

## The Impact of Islamic Banking

In mid-November of 2009, The Economist wrote an article dealing with France's sudden interest in Islamic banking, the irony being that France has been very intolerant of Muslim dress in public places in recent years as the country holds dearly to its secularist identity. Islamic banking is almost the term *du jour* for banks and financiers alike these days, especially since Islamic banks hold billions of dollars in liquid assets – and all the while the world's banks are suffering from an acutely arduous financial crisis.

Following the prophet Muhammad's death, "religious scholars developed a complex, cumulative set of guiding rules for Muslims that came to be known as the sharia"<sup>i</sup>. The dominant factor that differentiates sharia law from our own Western laws (aside from obvious religiosity) is that of usury. While Christians and Jews did away with this belief long ago, the Qur'an "forbids the charging of interest in exchange for a loan, or 'riba'"<sup>ii</sup>. The reason for this, according to the Qur'an, is "because it harms the humane aims of Islam towards mercy, solidarity and cooperation"<sup>iii</sup>. This is a founding principle that has shaped Islamic banking. Islamic banking itself has the essential belief that money should be used productively and investment activities should be dealt with in partnerships so that risks and rewards are shared by creditor and debtor alike. Also, according to sharia, excess capital (i.e. profits) ought to be put back into the community in the form of *zakat* (alms). But for all intents and purposes it includes stocks, real estate investments, insurances, and currency swaps that are sharia-compliant (called *sukuks*). There are limits, though; "sharia law prohibits investing in certain industries or products, including alcohol, tobacco, pork, and pornography"<sup>iv</sup>. Another popular instrument is the *murabaha*, "essentially cost-plus financing which involves the sale and repurchase of a commodity to fund a loan"<sup>v</sup>.

Some have estimated that the "sector has expanded at a brisk pace of between 15% and 22% annually in the past decade... in fact, there are currently (as of 2006) 250 Islamic mutual funds with \$300bn worth of assts under management and 300IFIs holding over \$250bn deposits... furthermore, \$200bn in assts are managed by dedicated Muslim 'windows' or subsidiaries of conventional banks"<sup>vi</sup>.

So it's an attractive market. But is it as pure as it looks? There are two big arguments against Islamic banking: first, that it is interest-based in the end, just well-hidden; and secondly, that it has acted for decades as a front for funding terrorist organizations. "The money considered as interest in a typical bank transaction is instead designed into the contract agreement in another way. Some Muslims consider Islamic banks to be engaging in legal trickery to hide the fact that they charge and pay interest. Most economic analysts would probably agree"<sup>vii</sup>.

As Islamic banking grew in the Middle East, it had different influences on different countries. Iran had no qualms adopting it as Islam was made the supreme 'law of the land.' Egypt and Saudi Arabia, however, adopted it rather reactively instead.

Some strong criticism has arisen against Islamic banking that claims that certain banks have funded terrorist networks indirectly and ought to be stopped. Al-Rajhi Bank has been the focus of some of this criticism. Since *zakat* can be given to anyone and does not need to be accounted for in the books as it is meant to be supportive community charity-giving, it has been a great tool for terrorist networks to receive funds and to prevent anyone from finding out where those funds are coming from. This is a gross abuse of the aim of sharia law to help out the needy. Though Saudi Arabia has been a key US ally in fighting against terrorism since 2001, it has been slow in tackling the financial infrastructure that is essential to terrorists, Al-Rajhi in particular<sup>viii</sup>. *Zakat* has also been used by other banks to fund other terrorist organizations, such as the Muslim Brotherhood's Hamas.

This is certainly alluring to the West and indeed the rest of the world. But there are challenges for Western banks as laws need to accommodate Islamic banking products. Britain has been at the forefront of this 'narrowing of the gap' shall we call it, but others such as France are having to take a real hard look at their own set of values and see if Islamic banking products and 'accommodating of laws' is reconcilable with that. France has eliminated the tax obstacles and improved the legal framework, certainly, but it has not prevented protests and serious public debate about the issue itself. Middle Eastern governments may now feel more empowered that they can rely on their own capabilities rather than borrowing Western banking systems. At the same time, it highlights the need for standardization and regulation of operations, especially where scholar-review is concerned.

As Islamic banking has been making inroads into Western markets, there has even been non-Muslim demand for Islamic financing products as it allows a greater range of investment products, especially for portfolio management groups. But without education on cultural gaps and indeed the gaps between the Islamic and Western banking structures, a constructive dialogue cannot start. In fact, without education (on both sides), Huntington's Clash of Civilizations theory is all but inevitable. And yet, as the Muslim world asserts itself economically and that the capitalist West sees the benefit of this new exotic form of banking, a hybrid international economic banking model, juxtaposing the two, may yet dawn. And isn't that what extremists in the end the most – understanding and mutually beneficial relationships among moderates?

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<sup>i</sup> Andersen, Roy R., Seibert, Robert F., Wagner, Jon G. *Politics and Change in the Middle East*. New Jersey: Pearson Prentice Hall, 2009: 36.

<sup>ii</sup> "Usury: The Principle Behind Islamic Banking." <http://tntalk.wordpress.com/2008/03/28/usury-the-principle-behind-islamic-banking/>

<sup>iii</sup> Al-Marzouqi, Dr Ibrahim Abulla. "Means of Earning Wealth." *Human Rights in Islamic Law*, POB 46619, Abu Dhabi, United Arab Emirates: 308

<sup>iv</sup> Grose, Thomas K. "The Rise of Islamic Banking." *U.S. News & World Report* 145.13 (2008): 41.

<sup>v</sup> Ibid.

<sup>vi</sup> Siddiqi, Moin. "The Islamic Dimension." *The Middle East*, October 2006: 42.

<sup>vii</sup> "Usury: The Principle Behind Islamic Banking." <http://tntalk.wordpress.com/2008/03/28/usury-the-principle-behind-islamic-banking/>

<sup>viii</sup> "The US Tracks Saudi Bank Favored By Extremists." *The Wall Street Journal*. <http://online.wsj.com/article/SB118530038250476405.html>