Islamic Finance in a Global Context: Opportunities and Challenges

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I. INTRODUCTION

The first Islamic financial institution was a mutual savings bank formed in the Egyptian town of Mit Ghamar in 1963. Since then, Islamic finance has evolved into an adaptive system of international practices and regulations capable of harmonizing classical religious precepts, social responsibility, and traditionalism with the modern exigencies of globalized banking. Today, according to the International Monetary Fund, there are over 300 Islamic financial institutions in more than 75 countries with total assets worldwide exceeding $250 billion and growth rates exceeding 15 percent a year.¹ As of June 2006, Moody’s estimated that there are over 250 Islamic mutual funds, with a total of $300 billion in assets.²

Despite this scope and imprint on the global economy, Islamic finance remains poorly understood at both the theoretical and practical level. Moreover, despite a number of recent optimistic trends, Islamic finance faces several ideological and structural challenges to full integration in the globalized economy. This Article aims to illuminate these challenges and provide a general overview of contemporary Islamic financial theories and practices. The first section concentrates on the size of the world’s Muslim population, the size of Muslim economies, and concepts of Islamic finance itself. The second section

¹ Mohammed El Qorchi, Islamic Finance Gears Up: While Gaining Ground, the Industry Faces Unique Regulatory Challenges, 42 Fin & Dev 46, 46 (Dec 1, 2005).
examines Muslim beliefs related to contemporary corporate finance. The third section looks at the challenges of Islamic finance. Security issues in Islamic finance, with a particular focus on the financial theories of the radical Salafi movement, are an important development and need to be understood clearly in terms of the challenges facing Muslim financial instruments and law. Specifically, we examine the fundamental paradox of the Salafi’s particular interpretation of Islamic finance. While Salafi-jihadist writings impose a sort of economic apartheid between Muslims and non-Muslims, their calls for economic jihad against the West (divestiture and boycott) try to exploit the very same interdependence and forces of globalization they decry.

II. SCOPE OF MUSLIM POPULATION AND SIZE OF ECONOMIES

Muslim people comprise over 20 percent of the world’s population. Countries with Muslim-majority populations are distinguished by significant economic and political statistics. As a group they generate over 10 percent of global GDP and constitute 10 of the 11 members of OPEC. One member of this group, Turkey, also belongs to NATO. These countries are clustered mostly in the second and third quartiles of the Heritage Foundation/Wall Street Journal Index of Economic Freedom and receive an average rank of 111 out of 177 countries in the United Nation’s Human Development Index (but include the lowest 5 in the index).

These statistics demonstrate the economic and political importance and diversity of countries where Muslims are the majority. But juxtaposed against this complex tapestry is the common faith of Muslims, which is based primarily on two literary works. The most authoritative work is the Holy Qur’an, consisting of divine revelations by the Prophet Muhammad. Another primary source is the Sunnah, a collection of books organized into narrations of the life

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3 Marc A. Miles, et al, eds, 2006 Index of Economic Freedom: The Link Between Economic Opportunity and Prosperity (Heritage Found 2006). Note that this Index measures the overall level of economic freedom for 161 countries by scoring 50 independent variables from 10 categories, including trade policy, monetary policy, wages and prices, regulation, capital flows, property rights and others. Several countries listed in the CIA World Directory as having Muslim majority population were not ranked by the Heritage Foundation Index. Of the thirty-seven Muslim majority countries ranked by the Index, six are ranked in the second quartile (designated as “Mostly Free”), twenty-six are ranked in the third quartile (“Mostly Unfree”), four are in the lowest quartile (“Repressed”), and one country was followed but not ranked by the Index. See also 2006 Index of Economic Freedom, available online at <http://www.heritage.org/research/features/index/countries.cfm> (visited Jan 15, 2007).

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and lessons of the Prophet Muhammad. Among other things, these works establish the laws of daily social life for Muslims, collectively called Shari‘ah. Rules are prescribed for marriage, diet, religious observation, dress, family obligations, and other issues that shape societal behavior.

III. IMPACT OF MUSLIM BELIEFS ON MODERN CORPORATE FINANCE

Shari‘ah prescribes certain rules that apply to business practices, perhaps the best known being the Islamic ban on *riba* (interest or usurious interest). But Islamic finance is complex and is broadly defined as business practices with a base of rules that are generally consistent with Muslim beliefs.

There are numerous ways that Shari‘ah impacts business from a Western perspective. From a philosophical perspective, Muslim ways prescribe a qualitative approach to business based on justice, equality, and fair play. While this approach is not necessarily unique from other religions, the qualitative aspects are combined with specific guidelines for trade. Specifically, Shari‘ah prescribes specific requirements for financial transactions and products in order for them to be compliant with Islamic law. These requirements can be broadly placed into several categories: prohibition of *riba*, prohibition of transactions and products with excessive uncertainty, and prohibited industries. Each is discussed in turn.

A. PROHIBITION OF RIBA

The definition of *riba* has been dynamic and evolving throughout Islamic history and is often the subject of intense debate among bankers and Islamic scholars. More devout Muslims and some social reformers define *riba* as any type of “interest,” and they demand that banking institutions refrain from charging it. Others believe the term refers to “usury,” or excessive compound interest, which is not sanctioned under Islamic law. Also, since Islamic finance

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(1) Those who devour usury shall not rise again except as he rises, whom Satan of the tough prostrates; that is because they say, 'Trafficking is like usury.' God has permitted trafficking, and forbidden usury. Whosoever receives an admonition from his Lord and gives over, he shall have his past gains, and his affair is committed to God; but whosoever reverts-those are inhabitants of the Fire, therein dwelling forever. 2:275.

(2) O believers, fear you God; and give up the usury that is outstanding, if you are believers. 2:275.

(3) O believers, devour not usury, doubled and redoubled, and fear you God; haply so you will prosper. And fear the Fire prepared for the unbelievers, and obey God and the Messenger; haply so you will find mercy. 3:125.
complies with Shari`ah and its prohibition on receiving *riba* on money lent, Islamic financing requires an Islamic bank and its customers to generate profits together.

### B. Prohibition of Transactions and Products With Excessive Uncertainty

The Islamic ban on transactions with *gharar* (excessive uncertainty or risk)—especially when combined with the prohibition on gambling—creates complexities for the appropriate use of many modern financial products including derivatives, options, and futures contracts. *Gharar* also prohibits the sale of things that do not yet exist, which has been interpreted to include the fish a boat may catch on its next voyage, an unborn animal, or a crop that has not yet been planted. These prohibitions impact the ability to sell forward agricultural, livestock, and other commodities as well as businesses oriented toward speculative trading, arbitrage, and related activities.

### C. Prohibited Industries

Financing must be for a worthwhile cause. Certain industries are viewed as inappropriate activities. Generally inappropriate business activities include gambling and casino games, alcoholic beverages, pork consumption, pornography and prostitution, weapons/defense, and financial services dependent on payment of interest (*riba*). Obviously, all of the above activities run counter to Islamic teachings and contributing to them would be seen as being unfaithful to the tenets of the prophet Muhammad (PBUH).

### IV. Challenges and Solutions

Notwithstanding these requirements, Islamic finance is functional, competitive, for-profit, and, in some areas, thriving. From a Western business perspective, the prohibition of interest is the single most challenging concept to adapt to when compared to traditional financing structures. There are two economic perspectives forming the nomenclature of this challenge: supply and demand.

From the perspective of the suppliers, there needs to be an incentive for lenders to provide capital. Prohibiting interest on debt leads many to expect that there would be no debt financing available for Shari`ah-compliant companies. No debt capital would be made available if there were no economic incentives or compensation provided for the time value of money and risk taken by lenders. To attract capital providers at a rate that is competitive with traditional financing, Islamic finance structures must provide alternative incentives to *riba*.
On the demand side, economic theory might predict an infinite number of potential borrowers competing for “no cost” credit. With no “charge” (that is, interest) for the time value of money, there would be an infinite demand for capital—everyone would want 0 percent financing! But this demand partially presumes that the capital could be used for investment in interest-earning ventures to take advantage of the interest rate arbitrage afforded by zero-cost financing. In Islamic finance, interest arbitrage is not allowed due to the inability to collect *riba* from other borrowers. Proceeds from Islamic financial activities must be redirected to non-trading, non-speculative activity such as purchasing tools of production or financing business or household operations.

Financing solutions that accommodate the Islamic prohibition of *riba* can take several approaches. The broader theme involves changing the paradigm of risk as compared to traditional financing methods, where financings are generally structured as either debt (with a fixed rate of return provided, regardless of the performance of the business) or equity (with returns based more completely on performance). Changing the allocation of risk sharing requires a cooperative or mutual sharing approach so that consideration provided to lenders is based more on the performance of the business. Business structures and arrangements that help achieve this shift include joint-venture and limited-partnership structures, which offer greater ability to fine-tune the allocation of risk and return. Rather than receiving a fixed interest rate, a capital provider has an element of responsibility for operations and shares in the potential returns and losses of the business through shared ownership. Some specific Islamic financing structures include: *mudaraba, musharaka,* and *takaful.*

*Mudaraba* is a limited-partnership arrangement with distributions of profit based on relative contributions of capital and management resources. This is a common arrangement, but the terms can vary significantly as to how the parties split the economics of the venture. In a *mudaraba* contract, the entrepreneur is the *mudarib* and the financier is known as the *rab al-mal.*

*Musharaka* is a joint-venture finance structure with two or more partners each contributing capital or labor and sharing the profits and losses of the venture. In the example of a home financing, both the borrower and lender initially share ownership of the property, and *musharaka* is applied as a diminishing partnership. The customer forms a partnership with a financial institution to acquire the home, and the financial institution rents the home to
the client. The total payments under many such contracts are very much like conventional mortgage schedules.

_Takaful_ is often applied in insurance schemes and reallocates the risk-sharing mechanism so that members pool their interests as a means to provide a form of group insurance similar to cooperatives or mutual insurance companies.

**A. RENT OR LEASE VERSUS OWN**

Islamic finance allows both rental and leasing. Sale-leaseback transactions are also permitted. Several instruments are available to customers and clients.

_Ijara_ is a leasing arrangement where the financing source retains title and in essence rents the asset to the customer. Title to the asset remains with the financing source and the customer makes regularly scheduled payments akin to rent or leasing. In most cases, at the end of this period the bank will transfer the title to the customer either by executing a sale agreement for a fair market value or by way of donations to various humanitarian causes. _Ijara wa-Iqtina'_ is similar to a lease but also has an option to purchase the property at the end of the contract's term. Finally, _Istisna'a_ is pre-delivery financing and leasing used mostly

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8 An important new aspect of Islamic financing is the ability to purchase a home through the process of _manqul_. The original scheme, which was introduced in 1997, provides for _murabaha_ financing through a trading mark-up contract. The Islamic Investment Banking Unit that runs the idea is a part of the United Bank of Kuwait, which was established in London in 1966 to serve Kuwaiti overseas financial and commercial interests. In August 2000 it was taken over by the al-Ahli Commercial Bank, which formed a new institution, the Ahli United Bank. This has been registered as an offshore banking unit in Bahrain with its shares listed on the stock exchange in Manama.

There is also the _manqul ijarah_ plan, introduced in March 1999, which has proved much more popular than original _murabaha_ house purchase plans. It is the flexibility that seems to appeal to clients, who can repay larger amounts as and when they can afford to do so to reduce their rental payments. The property is registered in the bank's name, not just initially, but throughout the period of the lease that may extend to twenty-five years. The tenant or lessee agrees at the outset to purchase the entire property eventually, but at the original price that the bank paid without any mark-up. The client's monthly payments comprise three elements. The first represents the repayment of the funds that the bank used to purchase the property. The second is the rent on the property, which is the source of the bank's profit. The rent is reassessed annually to ensure the bank is making a reasonable return and adjusted downward to reflect payments already made. The third element of the monthly payment, referred to as insurance rent, is to recover the cost of the insurance that the bank has to pay on the property. See Rodney Wilson, *Islamic Investment Products Available in the United Kingdom*, available online at <http://www.islamic-banking.com/acom/ibanking/rj_wilson.php> (visited Jan 15, 2007).
when dealing with long-term construction or infrastructure projects and manufacturing.

B. RECHARACTERIZATION OF INTEREST

Some Islamic transactions and financing structures are consistent with certain traditional transactions and financing structures. An example is zero-coupon financing, in which there are no interim interest payments but the principal repaid includes accumulated interest. Another is the murabaha (cost-plus arrangements) in which a product or commodity is purchased by a financial intermediary (that is, a broker or bank representative) and the murabeh (customer or beneficiary) enjoys use of the object while making interim payments to the intermediary. On a cumulative basis, these interim payments are greater than the original purchase price of the product. Title to the object is retained by the institution until all the payments are made by the murabeh. It is important to segment assets so that rent can be paid in lieu of interest payments as a funding mechanism to generate profit. Specific products or situations may combine these methods and mechanisms to resolve Shari'ah compliance in a specific financing context.

To ensure compliance, companies and financial institutions rely on Shari'ah scholars to determine whether a particular transaction structure or financial product complies with Islamic law. Specific rulings or opinions, also known as fatwa, may be made by Shari'ah scholars specializing in finance to certify that the transaction structure or financial product is consistent with Islamic law. This determination may be made for a particular type of product in retail applications or on an individual basis for a complex project. In part because Islamic finance has grown in recent years, there has actually been a reported shortage of Shari'ah scholars possessing the dual expertise in modern finance and Muslim practices required to make such determinations.9

V. PRESENCE AND GROWTH OF ISLAMIC FINANCE

Although in the past local banks in the Middle East and Malaysia held a monopoly on Islamic finance, a number of non-Muslim institutions have begun to offer Shari'ah-compliant services, particularly through the issuance of sukuk (Islamic bonds). The major Western banks currently engaged in this practice include HSBC, Citigroup, Barclays Capital, Deutsche Bank, BNP Paribas, and

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9 Gillian Tett, Banks Seek Islamic Scholars Versed in World of Finance, Fin Times 1 (May 20, 2006).
Similarly, a number of large law firms have Islamic business departments or units. Much of the proliferation of Islamic banking practices appears to have taken the form of non-Muslim banks opening Shari'ah-compliant "windows" or branches in the Middle East. Moody's estimates that over $200 billion individual assets lie in these Muslim "windows," in addition to cash and property assets held by dedicated Muslim banks.

The growth of Islamic finance can be attributed to numerous factors. First, Shari'ah-compliant products are increasingly attractive to capital providers. Islamic financial products will enjoy greater use as their effectiveness increases and the cost differential between traditional and Islamic products narrows. Many banks are already proclaiming their products are cost-competitive with traditional loans. Second, an increase in the wealth of Muslim countries, fueled in many areas by cash windfalls due to high oil prices, has caused Muslim investors to look for Shari'ah-compliant options. Third, an increased regional lending capacity in Muslim-populated areas has created a need for Islamic banking options. Fourth, large-scale development projects in the Gulf region have resulted in lenders entering the market. Fifth, a recent increase in the availability of Shari'ah-compliant products, including an increase in the penetration of capitalist markets, makes product adoption easier. Finally, there has been a growing sense of religious identity among professional Muslims, who are seeking new, tangible ways to express their values and faith.

Overall, Islamic finance is slowly becoming more regulated and practiced in countries where Muslims are a majority and even in countries where Muslim minorities dominate the political and business environments. In fact, the penetration of Islamic finance is becoming more consistent on a country-to-country basis and ranges in extremes, from countries where only Islamic finance

10 Some banking institutions, such as HSBC Holdings, already have an Islamic finance unit and extensive experience through its global operations. HSBC has a significant presence in many Muslim countries, including Malaysia, Pakistan and Bangladesh, and has become a major force in Middle Eastern banking since its acquisition of the British Bank of the Middle East. Its network includes six branches in Bahrain, six in Lebanon, fifteen in the United Arab Emirates, nine in Egypt, and five in Oman. HSBC Holdings also owns a minority stake in the Saudi British Bank that has eighty branches in the Kingdom. These financial networks give the bank unparalleled business knowledge of different Muslim societies.


13 Assif Shameen, A Novelty No Longer; Islamic-Friendly Banking is Spreading, Even Among Western Institutions, BusinessWeek 84 (Aug 8, 2005).

exists to the more common model of Islamic and traditional finance coexisting and competing with or complementing one another. Yet, not all Muslim countries are switching to full-service Islamic financial institutions. In a study conducted in 2004, only Sudan—out of twenty-four respondents—stated that its entire financial market was based on Shari’ah principles. In most other countries, the degree of coexistence varies.

A. SELECTED PRODUCTS AND MARKETS

On the investment side, there are three specific market segments that are noteworthy: money market funds and bank accounts, equity funds, and hedge funds. First, to eliminate *riba*, money market funds and bank accounts are structured so as to share profits, that is, without a fixed investment return. Second, several mutual funds and indexes now specialize in equity investments in Shari’ah-compliant companies, with the primary criteria being the prohibition against certain industries such as pork, gambling, entertainment, traditional financial services, and defense/weapon. Such investment also avoids companies that are excessively leveraged. Even with these criteria, a broad range of companies is eligible for investment. For example, as of June 2006, the Dow Jones Islamic Market Index listed 1,937 companies eligible for investment.

Finally, hedge funds are one of the fastest growing segments in all financing sources. Today it is estimated that there are nearly 9,000 hedge funds controlling over $1 trillion in assets. The first hedge fund to be consistent with Shari’ah was developed by the Saudi Economic and Development Company (“SEDCO”) in the fall of 2003. These funds offer an exciting new area of international finance in which many investors are depositing cash assets that help drive stock markets on the Arabian Peninsula today.


16 With respect to financial ratios, the Dow Jones Islamic Index lists as criteria certain financial ratios for eligible investment, including a maximum of 33 percent for the following ratios: (1) total debt divided by trailing 12-month average market capitalization; (2) the sum of a company’s cash and interest-bearing securities divided by trailing 12-month average market capitalization; and (3) accounts receivables divided by trailing 12-month average market capitalization. See *The Dow Jones Islamic Fund*, available online at <http://www.investaaa.com> (visited Jan 15, 2007).

17 Id.


Islamic finance also offers financing products to four other market segments: (1) consumer mortgages; (2) infrastructure; (3) corporate financing products; and (4) small-business lending and microfinance.

First, Shari'ah-compliant consumer mortgages are offered in many countries around the world including the United States. Many are structured between the bank and homeowner jointly owning the property with payments being roughly equivalent on an economic basis to traditional mortgage payments.

Second, large-scale projects such as toll roads, dams, power plants, refineries, telecommunications projections, and others may be financed with public and private funds and structured on a joint-venture basis. Many large-scale projects will have specific Shari'ah consultants to ensure compliance with Islamic law.

Third, corporate financing products include companies needing to finance acquisitions, growth, and development. A pioneering transaction in this area was the first Shari'ah-compliant high-yield financing for Loehmann's, an American retail chain that was acquired by Crescent Capital Investments. By incorporating some aspects of a traditional sale-leaseback structure, the company was able to raise, in essence, high-yield bond financing in compliance with Islamic law.20

Finally, 2005 was declared by the General Secretary of the United Nations to be the “International Year of Microcredit.”21 This form of small-business financing has been used in developing markets to increase economic activity and can be adapted to local practices including Islamic finance. Interest in Islamic microfinance is driven by several factors:

(a) Flexibility to suit local socioeconomic and cultural characteristics;
(b) Potential demand for tailored microfinance services;
(c) Strong demand for Islamic banking services in low- and middle-income Muslim societies;22

22 Such countries, particularly in Africa, appear to be increasingly fruitful areas for Islamic banking. Much of the current activity in these countries appears to be driven by governments. The hope is that implementing Shari'ah-compliant financial practices will increase their countries' attractiveness to Islamic financiers. One example is the Kenya Commercial Bank's July 2006 launch of a new interest-free Islamic banking account. Earlier this same year, the Kenyan Minister of Finance had announced that Kenya's Banking Act was being amended to accommodate Islamic banking. Kenya's chief qadi (Islamic judge), stated in a late July press interview, “I believe [Kenya Commercial Bank] has realized that for it to attract more Muslim customers it must
(d) Commercial banks’ view of Islamic microfinance as an opportunity to reach an attractive niche and create loyalty;

(e) Common principles with socially responsible financial objectives; and

(f) Sukuk financings by government and quasi-government entities.

VI. NODES OF ISLAMIC FINANCE: LONDON AND THE ARABIAN GULF

London has become the largest international center for Islamic finance outside the Muslim world, largely as a result of the city’s role as a hub for Middle Eastern and Asian banking. Treasury management facilities are provided on behalf of Islamic banks in the Gulf, and Islamic fund management and promotion is becoming more significant. Possibilities for Islamic electronic financial services are opening, and London is the major center for information gathering and dissemination on the Islamic banking industry. The British government has been an active driver of this growth. In 2003, for example, it enacted regulations that supported the Islamic mortgage market, which by 2006, was valued at $950 million.

Yet London’s role in serving the British Muslim community has been disappointing. Despite almost two decades of experience with Islamic financing, there are few retail products available. (To be fair, there are inherent difficulties in reaching the audience in question.) The Muslim community in the United Kingdom numbers more than 1.5 million British citizens and permanent residents, with up to another 500,000 temporary residents including students and visitors. However, the community is ethnically and linguistically diverse and geographically scattered, all of which makes marketing aimed at attracting the attention of that community a major challenge.

Although casual evidence suggests there is a greater propensity on the part of the British Muslim community to use cash for transactions than other products include underwritings by the International Finance Corporation and the government of Malaysia.


24 These products include underwritings by the International Finance Corporation and the government of Malaysia.


27 See generally Karasik and Benard, Muslim Diasporas (cited in note 25).

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segments of society, the demand for banking and financial products is not markedly different from the national average. Some devout Muslims avoid using conventional interest-based banks. Others do use them, but donate interest earnings to charity in an attempt to purify their income. Indeed, the majority use conventional financing services, largely because they have little alternative. Like the rest of the population, they also tend to have greater trust in large retail financial institutions with established brand names.

In the Arabian Gulf, the demand for Islamic investments is growing as oil money pours into the Arabian Gulf nations including Saudi Arabia, Kuwait, and Qatar. About $3.5 billion was raised from the sale of Islamic bonds in the Gulf in 2005 as part of the record $7.6 billion sold worldwide. The sale of these sukuk in the Middle East may increase at an average annual rate of 45 percent over the next 4 to 5 years. The Islamic bond market is based on Shari'ah law, which forbids receiving or paying interest as discussed above. Such bonds are typically backed by assets sold to a special-purpose company which then rents them back. The popularity of such instruments is growing rapidly with Saudi Arabia now launching an $800 million effort with Saudi Basic Industries Corporation in order to raise expansion capital in the chemical sector. This trend continues to dominate the financial institutions of the Islamic banking sector throughout the Gulf region and is a major initiative driving modernization in Gulf societies while maintaining social order in turbulent times.

One problem that currently constrains the growth of Islamic banking institutions is the paucity of qualified Islamic scholars who can interpret the classical sources in light of today's modern fiscal challenges. In order for Muslims to perceive a particular banking service as "Shari'ah-compliant" it must receive a fatwa (religious ruling) from a credentialed, established cleric. This scholar must possess a rare combination of intellectual assets—a thorough grounding in classical fiqh (jurisprudence), as well as a solid understanding of modern micro- and macro-economics. According to Dar al-Istithmar, a London-based consultancy, there are roughly a dozen such scholars worldwide. Consequently, a number of Islamic banks have begun to fund programs to train scholars in the jurisprudence of modern finance. Given the fees that such experts command for providing their religious imprimatur on banking—a common estimate is $300,000—these programs will hopefully attract a new generation of Islamic legal scholars who will strive to harmonize traditionalism

28 Id at 463.
29 These numbers come from proprietary RAND interviews conducted with Dubai business leaders in the United Arab Emirates during 2005–2006. Interviews are on file with authors.
30 Id.
and globalization by offering fresh, innovative interpretations of the classical Islamic sources.\textsuperscript{31}

In the face of these optimistic trends, there is another powerful presence in ongoing Islamic debate that could retard the maturation of Islamic finance and jeopardize its integration into the global market economy. This view is encapsulated in the pronouncements of the obscurantist, puritanical strand of Islam known as Salafism. To understand how this ideological force could impact the evolution of Islamic finance, we must examine the writings of one of its major spokesmen on issues of banking and finance.

VII. A SALAFI VIEW OF ISLAMIC FINANCE: SHAYKH HAMID AL-‘ALI

Examining Islamic finance from the point of view of Salafi ideologues is important because of the enormous impact on the global economy of Salafism’s primary patron state, the Kingdom of Saudi Arabia. Here, Wahhabism, a variant of Salafi ideology named after Saudi Arabia’s religious progenitor, Muhammad Ibn ‘Abd al-Wahhab, casts a long shadow over Saudi Arabia’s political dynamics and foreign policy.

Broadly defined, Salafis across the globe are united by a common creed that seeks to emulate, in all spheres of human activity, the example of the “pious predecessors” (\textit{al-Salaf al-Salih})—the Prophet Muhammad, his companions, and the first three generations of his followers. Consequently, doctrinaire Salafis are extremely hostile to the idea of \textit{bida’} (innovation) in the legal interpretation of classical texts, in forms of government, and particularly in financial transactions.\textsuperscript{32} Despite their fixation with the emulation of classical Islamic social norms, modern Salafis appear to have reconciled other aspects of their belief system with globalization and modernity—they have certainly embraced modern medical treatments, cellular technology, and the Internet. Still, influential Salafi ideologues, particularly those who espouse support for violent jihad, have advanced an interpretation of Islamic finance that is unyieldingly hostile toward globalization and designed to maintain the strict purity of the conservative Islamic community. Much of their justification for forbidding any financial interaction with Western-based systems stems from the Salafis’ core tenet of \textit{al-}

\textsuperscript{31} Tett, \textit{Top Scholar Hails Boom}, Fin Times at 1 (cited in note 2).

wala’ wa al-bar’a (loyalty and disavowal), exhorting Muslims to associate only with fellow Muslims and disavow all ties—economic, political, and social—with non-Muslims.\(^3\)

The influential Salafi cleric Hamid al-'Ali has been a vocal and prolific voice on this issue, effectively calling for economic apartheid between Muslims and non-Muslims. Al-'Ali’s Saudi-based education and subsequent career is fairly typical for a number of major Salafi ideologues who have offered exclusionary interpretations of Islamic finance. According to his biography—posted on an Islamist website—Hamid al-'Ali was born in 1960 in Saudi Arabia and received his master’s degree in Qur’anic Sciences from the Islamic University of Medina, a major intellectual hub for Salafi ideology.\(^3\) After moving to Kuwait, he was the Secretary General of the Kuwaiti Salafi Movement from 1997–2000, a professor of Islamic culture at the College of Islamic Education, and a mosque imam in Kuwait City. In 2003, he received a two-year suspended prison sentence for publicly opposing Kuwait’s stance on the Iraq war and was released in November 2005.\(^3\) In December 2005, he was acquitted by a Kuwaiti judge of conspiracy charges against the Kuwaiti government.\(^3\) Among the virtual jihadi community, his pronouncements continue to enjoy wide popularity.\(^3\) He has written on diverse topics such as the Iraq war, suicide operations, globalization, and economic boycott.\(^3\)

These last two items—globalization and economic boycott—illustrate a critical paradox in broader Salafi interpretations of Islamic finance. On the one

\(^3\) For the doctrinal roots of this idea in early Islamic history, see Patricia Crone, *God’s Rule: Government and Islam* 25–26 (Columbia 2004).

\(^3\) A critical paradox of the Saudi kingdom is that its major religious universities cultivate an ideology that is doctrinally hostile to globalization, yet the royal family continues to undertake a number of reform and modernization efforts. For more on the Kingdom’s fiscal policies, see Paul Aarts and Gerd Nonneman, eds, *Saudi Arabia in the Balance: Political Economy, Society, Foreign Affairs* 111–81 (NYU 2005).

\(^3\) See personal biography, available online at <http://www.islamway.com/?iw_s=Scholar&iw_a=info&scholar_id=500> (visited Jan 15, 2007).


\(^3\) His writings have frequently appeared on Islamist chatrooms. See, for example, al-Meer, archived copy available online at <http://web.archive.org/web/20060521071222/www.almeer.net/vb/> (visited Jan 15, 2007); al-Sakfah, archived copy available online at <http://web.archive.org/web/20060526183325/http://www.alsakfah.org/> (visited Jan 15, 2007); and Islamway, available online at <http://www.islamway.com> (visited Jan 15, 2007).

\(^3\) The Norwegian scholar of transnational jihadism, Thomas Hegghammer, has identified Hamid al-'Ali as "the most important mufti for jihadist groups operating in Iraq." See Thomas Hegghammer, *Global Jihadism After the Iraq War*, 60 Midd. E J 11, 19 n 24 (2006).
hand, these clerics are virulent opponents of globalization, arguing for the establishment of Muslim-only banking systems and for capital management by Muslims, for Muslims. Yet this effort to impose barriers to market integration would appear to threaten a number of their strategies for confronting the US and, more broadly, the West. Many of these same figures have called for *jihad al-mal* (financial *jihad*) encompassing a range of tactics, from divestiture to consumer boycott. These are actions that appear to exploit precisely the same economic interdependence that the Salafi clerics decry in their rulings on Islamic banking. To further illustrate this strategic quandary, we need to examine some of al-’Ali’s representative texts on globalization, Islamic banking, and economic boycott.

On globalization, al-’Ali has authored an article that decries the morally corrosive effects of global economic integration. In particular, he attacks the serialized book, *Hawiya bi-la Hawiya: Nahnu wa al-’Awlama* (Identity With No Identity: Ourselves and Globalization) by noted Saudi reformer Turki al-Hamid, who has argued that Saudi religious culture is incompatible with globalization. According to al-’Ali, al-Hamid’s endorsement of globalization is repulsive precisely because it “ demolishes the barriers between Muslims and non-Muslims.”

To keep these barriers intact, al-’Ali has also authored texts on the principles of Islamic economics, as well as a more practical guide on Islamic banking. Here, he argues that the ultimate purpose of Islamic banks is not merely to provide financial services, but rather is closely linked with the Salafis’ larger goal of preserving the doctrinal purity of the worldwide Islamic community. Specifically, he argues that the aim of Islamic banking is “the liberation of economics from its enslavement to non-Muslims.” The subordination of international banking transactions and monetary policy to non-Muslims, he believes, has led to the religious alienation of Muslims across the

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40 Id.

41 Id.


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globe. To end this predicament, he proposes a series of specific fiscal steps in the following areas:

1. Banking Transactions: Establish Islamic banks in Muslim countries to promote banking transactions between Muslims, support investment in domestic projects that will benefit Muslim youth, and open lines of credit specifically for Muslims.

2. Monetary Policy: Establish an Islamic currency standard that rivals or exceeds the international strength of the US Dollar.

3. Capital Investment: Keep capital inside Muslim countries, invest in Muslim projects, and ensure that capital is administered “by Muslim hands.”

Al-‘Ali appears particularly concerned with this last point and divides “the accumulation and investment of Islamic capital” into discrete sub-tasks, further emphasizing his focus on creating a separate, autonomous Islamic financial sphere. Accordingly, Islamic banks should: invite capital owners to invest in long-term projects that will benefit Islamic countries; limit inflation; encourage direct trade and financial transactions between Muslim countries, with no interference from international, non-Muslim banks; and establish free trade zones. Ironically, al-‘Ali admits “with great sorrow” that this goal has already been attained not in the Islamic world but rather co-opted by Europe and the West—regions that provide interest-free loans to business developers and investors in Islamic countries.

Al-‘Ali’s utopian vision of Islamic finance was confronted with a glaring contradiction during the aftermath of the publication of an offensive picture of the Prophet Muhammad in a Danish newspaper in early 2006. Here, a number of Salafi clerics urged the economic boycott of Danish goods—a strategy that exploited the interconnectedness of the global consumer economy. Al-‘Ali joined the fray. In his nearly thirty-three-minute audio message entitled “The Cutting Sword Against the Blasphemer of the Chosen,” posted to the al-Meer jihadi forum on February 3, 2006, al-‘Ali urged his listeners to expand the boycott to other Muslim issues such as Palestine. He appeared surprised that Muslims had gone to such great lengths over a small country like Denmark, believing more appropriate targets to be the United States, the European Union, and the World Trade Organization.

This expansion of economic boycott to the global stage received approval from a number of Salafi luminaries, many of whom define the West’s war with Islam as a struggle without boundaries. The well-known Saudi cleric ‘Ali bin-Khudayr al-Khudayr, in an undated article, argues that since the “Crusaders’

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44 Id.
war” has targeted Muslims on numerous fronts—military, cultural, social, and economic—consumer boycotts “are one of the most powerful and damaging forms of popular resistance [and] everyone who is able to participate should.”

Similarly, a book published in February 2006 by an al Qaeda affiliated media outlet, argues that economic jihad is designed to safeguard Islamic economies and encompasses much more than boycotts and propaganda, such as violent attacks on oil infrastructure. A seven page article entitled, Al-Qa’ida’s Battle Is an Economic Battle and Not Military, is even more explicit in arguing that America’s global interdependence with Gulf state economies is at once the basis for its strength, but also a useful vulnerability. The article continues with an exhortation to attack Western economic nerve centers in Wall Street, Venezuela, and Saudi Arabia.

Clearly, Salafi definitions of Islamic finance, with their ritualistic focus on ideological purity and the exclusion of non-Muslims, provide useful rhetorical cover for violence against Western economic targets. However, calls for a separate Islamic economic sphere would appear to contradict the growing trend in al Qaeda targeting which exploits, rather than severs, the interconnected web of globalization.

We are therefore likely to see the puritanical Salafi interpreters of Islamic finance become eventually overpowered by two other voices within the broader Islamic community: the entrepreneurial clerics in London and Dubai who aim to harmonize traditional Islamic discourse on finance with the challenges of modern banking and the jihadi operational commanders who have identified the West’s growing intermingling with Muslim economies as an expedient targeting opportunity.

VIII. Future Challenges and Conclusion

As advances in Islamic financial products continue, the chasm between Western transaction structures and what was previously thought to be achievable under Shari’ah structures is beginning to blur. Islamic finance, in both theory

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48 Site Institute, Al-Qaeda’s Battle is an Economic Battle and Not Military (Oct 27 2005), available online at <http://siteinstitute.biz/bin/articles.cgi?ID=publications112505&Category=publications&Subcategory=0> (visited Jan 15, 2007).

49 Id.
and practice, has shown itself capable of accommodating and advancing globalization. The six-nation Gulf Cooperation Council is set to lead the way in Islamic bonds, relying on rich domestic investors keen for Islamic assets. In 2007, the People's Republic of China is set to launch its first Islamic bond with a $200 million deal with Kuwait Finance House for a Chinese power company. And further changes may be coming. The concepts of fairness and compassion embodied in Islamic finance, which may deter many forms of vulture-like investing as practiced in the US, may be viewed differently if, as, and when defaults occur in Islamic finance products or in the context of broader international economic events. And increased acceptance by religious scholars to topics such as futures, options, credit default swaps and other Western finance products are likely to be a one-way street; that is, the interpretation of uncertainty and other prohibitive factors can be parsed and repositioned as one gains a more thorough understanding of these western products.

Thus, finance and banking are contested arenas within the broader sphere of Islamism. In this sense, the maturation of Islamic finance and its full integration into the global economy is inextricably linked with the larger war of ideas in the Islamic world: between obscurantism and rationalism; traditionalism and modernity; and extremism and moderation. Salafists such as al-'Ali are voicing their concerns about these latest trends in Islamic banking. The fact that the radical clerics have been unable to resolve the fundamental tension between their calls for disengaging Muslims from financial interdependence with the West and exploiting the very forces of globalization they condemn appears to be cause for guarded optimism in this generational struggle.

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