

Draft conclusion: Islamic finance in political perspective.

World politics, notably United States policies concerning Iraq and Palestine, are mobilizing Muslims against American imperialism and against the governments in the Muslim world that are allied with the United States. America's "war on terrorism" may in fact become a self-fulfilling prophecy, as the various, supposedly related, military efforts, such as war on Iraq, produce waves of sympathy and support for the transnational terrorist networks associated with Osama Bin Laden. Islam in the modern world, however, presents a complex of personal and social as well as political meanings, and they are undergoing constant change. Islam may in theory be a unified body of thought, but political Islam should not be conflated with Islam's other economic and societal dimensions. Even governments in the Muslim world that wage war against political Islamists and do not readily distinguish moderate partisans from terrorists recognize the distinction between Islam's political and economic practitioners. Yet the distinction should not be cast in stone. Any rigid analytic separation of the economic from the political aspects of Islamic revival may obscure some of the rich potential for political development implied by a steady accumulation of Islamic capital.

This book has examined a force for change that is far less powerful than American imperialism; indeed, as Ibrahim Warde has documented, Islamic banks remain highly vulnerable to external forces emanating from New York and Washington, D.C. since the bombings of the World Trade Center and the Pentagon. In most of the Muslim world they remain marginal to national commercial banking systems, and globalization is meanwhile eroding protective national barriers – especially in the areas of trade and finance.

As Monzer Kahf implies, however, Islamic finance allied with local leaders of religious opinion – the *Ulama* – may exercise an influence in the Muslim world at least as profound as the Bush Administration's hopefully short-lived adventures in imperialism. Political Islam in the modern world is suspended between radical and moderate poles, and the gradual emergence of a distinctively Islamic form of capitalism – exemplified by the alliance between the *ulama*, bankers, and entrepreneurs – could tip the balance and effect a deep structural transformation in much of the Muslim world. In fact United States policy makers concerned with the lack of democracy in the Arab world and the need for "regime change" might well ponder the implications of Kahf's argument. U.S. and international programs designed ultimately to build democratic institutions often focus for a start on civil society, so as to avoid upsetting incumbent dictators. But instead of supporting bunches of upper middle class NGOs -- a cottage industry in the developing countries that are endowed with international aid programs -- they might assist Islamic institutions that promote the spirit of capitalism and free enterprise. Any stable democracy presupposes an indigenous capitalist class that animates vibrant middle and working classes.

Unfortunately the events of September 11, 2001, triggered the "clash of civilizations" that most American foreign policy strategists had previously dismissed as an imaginative but tendentious neo-conservative mapping of the post Cold War world --

an American equivalent of Muslim fundamentalist views that many Islamists appreciated. Ibrahim Warde shows how the paradigm “went mainstream” when President Bush “foreclosed any discussion of U.S. foreign policy” and asserted “if you’re not with us, you’re with the terrorists.” A Manichean neo-conservative ideology currently guides the American “war on terrorism,” with very adverse consequences for Islamic finance and the development of any sort of capitalism or democracy in the Middle East. Indeed the American Secretary of Defense targets “bankers’ pinstripes” as much as the actual terrorists. They are easier prey. Apparently Islamic banks are suspected of belonging to money laundering networks for transnational networks of terrorists and judged guilty unless they can prove their innocence. The Saudis, in particular, are the “kernel of evil,” and the Saudi leaders of both Islamic banking transnationals, Faisal and Al-Baraka, were among those accused of “racketeering, wrongful death, negligence and conspiracy” in a lawsuit raised by families of victims of the September 11 attacks. Though the case was subsequently dismissed, all Middle Eastern banks, and Islamic ones in particular, are subject to pressures that may deter potential Muslim investors and depositors. The growth rates of Islamic deposits diminished during the year following September 11.

The logic of Islamic finance remains intact, however: driven by the demand of pious investors, investments in Islamic banks and in the Islamic instruments engineered by international banks will probably continue to grow faster in most MENA countries than conventional bank deposits. This book has examined the competitive advantages and disadvantages of the Islamic banks. We conclude that in much of the MENA the Islamic banks still enjoy a prime advantage of being able to reach significant market segments that distrust conventional banks. They are not usually able, however, to generate as much profit from their investments as the latter, at least not without incurring significantly greater risk. Most commentators agree that they are in need of a broader portfolio of religiously acceptable financial instruments. Acceptable markets in options to buy and sell things on forward markets would be particularly useful.

Ellis Goldberg concluded on the basis of Egypt’s experience with cotton options that powerful economic interests may override any legal obstacles to innovative financial engineering if it is really needed. Tarik Yousef indicated, however, that the MENA, like other developing region of the world, requires substantial political reform as well as structural adjustment if Islamic finance is to transcend its “Murabaha syndrome.” For reasons that are extrinsic to Islamic finance, it cannot yet fulfill its potential to finance development in its true spirit of venture capitalism, but it may still sensitize traditional Muslims to new arts of economic management. Parallel to Yousef’s macro-economic analysis, Clement Henry’s micro analysis of the financial performances also suggested that Islamic finance is most likely to prosper in domestic environments that are politically as well as economically liberalized. Otherwise Islamic finance tends merely to siphon off Muslim deposits into overseas investment, as Rodney Wilson demonstrated to be the case in the GCC countries. Much of it is funneled into a variety of mutual funds and other investment vehicles that follow Islamic conventions. Much of the vaunted growth in Islamic financial instruments may thus simply constitute new forms of capital flight. Passive rentiers, not dynamic bourgeoisies, may be their principal beneficiaries (along with the western or Asian recipients of their investments). In Jordan, too, substantial

investment revenues of the Islamic banks come from foreign trade finance and commodity markets rather than Islamic investments inside the country or region. Greater domestic investment evidently requires both political and economic reform.

But our case studies suggest that a relatively liberal climate may be a necessary prerequisite if Islamic finance and commerce are to animate a new form of capitalism. Indeed more political liberalization may be needed even to achieve the benefits that Montesquieu ascribed to “gentle commerce” before the rise of capitalism. *Le doux commerce* was supposed to polish tyrants’ political manners by making them realize that their Machiavellian tactics were counterproductive and politically irrational -- but perhaps the polishing already required a smooth surface. Let us here recall the three scenarios that the case studies were supposed to illustrate.

1. **Integration.** Islamic capital channeled through private sector Islamic banks builds up strong national business communities. The equity-like financing of Islamic banks is extended with the help of political monitors from Islamist parties who insist on probity and transparency in business operations. Greater proportions of equity financing make the Islamic banks more profitable with less risk than conventional banks. The business community, with much to lose in the event of conflict, moderates the oppositional activities of the political Islamists while giving them the necessary material support for autonomous political activity. Synergies between political Islamists and Islamic capitalists help the combined movements to achieve gradual acceptance in the political system, reinforcing trends toward greater political pluralism.
2. **Separation.** Islamic capital, like all capital, is "coward" and avoids any association with political Islam. Indeed, that is its strength: Islamic financial institutions enjoy relative operational autonomy because the political regime considers them politically harmless yet, ever in need of legitimacy, does not wish to appear opposed to experimentations with *Shari'ah* practices in financial matters as long as the banks stay out of politics. Separated and blocked from any natural constituency of Islamically-minded entrepreneurs, however, the Islamic banks are heavily dependent on state subsidies to survive the competition from conventional banks. The state represses the political Islamists and any potential Islamically-minded business allies while demonstrating its support for Islam by subsidizing the banks and possibly even creating new ones under direct state control.
3. **Uneasy coexistence.** Elements of the state that favor structural adjustment ally with their counterparts in the Islamic financial institutions. These are permitted access to Islamically-minded entrepreneurs, and the state encourages a relatively autonomous Islamist business community while repressing Islamist political parties. Neither integration nor separation but rather an uneasy coexistence characterizes the respective relationships of the political Islamists with the Islamic business community, on the one hand, and with the state, on the other.

The first scenario only concerned relatively liberal political climates, where Islamic banks could work comfortably with political Islamists. Whether or not they did so was an empirical question that the case studies of Jordan, Kuwait, Turkey, and the

Sudan addressed. In theory the political movement could help monitor the uses to which Islamic finance is put and extend the ability of the banks to engage in profitable *musharika* and *mudaraba* operations. By reducing the banks' monitoring costs, they would render them more profitable. Bankers and politicians would share an interest in the success of the Islamic financial experiment, and the politicians, enjoying financial support, would presumably strengthen the political movement's business interests and further moderate opposition to the incumbent regime. This ground-up approach suggests a gradual increase in the power of political and business Islam, operating in a relatively stable pluralistic political environment. It assumes that political liberalization is a gradual process and that money can soften up the opposition by bringing it into the moneyed establishment. But it runs against the grain of recent political development in the MENA. In the 1990s the political trend has been one of deliberalization and reinforced authoritarianism. Politics remain too turbulent and frightening to business and banking interests in much of the region, and the new American war on terrorism, even when not targeting Islamic banks, is bound to further authoritarian trends, just as the Desert Storm and Desert Shield were partly responsible for the hardening of opposition between regimes and Islamist parties in the 1990s.

In framing this first scenario, we originally thought that Jordan and Turkey could exemplify synergies between Islamic financial networks and the members and sympathizers of Islamist political parties as much as Kuwait and the Sudan. Mohammed Malley and Filiz Baskan discovered some affinities between Islam's financial and political forces, but they concluded, even in these relatively liberal climates, that the Islamic financiers and businesspeople had to keep their distances from their respective country's Islamist politicians, lest they antagonize their governments. Only in Kuwait, it seems, could the politicians and financiers mutually benefit each other, advancing the bank and encouraging moderate tendencies within the Islamist political movement as Kristin Smith demonstrates. In the Sudan, by contrast, Turabi's political Islamists coexisted uneasily with the military, but Turabi, who in association with the Faisal Islamic Bank of the Sudan had originally achieved power with the help of the Islamic banks and their new business constituencies, lost them when General Beshir removed him from power in 1999.

For Jordan, however, Malley still sees interesting prospects, albeit only if the regime first engages in real political liberalization, whereby the elected elements of the Jordanian parliament actually exercise some power. In the current regional and international climate such liberalization seems extremely unlikely, but in the longer run Malley envisions a pivotal role for the country's two Islamic banks. They could serve as intermediaries between the government and the political Islamists, and help transform the latter from a populist mass party into a conservative party, like the Christian Democrats in Germany, that would coexist more easily with other parties in a constitutional democracy.

Filliz Baskan is less sanguine about Turkey, but the victory of the moderate successor to Turkey's series of Islamist parties in the November 2002 elections may augur closer relations between Islam's political and financial wings. The Justice and

Development Party has apparently occupied the political spaces of Turkey's Center Right, suggesting that the political Islamists have already effected the sort of transformation that Malley envisions for the Jordanian Muslim Brotherhood. The special finance houses may have played some part in this major change. Baskan's research before the elections already indicated that these banks tended to concentrate in the Turkish cities that had registered the most votes for the Islamists in previous elections; in the previous parliament, moreover, the deputies who joined the more moderate and progressive of the two Islamist parties that succeeded the banned Virtue Party tended to be more closely associated with those cities than their colleagues who opted for the more conservative successor party (cite Ji-Hyang here!). Of course it is too early to say whether the Islamic banks, businessmen, *ulama*, and religious orders may overtly support the new ruling party, much less whether the banks, now integrated into the Turkish commercial banking system, will ever wield market power commensurate with the Justice and Development Party's electoral power.

Our second and third scenarios, by contrast, suggest a top down development of Islamic finance in alliance with the incumbent regime. In politically repressive settings there may be few real affinities between timid Islamic business and banking interests, on the one hand, and radicalized Islamist oppositions, on the other. Alliances with economic reformers within the government, however, may enable the Islamic banks gradually to gain market share. Protected by their governments, they may offer modest "profits" to their depositors and lure more of them away from non-interest bearing accounts in conventional banks. The financial returns of these Islamic banks under these scenarios were expected to remain modest, however, as long major structural adjustment did not occur, because the banks are at a structural disadvantage in generating revenues even if they can gain more deposits. But no matter: they are protected. The major competitive threat then comes from conventional banks that open Islamic windows to prevent the haemorrhaging of their non-interest bearing deposits. They, too, may then acquire a greater interest in structural adjustment, market reforms, better accounting procedures and the like. Under this top-down approach the Islamic banks may offer cover to the government for further engagements with international financial institutions and the Washington Consensus. Even where, as in Algeria, their market share is miniscule, their approval can contribute to the (sorely deficient) legitimacy of a government embarked on structural reforms. However, the public sector banks of countries like Egypt and Tunisia may oppose any globalizing alliance that takes deposits away from their weak balance sheets and endangers their state patronage machines.

Egypt did not in fact fulfill the heady expectations of Islamic finance in the mid-1980s. While losing market share, however, the Islamic banks nonetheless managed to survive the country's political deliberalization in the 1990s. After veering between our second and third scenarios Egypt settled down to into a revised third scenario of easy coexistence between government, Islamic banks, and Islamist parties. This pattern of coexistence illustrates the survival capacity of Islamic financial institutions in authoritarian settings. Although the Mubarak regime hardened up and deliberalized during his second decade of power, it still permitted enough space for Monzer Kahf's alliance between the financiers and some of the *ulama*; for the regime lacked the will as

well as the capacity to subordinate the latter to any single line of religious interpretation, however much it preempted political space and denied any voice to Islamist political oppositions. Samer Soliman concluded by observing that the Islam's financial banners wave freely in the air like women's headscarves, unfolding a harmless variety of meanings.

Authoritarian rule in Tunisia has yet to develop the depth and sophistication of its Egyptian counterpart. Consequently, as Robert Parks observed, its sole Islamic bank is strictly confined, for the most part offshore, to the margins of the Tunisian commercial banking system. For fear of being associated with Tunisia's outlawed Islamist opposition, BEST Bank dared not even advertise itself as an Islamic bank. Tunisia is in fact the only case among the countries studied in this volume that exemplifies our second scenario, a sharp separation between financial and political expressions of Islam in this "Republic of fear." Even in neighboring Algeria, where the government was at war with subsets of self-proclaimed Islamist *mujahidin*, Islamic financial institutions enjoyed more opportunities for growth and development.

Indeed the most interesting experiments in Islamic finance may be occurring in relatively under banked countries such as Algeria and Yemen, which were not among our case studies. The heavy hand of state banking institutions discouraged people away from banks altogether, as evidenced by the relatively high proportion of the money supply held in cash outside their respective commercial banking systems, so that they offer their newly established Islamic banks virtually untapped markets. Syria and Iraq may also offer fertile fields for Islamic finance when they eventually permit it like most other Arab states. Yet almost by definition these countries also have the weakest civil societies, for their private sectors remain weak and deprived of credit. Islamic finance could enjoy a competitive advantage on the supply side, but the very conditions that discourage people away from the state banks may make Islamic banks shy away from investing in these countries.

The other major state in the Arab world that does not yet permit Islamic banking is Morocco, whose king and Commander of the Faithful has understandably hesitated to risk his religious authority being contested by any alliance of capitalists and *ulama*. Morocco's relatively liberal political system, however, could perhaps tame some of the political Islamists in a ground-up alliance with the financiers.

In the wealthy Gulf countries, where Islamic banking is developing substantial market shares, the impetus seems to come from wealthy individuals who refuse interest as a matter of principle and who seek substitutes for conventional banks where their funds may lie idle. In the coming five years Saudi Arabia is likely to be the major battleground for Islamic finance. Substantial non-interest bearing deposits seem ripe for redeployment to Islamic financial markets. Were Al-Baraka, for instance, allowed entry into the Saudi market, it would grab market share from ARABIC as well as the National Commerce Bank and SAMBA, to mention Saudi Arabia's two largest banks, both of which have set up Islamic windows. Some *ulama* and Islamic bankers argue that these windows cannot really work in accordance with the *Shari'ah* because their funds cannot

be separated from the others based on *riba*. In Jordan the Arab Bank was required to build up an entirely new bank for its Islamic operations. Were such a ruling to take effect in Saudi Arabia, there could be a major shake-up in the commercial banking system. An influx of Islamic banking might then tip the scales within the government in favor of its economic reformers. Paradoxically, however, the risk of rapid economic change in Saudi Arabia is that its principal beneficiaries would be members of the royal family like Prince Walid al-Talal and other less professional uncles and cousins, the Saudi equivalents of the nomenklatura in single-party regimes.

The potential political fallout from Islamic banking differs widely from state to state in the MENA. The grounds-up view of synergies between political and financial Islam seems less likely today, however, in this era of deliberalization, than the top-down approach. Whether further structural adjustment will lead to greater political liberalization in the long run is yet to be seen, but so far, in the MENA at least, neither process has been linear and uni-directional. Meanwhile Islamic finance, with its small shares of the market to date, may incrementally acquire larger shares of many MENA markets. Self-consciously Islamic financiers seem bound to prosper, irrespective of the regime's treatment of political Islamists.

Any Third Gulf War is likely to hinder Islamic capitalist development by radicalizing Islamist opposition and further hardening authoritarian regimes in the region. Islamic finance's promising alliance with the *ulama* remains vulnerable, depending above all on domestic and regional stability. The threat of U.S. military action is just as disturbing as any Islamist threat. Instead of imposing regime change, 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. This book has drawn attention to the conditions that may facilitate the growth of what appears to be a distinctively Islamic variety of capitalist development. We have identified self-consciously Islamist financiers and tried to discover the conditions under which they best thrive. Distinctive financial practices seem to be mobilizing capital that would otherwise stay hidden in mattresses in much of the MENA. The processes of economic globalization, coupled with the steady accumulation of Islamic capital, may eventually overcome the present barriers to integration and promote more political pluralism in the region. Regime change imposed from the outside will only postpone this natural evolution of gentle commerce. Were big international business to polish the manners of the Bush Administration sufficiently to avert a clash of globalizations, however, it could help Islamic finance promote the steady structural transformation of the region that our essays have envisioned.