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The Politics of Islamic Finance

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THE POLITICS OF ISLAMIC FINANCE is co-edited by Clement M. Henry, Professor of Government, at the University of Texas at Austin, and Rodney Wilson, Professor of Economics in the Institute for Middle Eastern and Islamic Studies at the University of Durham. Professor Henry, author of *The Mediterranean Debt Crescent* (1996) and other works, which earned him fame in the circle of Islamic Banking and Finance after publishing the special issue of *Thunderbird Review of International Business* on Islamic Banking (1999). Professor Wilson is well-known to Islamic economists due to his numerous works in this field.

The events of 11 September 2001 had very adverse consequences for Islamic finance. Many credible financial institutions of Muslim countries were accused of 'racketeering, wrongful death, negligence and conspiracy' in a lawsuit dismissed later. But it had already inflicted damage to the fame and functioning of these institutions. The growth rates of Islamic deposits diminished in the subsequent years. The American officials, ignorant about Islamic finance, viewed any 'Islamic' bank with heightened suspicion. It is this situation in which the present work has been prepared. Covering political as well as economic constraints, and correcting misunderstanding about Islamic banking and finance, this timely book helps readers learn to appreciate the various political contexts in which Islamic finance operates in the Middle East and North Africa (MENA).

According to the editors, the focus of the book is ‘the politics conditioning and sometimes enveloping’ Islamic financial institutions. The book is divided into two parts. In addition to an introduction and conclusion by the editors, each part of the book has six essays. In part one a set of thematic essays lays the groundwork for the country-specific political analysis of part two of the book.

In part one, Monzer Kahf, in his paper “Islamic Banks: the Rise of a New Power Alliance of Wealth and *Shari`a* Scholarship” discusses the history of the new political alliance between private Muslim financiers and *Shari'ah* scholars. ‘The *ulama* were generally preferred over more politicized Islamists because of the moral authority that the former exercised over potential banking clienteles’ (p. 10). This alliance benefited both parties in several ways. Kahf mentions a note of optimism about this pleasant alliance: “After centuries of dormancy, the *ulama* have a new chance to play a crucial role in the development of events in their countries, without being brushed aside by political Islamic movements” (p. 32). Ibrahim Warde in his paper “Global Politics, Islamic Finance and Islamic Politics Before and After 11 September 2001” points out that ‘the international and particularly American authorities responsible for tracking down terrorist money’ have occasionally missed the distinction and distance found between ‘Islamic capital’ and ‘political Islam’ (pp. 10-11).

Tarik M. Yousef in his paper “The *Murabaha* Syndrome in Islamic Finance: Laws, Institutions, and Politics” notes that Islamic banks work under a disadvantage as the long-term financing with *mudarbah* or *musharakah* is far riskier and costlier than the long term or medium-term lending of the conventional banks. That is why there is divergence between the theory of equity-based finance and *murabahah*-dominated practices of Islamic banks. He examines the *murabahah* syndrome in Islamic finance through the prism of a systematic analysis of financial structures across the world. His findings show that ‘Islamic banks, as niche providers of capital, do not operate much differently from conventional banks’ (p. 75). It may be noted that the issue has been discussed by many scholars at various forums. Kazem Sadr and Zamir Iqbal in a study about the Iranian Agricultural Banks claim that this is due to the problem of asymmetrical information (Kazem and Iqbal, 2002, p. 142).

Ellis Goldberg in his paper “Marketing Commodities Does not Happen on Commodity Markets: The Egyptian *Bursat Al- 'Uqud* and Oil Futures Markets”, presents an analysis of ‘past Egyptian experiences with cotton futures and current experiences of oil-producing Muslim countries with their international markets’ (p. 11). According to the author, ‘futures markets constitute important building blocks of the global financial system. As a consequence, the creation of viable financial structures in the Islamic world might be jeopardized if the content of Islamic law posed an impediment to their existence’ (p. 81). He accepts that ‘existing research on Islamic law is fairly clear that the futures markets as presently known are not consonant with Islamic law’ (p.83). After stating the story of Cotton future market of Egypt functioning throughout the twentieth century, the author concludes that since Islamic law emerges out of request for judgment by interested parties rather than from the need to enunciate public policy, the landowners never cared to seek a *fatwa* about the future market. ‘Clearly, for a prolonged period, Egyptian Muslims engaged with the commodities markets felt the primary role of the state was to regulate them rather than subordinate them to a legal discourse' (p. 93). Finally he addresses the question 'whether the governments of oil-producing countries should be engaged in the futures markets for petroleum' (93). In the light of Egypt's experience, his conclusion is that 'powerful economic interests can, if necessary, override any legal obstacles to innovative financial engineering' (p. 288).

Clement M. Henry in his paper "Financial Performance of Islamic *versus* Conventional Banks" compares the financial performance of selected Islamic banks with comparable conventional banks of structural adjustment and economic reform in the countries where they operate (p. 11). His inquiry mainly focuses upon those countries that display fair playing fields of competition between Islamic and conventional banking. That is, Saudi Arabia, Kuwait, Jordan and Turkey. In the opinion of the author, ' Islamic banks would seem to have better opportunities to compete and to expand their shares of market in relatively open, liberal economies than in closed ones' (p.106). This means that the existing trend in the world order towards openness and globalization would provide prospects of growth and expansion to Islamic banking and finance. For example, 'as a result of the liberalization of the Turkish economy, Islamic business has become an important sector of the economy' (p. 219).

The last paper in the analytic section is by Rodney Wilson. As the title of his paper "Capital Flight through Islamic Managed Funds" indicates, Islamic banks generate wealth locally but invest it overseas same way as their conventional counterpart. The author terms it as 'capital flight'. To him, 'Islamic finance is by definition primarily of concern to Muslims, its adoption might be expected to result in capital markets of Islamic World'. Especially when 'global capitalism is often viewed as exploitative from a Muslim developing country perspective, with the gain from international financial integration unfairly distributed' (p.129). Surely it will be a great contribution of Islamic banks if they could prevent capital flight to abroad by creating investment opportunity in the home country.

In part two, Case Studies, three models have been selected:

1. Countries with close relations between 'Islamic banks and Islamic political movement'. This includes studies of Sudan and Kuwait.
2. Countries where 'indirect connections and interactions between Islamic financial institutions and Islamic political factions and parties' exist, e.g. Jordan and Turkey, and
3. Countries where regimes 'repress their political Islamists', e.g., Tunisia and Egypt.

Thus the editors classify the relations between Islamic financial institutions and Islamic political movements as integration, separation and uneasy coexistence (p. 12).

The integration between Islamists, as the editors would like to use the term, and incumbent power has shown different results. Endre Stiansen in his case study titled "Interest Politics: Islamic Finance in the Sudan, 1977-2001" finds 'a pattern of mutual destruction. While Kristin Smith's paper "The Kuwait Finance House and the Islamization of Public Life in Kuwait" finds 'possible synergies between financiers and political clienteles'.

Mohammed Malley presents "Jordan: A Case Study of the Relationship between Islamic Finance and Islamist Politics". In his opinion, Islamic banks may prove to be intermediaries between the government and Islamic activists. He sees a pivotal role for the country's two Islamic banks only if an environment of real political liberalization is provided that seems to be unlikely in the near future.

Filiz Baskan studies "The Political Economy of Islamic Finance in Turkey: The Role of Fethullah Gulen and Asya Finance". But first he examines the role of Islam in Turkish politics and tries to show that 'Islamic opposition has never been considered as legitimate by the state authorities'. 'Parallel to the suppression of political Islam, the Turkish state has repressed Islamic businesses, albeit not systematically' (p. 217). According to the author, 'the Islamic sects gained a significant place in the economic field by using the facilities of a market oriented economic model, which was initiated in January 1980 with the help of the World Bank and International Monetary Fund' (p.218). Islamic banks in Turkey are called Special Finance Houses because it is constitutionally illegal to found banks named "Islamic". These banks tended to concentrate in the Turkish cities that have registered the most votes for the Islamists. The author, in some details, examines the development of Asya Finance, which is affiliated to Islamic Fethullah Gulen Community, as an example of Islamic banking. Fethullah Gulen who believes in a *sufi* cult and known for his philanthropic and welfare works getting support of moderate as well as secularists to counter the radical Islamists. As compared to other special finance houses, performance of the Asya Finance is continuously improving. An interesting feature of Asya Finance is that the proportion of *mudarabah* financing reached to 41 percent, almost equal to *murabahah* financing. The establishment of the Union of special finance houses in 2001, which provides guarantees for depositors' money in case of bankruptcy, has strengthened the position of Islamic banking and finance in Turkey.

Robert P. Parks raises question "*Ayyu Bank Islami*? The Marginalization of Tunisia's BEST Bank". The distinguishing feature of Tunisia is that there is 'sharp continuity between the colonial and post colonial era'. In Tunisia 'the colonial order has replicated the colonial policy of maintaining a concentrated banking sector, adding a twist of state domination'. The author finds that when relations between the bank and the political regime are good, BEST Bank's coffers are full; when the relationship sours, BEST loses deposits. Thus, the BEST or Beit Ettamwil Saoudi Tounsi (*Bayt al-Tamwil al-Saudi al-Tunisi*) presents a case of 'separation and coward capital' (p. 242).

Samer Soliman's use of the phrase "putting Islam to work in the economy" in the very first sentence of his paper "The Rise and Decline of the Islamic Banking in Egypt" betrays his bias against the experience of Islamic banking in Egypt. In the same vein he is using phrases like 'mother land of Islamic fundamentalism', 'economic Islam' (p.265), 'akin to voting against Allah', 'pious customers' (277), 'a band of thieves' (281), etc. Those who classify Islam as 'Islamist version' or secularist version, 'political Islam' or sufi Islam, etc., they cannot make justice with the true version of Islam understood from the Qur'an and *Sunnah*. Based on mostly journalistic sources the paper seems to be rather a propaganda piece of article than a serious research paper. It is the "Prophetic version" as well as the Qur'anic requirement and not 'the Islamist version of Islam' that 'religion must apply to all aspects of material as well as spiritual life'. To the author 'spread of the veil' is a 'symbol of political Islam' (p. 274). The paper makes a big disclosure to all students of Islamic banking and finance when it declares that Mit Ghamr, established in 1963, and later the Nasser Social Bank, established in 1970, were not first Islamic banks or for that matter 'Islamic' at all, because they did not use the word 'Islamic' nor did they announce that they were making an experiment of interest free Islamic banking (p. 268), as if to him, word is more important than work. No doubt, Najjar, the founder of Mit Ghamr Saving House, was inspired by the German model of interest-free banking and he presented it also as a German experience but as himself noted in his work *Harkat al-Bunuk al-Islamiyah* (1993, p. 32), "He started it in disguise of a saving bank using the name of an European government so that his step might succeed amid the interest based banks as it was a time when opposition to Islamic trend was at the peak, without making explicit its Islamic nature, something which was exposed anyway. It was a great success, and its success revealed its Islamic identity. We had no other way. The result was that it was targeted with all might and its founder was forced to leave the country to merge it with other interest-based banks to loose its identity". To conceal the Islamic identity of the bank even the *zakah* fund was named as the 'social service account'. If we see the background of al-Najjar, a nephew of Muhammad Abdullah al-Arabi, one of the pioneers of Islamic economics and interest-free banking (p.19) and his later age career, there seems no reason to belie him and to attack on his intention. The author's statement that 'the bank was unsuccessful and was liquidated in 1973' (p. 268) is contradictory to the statement of Monzer Kahf, a senior Islamic economist who says that it was closed and liquidated in1967 and that it was a successful experiment (p.19). According to Kahf, "This may have brought pressure on the government to fill the vacuum created when the houses were closed. Hence, in 1971 the government of Egypt created the first Islamic bank, Nasser Social Bank (NSB)" (ibid.). But to Soliman, NSB can 'hardly be regarded as an Islamic bank' because it did not use 'Islamic reference and discourse' (p. 268). A third revelation in this article is that in Egypt Islamic banking was introduced by the conventional banks themselves and under the very patronage of the Government (p. 271, 272, 283). At occasions the article lacks proper documentation. For example: no reference has been provided in support of his statements that 'suspicion about the conventional banks has been in evidence since the late nineteenth century' (p.269), or 'the religious supervisory boards accepted that the fines were in conformity with Islamic law' (p.277). As against his own finding (see p.278), he declares that 'Islamic banking is no longer rising in Egypt', 'the model has lost much of its appeal' and that 'the practical application of *economic Islam* has brought the concept down to earth' (italic added) (p. 279). Indeed, there is much relief in this assertion for those who are opposed to the abolition of interest and the establishment of Islamic banking.

But this is a short-lived relief if one reads Soliman's statement along with what the two editors have said at the beginning of the book: "by narrow as well as broad definitions, Islamic capital is growing" (p. 2). 'The most significant guarantee of Islamic finance's future may be the large multinationals that have opened Islamic windows for receiving deposits…..' (p. 3). 'Islamic finance, in short, is becoming respectable in international business circles' (p. 4). And what the editors have observed in their concluding remarks: 'The logic of Islamic finance remains intact', '….investments in Islamic banks and in the Islamic instruments engineered by international banks will probably continue to grow faster in most MENA countries than will conventional bank deposits' (p. 287), and that along with the 'relatively underbanked countries, such as Algeria and Yemen', 'Syria and Iraq may also offer fertile fields for Islamic finance when they eventually permit it, like most Arab states' (p. 291). They have rightly observed that 'it is surely in the Western world's interest to encourage a more benign sort of globalization whereby Islamic financial instruments are integrated into international finance' (p. 293).

The editors have tried to take full care of the transliteration system but still some inconsistency is noted. For instance: Shaykh p. 92, Sheikh p. 24, Shaikh p. 24; Faisal p. 275, Faysal p. 275. Similar is case in proof reading. A few examples: m*udarrib* p. 3 (for *mudarib*), Moncer p. 13 (for Monzer), *Taweed* p. 132 (for *Tawheed* or *Tawhid*), *bai al dawn* p. 148 (for *bay` al-dayn*), Bazagan p. 36n (for Bazargan), etc.

Since the book mainly addresses western man, at occasions certain terms needed explanations. A glossary of the terms would have been more helpful. On p. 270 the phrase '*infita* Laws' is not clear. If it means "laws related to openness (*infitah*)", then it should be noted that it would be incorrect to drop the letter '*h*' from the end as it is a root letter of that word.

In the end we must admit that though the book is dealing with the 'politics' of Islamic finance and perhaps therefore most of the contributors have been selected from the Departments of Government and Political Sciences, it is also a valuable addition to 'economics' of Islamic finance specially to understand the Western perspective of the subject.

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Global Politics, Islamic Finance and Islamist Politics Before and After 11 September 2001. Clement Henry, Rodney Wilson, Ibrahim Warde. Published: 17 February 2004. by Edinburgh University Press. in The Politics of Islamic Finance. The Politics of Islamic Finance pp 37-57; doi:10.3366/edinburgh/9780748618361.003.0002. Show/hide abstract. The publisher has not yet granted permission to display this abstract.Â The Political Economy of Islamic Finance in Turkey: The Role of Fethullah GÃ¼len and Asya Finans. Clement Henry, Rodney Wilson, Filiz BaÅŸkan. Published: 17 February 2004. by Edinburgh University Press. in The Politics of Islamic Finance. The Politics of Islamic Finance pp 216-237; doi:10.3366/edinburgh/9780748618361.003.0010. Show/hide abstract. Ibrahim Warde in his paper â€œGlobal Politics, Islamic Finance and Islamic Politics Before and After 11 September 2001â€ points out that â€˜the international and particularly American authorities responsible for tracking down terrorist moneyâ€™ have occasionally missed the distinction and distance found between â€˜Islamic capitalâ€™ and â€˜political Islamâ€™ (pp. 10-11). Tarik M. Yousef in his paper â€œThe Murabaha Syndrome in Islamic Finance: Laws, Institutions, and Politicsâ€ notes that Islamic banks work under a disadvantage as the long-term financing with mudarbah or musharakah is far riskier and costlier t...Â Clement Henry and Rodney Wilson: The Politics of Islamic Finance. 47. discourseâ€™ (p. 93).