of the main reference currency, be able to adopt a monetary policy independently of its consequences on the world economy; Therefore, most of the different currencies have entered a phase of general volatility, with the exception of those economies, such as Saudi Arabia, which are linked by political decisions⁷ ... that, like the recycling or oil dollar pincer,

⁷The Taif Agreement (1972).

allows the timely cancellation of the balances of the real transactions; thus, avoiding the depressive consequences of the monetary in functionality.

The third conclusion is that the interaction between public debt, production growth and employment, plays two contradictory catalytic effects in time; in a first phase it stimulates growth, followed by the repayment phase which is discouraging; producing what is known as financial cycle; which occurs with variable intensity, depending on the importance of speculative financial markets that are present.

From there, the chaining of the sequences of indebtedness, paid growth and brake, can be seen as financial crisis, and that in said crises, the valuation expectations of the titles (inflation/deflation of the balances of lenders and borrowers) play a central role.

The fourth conclusion is that a key activity in the interaction between monetary and fiscal policy today is to counteract, through institutional changes, the temptation to engage in speculative activity by investing in public bonds, which are not usually perceived as direct drivers of increased demand for labour.

As a fifth conclusion, it is recommended to take advantage of the experience of banks, which operate on two levels: the first, facilitating the large businesses associated with international trade, users of foreign exchange, and the second, visualizing the myriad of opportunities to create self-employment with reproductive microcredit⁸ finance, can be seen as a viable option to combat contemporary economic crises, which combine unemployment and inflation, main components of social dissatisfaction ... and, therefore, driving political instability.

⁸Where the economic rationality is concretized in the compensatory virtue of the great numbers; circumstance that is manifested in the socio-economic reality of the high percentages that represent, in the labor market, the diverse categories of underemployment, also grouped under the expression informal economy.

ANNEXES

CUADRO No. 1

Flujo de Petróleo Mbd

2000	C	P	I	M	X
Mundo	75.8	70.8	5.0	38.9	38.9
OCDE	43.9	20.6	5.0	18.3	
Otros	27.1	22.2		20.2	15.3
OPEP	4.8	28.0		0.4	23.6
Venezuela *	(0.4)	(2.8)			(2.4)

Fuente: Actualizaciones de LMM (2018, p. 68). (*) Las cifras de Venezuela están incorporadas en las de la OPEP, por ello aparecen con paréntesis.

CUADRO No. 2**Flujos de Petróleo Mbd (1)**

2010	C	P	I	M	X
Mundo	86.9	84.9	1.0	41.7	41.7
OCDE	46.2	19.0	1.0	26.2	
Otros	34.2	37.4		15.0	18.2
OPEP	6.5	29.5		0.5	23.5
Venezuela *	(0.6)	(2.4)			(1.8)

2016	C	P	I	M	X
Mundo	96.0	94.0	2.0	36.0	36.0
OCDE	53.0	25.0	2.0	26.0	
Otros	31.0	35.0		10.0	14.0
OPEP	12.0	34.0			22.0
Venezuela *	(0.7)	(2.3)			(1.6)

2018	C	P	I	M	X
Mundo	99.8	94.7	5.1	29.8	29.8
OCDE	47.4	26.3	5.1	16.0	
Otros	42.9	29.1		13.8	
OPEP	9.5	39.3			29.8
Venezuela *	(0.4)	(1.5)			(1.1)

Fuente: Actualizaciones de LMM (2018, p. 68). (*)Las cifras de Venezuela están incorporadas en la OPEP, por ello aparecen entre paréntesis

APPENDIX No. 1

THE DOLLAR-PETROLEUM PINCER

The commercial surpluses of the oil exporting nations, associated to the rise of oil prices in the seventh decade of the XX century caused, in the United States, as a reactive strategy⁹, to attract them through a process called recycling of petrodollars, by which the expenditure and investment of the income in some country of the OECD was stimulated to the monetary resources that could not invest efficiently in their own economies; due to the narrowness of their domestic markets: due to relatively small populations and being, industrially, in the early stages (only consumer goods); which could make it attractive for profitable placement in the banking systems of the West and the secure supply of advanced military equipment, according to H. Hertzberg (2004) and S. Kinzer (2007).

It should be clear: 1) that global economic growth would have suffered if this money was withdrawn from the world economy, and by accumulating as monetary reserves in the banking systems of oil exporters, and 2) that importing countries would face financial problems by paying high prices for oil and incurring long-term debts. Thus, the International Monetary Fund (IMF) estimated that the external debts of 100 oil-importing developing countries increased by 150 per cent between 1973 and 1977. This is a complex situation because of the widespread use of floating exchange rates.

With "recycling", large volumes of Arab petrodollars were invested directly in United States Treasury securities and other financial instruments in the major industrial economies, often discreetly managed by government entities according to D. Spiro (1999) known as sovereign wealth funds, through the major commercial banks in the United States and Europe. In fact, the process contributed to the growth of the Eurodollar market, as a less regulated rival to the US money market; lending money, directly to developing country governments, especially in Latin America such as Brazil and Argentina, not forgetting other developing nations such as Turkey, according to I. Oweis (1990).

⁹The geopolitical history of the seventh decade of the 20th century, tells how R. Nixon and his Secretary of State H. Kissinger, feared that the breakdown of the Bretton Woods Agreements and the growing fiscal deficit due to the Vietnam War, would cause a reduction in the demand for dollars in the international arena; therefore they entered into meetings with the Shah of Iran and the Saudi royal family, to convince them not to negotiate oil transactions in currencies other than the US dollar.

In subsequent decades, many of these developing nations found their accumulated debts to be unpayable, concluding that avoiding foreign debt was a sensible option¹⁰.

With the beginning of the 21st century, financial decision makers were able to benefit from the lessons and experiences of the previous cycle by taking advantage of the fact that interest rates were contained.

Thus, some oil-exporting countries have used part of their petrodollar surpluses to finance foreign aid programmes, as a prominent example of so-called "checkbook diplomacy" or "petro-Islam". The Kuwait Fund was one of the first leaders from 1961, and certain Arab nations became some of the largest participants in the years since 1974 in the OPEC Fund for International Development. Not to mention that Islamic oil exporters have also helped poorer nations indirectly through personal remittances sent home by tens of millions of foreign workers in the Middle East, although their working conditions are generally harsh (Mukherger 2016).

Let's also remember that high price oil allowed the USSR to support the economies in difficulties of the Soviet blockade, during the increase of the petrodollar in 1974-1981, and that, the loss of income during the oil over-supply in the eighth decade contributed to the collapse of the blockade in 1989, according to McMamaken (2014).

Let us conclude by saying that the United States dollar remains the de facto world currency. As a result, almost all oil sales worldwide are denominated in United States dollars (USD), so most countries are forced to maintain large dollar reserves in order to continue imports. This creates a constant demand for USD, regardless of economic conditions in the United States.

Moreover, the return of petrodollars allows the U.S. government to issue bonds at lower interest rates, generating higher budget deficits than most other countries, as it does not need to worry about exchange rate fluctuations.

¹⁰As failed attempts we can remember that Iran made efforts to sell oil in euros, yen and gold just like Libya under Gaddafi and that Iraq, in the year 2000, carried out all its oil transactions in euros using an account guarded by the UN, in parallel with dollar reserves in the domestic financial system; which led to cumbersome administrative processes that were suspended in 2006.

Hence, the geopolitical competitors of the United States, have an interest in seeing oil traded in euros or other currencies... aspiring to obtain the same benefits.

APPENDIX No. 2

THE ISLAMIC FINANCIAL SYSTEM

1) General Description

At the end of World War II, in the fifth decade of the 20th century in the Islamic countries a body of thought known as: Islamic banking was developed, within a global context of the Islamic economy or model of development based on the religious principles of Islam; having as a fundamental nucleus the individual enterprise with financing, which prohibits the payment of interests in financial operations.

In such an approach, individual activity must be based on the acceptance of Islamic law (Shariah); therefore, a great effort was initiated to adapt the laws of commerce and finance to the rules specified in the text of the Koran; to raise the awareness of Muslims with respect to the issue of fixed interest rate, taken as usurious (the *riba*), although this meant the elimination of all debt contracts with fixed interest and the development of a banking business, based on the principle of profit and loss sharing.

In the 1970s, with the significant increases in the price of oil, the Islamic economy found financial surpluses that allowed it to test the economic model described. Thus, since the opening of the Islamic Bank of Dubai in 1975, the number of Islamic banks increased, significantly in the countries of the Persian Gulf; presenting themselves as an alternative to the conventional banking of the West. For this reason, according to the Global Islamic Finance Report (2010) there are more than six hundred banks of this type, present in almost fifty countries, including important Western countries where they coexist with conventional banking, under the figure of the *Islamic window*.

This innovation in Western countries is mainly explained by the influx of sovereign funds from the Gulf oil countries, including the arrival of important Muslim investors. To date, London constitutes the main centre of Islamic finance in Europe, followed by France, which is trying to gain space in this sector.

In principle, Islamic finance aims at its development by targeting mainly the 1.6 billion Muslims worldwide and investors who are looking for a financial system based on ethical criteria alternative to those used by the banking born out of the British experience.

While the concept of Islamic banking, based on profit sharing, emerged in the late 1970s, much of its theoretical construction developed from the 1980s onwards. The development of this banking system reached a great momentum in the mid-1980s when the republics of Iran and Pakistan adopted the elimination of interest in their constitutions...so it is interesting to describe the operations it carries out.

2) Operations of Islamic Banking

Muslim ethics are prescribed in the law based on the precepts of the Koran (the Holy Book); in the documents of interpretation (the Sunna) and the jurisprudence (the Fiqh).

The financial rules cover the production, distribution and allocation of resources. Compliance with these rules ensures economic development and economic justice. Justice before production is achieved by ensuring that all members of society have equal opportunities to access and use resources.

By facilitating the acquisition of property rights by the most dispossessed, Islam hopes to achieve its goals. The first axiom of Islamic property rights states that Allah alone is the creator and ultimate owner of all land property. Man has been given only the right to own property during his lifetime in this world. The second axiom of Islamic property rights states, that the right of possession is a collective right and individuals can only gain priority in the use of these resources.

The main application of this financial ethics is expressed in the prohibition of interest, banks cannot offer fixed interest on deposits or credits. In financial transactions, the

interest rate is replaced by the profit and loss sharing (PLS) rate on both assets and liabilities. The investor must be exposed to the risk of loss of expected profit.

This form of intermediation is strongly intertwined with the real economy, relating to the production and exchange of goods and services; with the only limit being to prohibit the financing of activities prohibited by Islam, such as speculative activities.

In the financing operations, debt is created through the acquisition of real assets, instead of a debt for money and interests' loans; admitting post-sales, at nominal value.

The banking activity is very similar to the operations of conventional universal banks; in that it can work with own capital and carry out operations with the trade; the clients can be part of the boards of directors. The modes of financing include trade and profit sharing; the main requirements remain the creditworthiness and profitability of the project presented.

Linked to the soundness of the project is the competence of the entrepreneur, which contributes to the stability of the system. The financing, being linked to a real asset, minimizes the speculative use of funds.

In banking intermediation there are generally two types of accounts:

- Unrestricted Share Investment Accounts (UPSIA), where the investor authorizes the bank to invest the funds according to its experience and criteria, and
- Restricted Partnership Investment Accounts (RPSIA), where the investor imposes certain conditions on the use of the funds.

The direct consequence of the interest prohibition does not mean that capital and risk are not rewarded. On the contrary, the Islamic system assumes the existence of a rate of return on the capital markets used in the real sector of the economy.

The firm's incentive to invest will depend on profitability and therefore a maximizing firm will continue to invest until the marginal productivity of capital equals the cost of capital; and this cost of capital may be represented by the rate of return on the risk-sharing investment.

In practice, there are sixteen forms of contracts that can be grouped under two types of variable return financing and fixed return financing. Variable return financing involves sharing the profit and loss of the financed project and is therefore called profit sharing (PLS). Fixed-return financing is based on trade contracts. It should be added that in recent years transactions have appeared on the secondary market.

2.1 Variable Return Financing (PLS)

Variable return financing is a contract in which the rate of return of the financier cannot be determined in advance and depends rather on the final outcome of the business. Therefore, the financier fully participates in the business risks. These modes include the following:

Passive Society (Mudarabah)

This is a special type of partnership between two parties: a capital owner and an entrepreneur to run a business. The profit is distributed between the two parties according to the proportion that they can freely agree upon at the time of the contract. The financial loss is borne by the investor-owner of the capital; the entrepreneur's loss is the opportunity cost of his own work, which did not generate the expected income. The owner's liability in this type of contract is limited to the extent of his investment contribution.

Passive Society for Financing (Financing Mudarabah)

As a financing instrument applied by Islamic banks on the liabilities side, the depositors serve as investors and the bank is the entrepreneur. Deposits under this contract may be general investment accounts or restricted investment accounts, which are specified for certain projects. On the asset side, the bank serves as the investor.

Active Partnership (Musharakah)

This contract is similar to that of the Liability Company, with the difference that in the Active Company both partners can participate in the management and provision of capital.

Restricted joint venture (restricted Musharakah)

This is a contract between the bank and a beneficiary, in which it is agreed to form a partnership to own an asset, with the understanding that the bank will gradually sell its share to the beneficiary according to a schedule. The sale price of the shares will be determined at the time of sale, taking into account the market value of the asset. The usufruct, risks and responsibilities of ownership will be shared by the parties.

Shareholding company

A shareholding company is a company whose capital is divided into equal units of marketable shares and the liability of each shareholder is limited to his shareholding. It can be considered a combination of passive and active partnership contracts, in the sense that while all shareholders are equity partners (investors), the directors are simultaneously investors and entrepreneurs.

2.2 Trade based fixed return financing

Traditional trade contracts do not involve more recent credits with some exceptions. However, in the more recent formulations it almost invariably involves credit together with an agreed rate of return on cost, and it should be noted that there is a difference of opinion among Islamic scholars about the permissibility of this rate of return, but a large majority is in favour.

Sales contract with deferred payment (bayy al-muajjal and bayy al-murabahah)

As a traditional contract it refers to the sale of goods or property with deferred payment. The essential element that distinguishes it from a normal sale is the deferral of payment. There are two types with or without a profit margin.

Sales contract as financing (for the buyer)

As a mode of financing it necessarily implies credit. It works in the following way: the client asks the bank to buy a certain product at a specific price, promising to buy such product from the bank, with a deferred price, which includes a pre-agreed profit margin.

Prepaid sales (Bay-Salam)

Deferred delivery sale, where the price is paid in advance. The sale involves advance payment and deferred delivery of the goods, applicable to all consumables.

Advance payment as financing (Bay-Salam financing)

Islamic banks can provide financing through a Prepayment Agreement through two separate Prepayment Agreements, or a Prepayment Agreement and an Installment Sale Agreement. For example, the bank could purchase a commodity by making an advance payment to the supplier and setting a delivery date. You can then sell the goods to the customer on the basis of the hire purchase.

Works contract (Bayy al-Istisna)

A contract by which a manufacturer agrees to produce and deliver a certain good by a certain date. The price is agreed upon and may be paid in installments.

Contract for financing works (Bayy al-Istisna)

It consists of two separate works contracts. The first contract is signed between the beneficiary and the bank, in which the price is paid in instalments and the bank undertakes to deliver the product on the agreed date. The second contract is a subcontract between the bank and a contractor to manufacture the product; the bank pays the price in advance or in instalments; the manufacturer undertakes to deliver the product to the bank on the date specified in the first contract.

Financial leasing (Ijarah wa Iqtina)

The lease or purchase contract converts the lease period into a period of time sufficient for the lessor to amortize the cost of the asset, with some profit. The lease payments are calculated in such a way that they actually include the recovery of the cost of the asset plus the profit margin. At the end of the lease period ownership of the asset is transferred to the lessee.

Business management (Wakalah)

A contract by which someone appoints someone else to act in a matter on your behalf and is allowed to charge a fee for providing those services. In the financial field, Management is widely used in the area of fund management. Under this contract, an Islamic bank serves as an investment manager for a client. The bank establishes a mutual fund in which customers purchase units.

The promoter of the fund (bank) is the agent of the unit holders and charges a fixed fee for its services. The profit or loss is passed on to the fund providers after deducting the bank's fee. In the case of investment funds, any loss is borne by the unit holders.

Mutual (Tawarruq)

In many cases, customers would need cash that cannot be linked to the purchase of commodities. This is how it works: Suppose A applies to B for a cash loan. B has no cash, but I can lend you a load of wheat. A takes that loan in kind, sells it at the market, and gets the cash. For repayment, A goes to the market to buy the wheat and returns it to B. It is therefore a loan in kind.

When the application is with a bank, a prior Mutual contract is signed, whereby the bank is responsible for buying a product and then selling it to deliver the cash to the applicant.

Sale of debt

For most scholars, the sale of debt is allowed only at face value. Although used in some countries, the law prohibits the sale of debt at a discount. The Fiqh Islamic Academy in Jeddah, the largest representative body of scholars, with representation from all Muslim countries, has unanimously confirmed the ban on such discounted contracts.

Mandate (Ju-alah)

A contract by which one party agrees to pay a fee to another party to perform a task. The Mandate contract could be useful in the area of issuing letters of guarantee from Islamic banks.

In international trade, security has become a necessity, where sellers and buyers do not know each other and there has to be an intermediary who can guarantee payment. But for scholars the prohibition of the guarantee fee is deduced as one of the secondary consequences of the ban on the riba. This issue remains unresolved.

2.3 Secondary market instruments

Recently, several instruments have emerged for the secondary market, they are an alternative to conventional bonds (sukuk) and are generally negotiable in secondary markets. These bonds are basically certificates based on the ownership of certain assets. They are capable of meeting the credit needs of large corporations and the government sector. The main types of bonds are:

Lease bonds (Ijarah Sukuk)

Lease bonds are the most widely used types of bonds, they are securities of equal denomination from each issue, representing physical securities. These bonds are based on leased assets and the holders are not directly linked to any particular company. These bonds represent the proportional undivided ownership by the holder of the underlying asset; they are freely negotiable at par, premium or discount in primary and secondary markets. They can be issued through a financial intermediary or directly by the users of the lease.

Liability Bonds (Mudaraba Sukuk)

These bonds have as an underlying instrument a partnership contract in which one party provides the capital, while the other party contributes its labour to the partnership and the profit must be shared. The certificate holders hold the assets of the partnership operation and share the profits and losses. These bonds give their

owner the right to receive their capital at the time the bonds are delivered and an annual share of the profits.

Active Bonds (Musharakah Sukuk)

They are similar to the above, with the difference that the issuing corporation acts as an active partner instead of an entrepreneur. The issuer of the certificate is the promoter of a project, the subscribers are the partners in the Active Partnership contract and the funds made are the subscribers' contributions to the capital of the Active Partnership. The certificate holders own the assets of the partnership and share the profits and losses.

Quota bonds (Murabahah Sukuk)

The advantage of this mode of financing is that if the operation required in the bonds has a very high value for the banking institution to buy it with its own resources, it is possible in this modality to attract additional investors.

If the investment required for a project is \$70 million, an agreement could be mobilized with a final price of \$90 million, which would be reimbursed in equal installments over five years. The different financiers can share the \$20 million of bond proceeds, in proportion to their financial contributions to the operation.

According to scholars, the bond certificate represents a monetary obligation of a third party arising from an installment transaction, meaning that it can only be traded at face value, because any difference would be equivalent to interest. Therefore, these bonds can only be sold in the primary market.

3) Islamic Banking Literature

Among the first studies to try to determine the main determinants of the performance and profitability of banks were those by Shorta (1979) and Bourke (1989). Since then, we find Molyneux and Thorton (1992), Demirguc and Huizinga (1999), Gibson

(2001), Abreu and Mendes (2002), Staikouras and Wood (2004), Althanasoglou (2006), Micco (2007) and Pasiouras and Kosmidou (2007).

Mollyneux and Thorton (1992) studied returns in 18 European countries over the period 1986-1989 and found a significant positive relationship between return on equity (ROE). Bashir (2000), on the other hand, studied the performance of Islamic banks in 8 Middle Eastern countries in the period 1993-1998 and concluded that foreign-owned banks were more profitable.

Halkos and Salamouris (2004) discussed the situation in Greece and the study showed that banks with large assets are more profitable.

Kosmidou (2008) studied the determinants of the performance of 23 Greek banks in the period 1990-1992. In his study on average return on assets (ROAA) he considers the efficiency ratio, equity and total assets, loans where the bank provides short-term funding, the reserve for loan losses where the bank provides short-term funding, the reserve for losses and loans and total assets of the banks taken as determinants, the annual change in GDP, inflation, stock market capitalization and the level of concentration as external determinants of the bank's performance. The results obtained suggest a link between GDP growth and the bank's performance, while inflation had a negative impact on it.

Guru (2002), focused on Malaysia: 17 commercial banks in the period 1986-1995. The results suggested that high interest rates lead to a decline in profitability.

Ahmed and Khababa (1999) investigated the determinants of the banking sector in Saudi Arabia. The studies found that commercial risk and bank size were the main determinants of bank performance in Saudi Arabia.

Srairi (2009) studied the impact of bank characteristics, macroeconomic factors and financial structure on the profitability of conventional and Islamic commercial banks operating in the countries of the Gulf Cooperation Council (GCC), for the period 1999-2006. Its empirical results show that macroeconomic variables excluding inflation rates positively affect profitability.

Olson and Zoubi (2008) used 26 financial ratios/parameters for the comparison of Islamic and conventional banks in the countries of the Gulf Cooperation Council (GCC) in the period 2000-2005. They suggested that Islamic banks were less efficient and operated at higher risk compared to conventional banks.

4) Islamic Banking in the International Context

As indicated in the Mata-Asker test (2018: 33-44) the third generation banking experiment was born within the dominant culture in the countries of the Middle East or the Islamic Universe (Dar Al Islam) during the fifth and sixth decades of the 20th century, on the religious basis of the rejection of the concept and management of interest rates, of the search for progress and economic welfare for a growing population within a political kaleidoscope that goes from theocratic, hereditary monarchical regimes, with conservative nuances, to progressive variants not exempt from radical pions.

In the geographical-demographic context, the above-mentioned panorama covers 23% of the world's population, that is, some 1.6 billion inhabitants, of which two thirds are located in the Asian continent, although evaluated through the distinction of countries, the Islamic population constitutes between 100% and 95% in Turkey, Iran and Iraq in the Middle East and followed by Egypt and Nigeria with 75% and 50% respectively.

Addressing the financial terms, it is explainable why the largest concentration of assets is in the Gulf States, where more than \$410 billion is in the assets of Islamic banks. In Asia, Islamic banks have \$144.8 billion, while the total assets of Islamic banks in Europe and North America are estimated at \$42.9 billion. The largest emerging banking market is Iran with a 42.7% share, followed by Saudi Arabia with 12.2%, Malaysia with 10% and the United Arab Emirates with 8%. In Asia, where the majority of the Muslim population lives, only 15% of the asset value of Islamic financial institutions is concentrated. Whereas, in Indonesia, a country with a large Muslim population has a relatively small and underdeveloped Islamic banking

market; similar to what happens in Sub-Saharan African countries, where it barely covers 1% of banking assets.

BIBLIOGRAPHY

- AJAGBE, S. T., Brimah, A. N., Olanipekun, W. D. (2015): Islamic Banking and Finance Evolution: A Panacea for Sustainable Development in Nigeria. International Journal of Accounting Research. Vol. 2, No. 5, 2015
- ASKARI, H. y Aghavi R.: The Principle Foundations of an Islamic Economy. Columbia University, New York (USA). BNL Quarterly Review, Vol. LVIII, No.235, Dec. 2005, pp. 187-205
- BETTATI, M. (1971): Le Conflit Sino-Sovietique. Edit. Armand Colin, Paris
- GARCIA BANCHS, A., L. Mata Mollejas y E.J. Nell (2008): Asimetrías Monetarias Internacionales y Banca Central. Edit. Investigación Económica Vol. LXVII No. 265
- GREENSPAN, A. (2008): La Era de las Turbulencias. Edit. BS. Barcelona
- HERTZBERG, H. (2004): In the Soup-Bob Woodward's plan of attack. New Yorker.
- HOYOS, C., Morrison Kevin (2003): Financial Times
- KABIR HASSAN, M.(2007): Handbook of Islamic Banking. Cheltenham, UK, Northampton, Ma. USA. Kabir Hassan and Mervyn K. Lewis 2007
- KENNAN, G. (1951): American Diplomacy: 1900-1950. Edit. Mentor Book/The University of Chicago
- KENNEDY, P. (2006): Auge y Caída de las Grandes Potencias. Edit. De bolsillo, Barcelona
- KINDLEBERGER, C. (1991). Manías, Pánico y Crack. Edit. Ariel, Barcelona
- KISSINGER, H. (1979): Mis Memorias. Edit. Atlántida, Buenos Aires
- MATA MOLLEJAS, L. (2018): La Crisis Terminal Venezolana. Edit. Fundación A. Adriani, Caracas
- MATA MOLLEJAS, L. (2017 a): Consecuencias del Neo-Imperialismo (p. 118). Edit. A. Adriani, Caracas
- MATA MOLLEJAS, L. (2017 b): Trump y Putin ¿Nuevo Orden Mundial? Edit. A. Adriani, Caracas
- MATA MOLLEJAS, L. (2016 a): La Política o Negocio o Reto? Edit. Fundación A. Adriani, Caracas
- MATA MOLLEJAS, L. (2016 b): Dinero y Petróleo en el debut del Trecer Milenio. Edit. A. Adriani, Caracas

MATA MOLLEJAS, L. (2016 c): Política, Petróleo y Restricciones Financieras. Edit. A. Adriani, Caracas

MATA MOLLEJAS, L. (2014): Ilusiones monetarias en el ámbito económico. Comité Interacadémico/Academia de Ciencias Físicas y Matemáticas. Edición Digital. Caracas

MATA MOLLEJAS, L. (2000): Reflexiones sobre la Política Monetaria en una economía pequeña y abierta, con referencia especial al caso Venezuela. Revista Venezolana de Análisis de Coyuntura. Vol VI. No. 2

MATA MOLLEJAS, L. (1999): Essay on the Economic Synthesis and Financial Hegemony in the Current State of Economic Science (Vol III). Spellbound Publications, Rohtak

MATA MOLLEJAS, L. (1994): Crisis Financiera y Desarrollo. ANCE. Caracas.

MITTERAND, F. (1981): Aquí y Ahora. Edit. Argos-Vergara. Barcelona

OKUM, A. (1981): Prices and Quantities: A Macroeconomic Analysis. The Brookings Institution, Washington

PRIESTLAND, D. (2012): Merchant, Soldier, Sage: A new history of Power. Edit. Penguin Books, New York

RECKNAGEL, Ch. (2000): Iraq: Baghdad Movesto Euro. Radio Free Europewebsite.

ROGALSKI, M. (1994): El auge de la fractura Norte-Sur ¿Es posible un gobierno global? Nueva Sociedad No. 132 pp: 100-117

SCHUMPETER, J.A. (1995-1954): Historia del Análisis Económico. Edit. Ariel, Barcelona.

SHIPLEY, Tyler (2007): Currency Wars: Oil, Iraq, and the Future of US Hegemony. Studies in Political Economy.

SEDILLOT, R. (1975): Historia de las Principales Monedas. Ediciones Guadarrama, Madrid.

SEYED. H. A.: Ignored Aspects of Islamic Banking and Finance. Management and Business Administration. Central Europe Vol. 22, No.2 (125): 98-110, ISSN 2084-3356. Copyright by Kozminski University. Department of Economics, Qom, I.R. Iran Vol.22, No. 2 (125), 2014

UCHENNA, C.E. y Thambiah, S. (2011): Customers' Perception on Islamic Retail Banking: A Comparative Analysis between the Urban and Rural Regions of Malaysia. International Journal of Business and Management Vol. 6, No. 1; Jan. 2011

VENN, J. y L. Euler (1881): Symbolic Logic. Mc Millan and Co. Londres.

WAHYU, J. (2017): Towards a Sustainable Islamic Banking System: Re-embedding Murabaha Mode of Financing Indonesian Capital Market Review 9 (2017).

YERGIN, D. (2012): The Quest. Edit. Penguin Books. Londres

WICKSELL, K. (1898/1962): Interest and Prices. Edit. A. Kelley. New York

ZARAZAGA, C. (1995): Hyperinflations and Moral Hazard. Federal Reserve Bank of Dallas. Working Papers 95-17.

BP, Statistical Review (2019) 68th Edition

OPEP, Reporte Anual 2018