

Hossein Askari, Zamir Iqbal and Abbas Mirakhor
Globalization and Islamic Finance: Convergence, Prospects
and Challenges

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Reviewed by:

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For those who are interested in the issue of the relationship of globalization with Islamic finance and are very short on time to read the whole book or even few chapters of it, section 1.4 (pp: 28-29) will do. Others who have a little more time to spare, chapter 7 (Conclusions and the Future of Islamic Finance) will offer a little more perspective on the issue.

The main objective of the book is to answer the question: will spreading the phenomenon of globalization lead to convergence or diversion between Islamic finance and conventional finance?

The main difference between Islamic finance and conventional finance lies in the management of risk in finance. While Islamic finance is supposed to rely on equity as a tool of financing projects and transactions, conventional finance is debt-ridden. The truth of the matter is that Islamic finance has recently inclined towards debt financing because of logistic, administrative and moral hazard factors, thus approaching to conventional finance except for dealings based on interest.

On the other hand, conventional finance's attempt to reproach equity dominated dealings is influenced by several factors prominent among which are the extent of trust in investment necessary for risk-sharing and equity participation, property rights and enforcement of contracts, the existence of legal institutions, transparency, accountability and corporate governance.

The structure of the book starts by delineating the main concepts. "A Brief History of Globalization and Islamic Finance" (Chapter1) introduces the concept of " Globalization " and its relationship to Islamic finance. The chapter concludes with a subtitle (1.4) explaining concisely the core theme of the book which attempts to answer the question whether globalization contributed to the convergence Islamic finance with conventional finance or otherwise, thus probably summarizing the theme content of the book (see first paragraph above in page 1).

Chapter 2 focuses on the "Consequences of Globalization: Convergence or Divergence with Islam". Through its promotion of the international trade and flow of capital, labor, technology and financial services, among others, globalization has enhanced growth, income distribution, poverty alleviation and regulation of financial services, thus raising the possibility of compatibility and convergence with Islamic finance.

However, some questions have to be answered, significant among which are:

1. Is the relationship between globalization and Islamic finance reciprocal or one-sided effect from the first to the second?
2. Is there a possibility of reconciliation between globalization and Islamic values?

How both Islamic and conventional finance are affected by the globalization process is explained in chapter 3. Starting from tracing the emergence and development of Islamic finance as well as conventional finance, the authors proceed to explain the mechanisms through which globalization affected this growth and development. Factors that influenced the stability of and relationship between Islamic finance and conventional include, according to the authors, : the extent of credit creation and expansion, speculation and the degree of risk-sharing.

Chapter 4 exposes the pitfalls of the existing conventional financial system, mainly extensive deregulation of the financial sector, the fractional reserve requirement and the subsequent power of credit creation by commercial banks, over-leverage due to interest-based financing and the detachment of real assets (real capital base) from credit expansion. Islamic finance, on the other hand, albeit theoretically, is based on non-interest trade and production activities, 100 percent reserve banking and risk in financing is attached to returns from investment operations and not to the capital of the financial institutions. Lessons for Islamic financial system from the recent international crisis concludes the chapter.

Supported by tabled data, chapter 5 traces trends in the development of Islamic and conventional financial globalization, growth in Islamic finance in the Islamic as well as non-Islamic countries and explains the factors that contribute most to the convergence process of Islamic and conventional financial systems, prominent among which are: the recent experience of the international financial crisis which showed the vulnerability of the conventional financial system in terms of observed instability, expansion of the flow of capital across borders and the growth of Islamic financial institutions in the markets of non-Moslem countries and the accumulation of surplus capital in the oil producing Islamic countries.

Meanwhile, the authors expect that extra liquidity in Islamic financial institutions and depressed asset prices in developed countries financial markets have facilitated the globalization of the Islamic financial system.

The institutional and legal infrastructure of the Islamic financial system dominated the contents of chapter 6. In this regard many lessons can be learned from the conventional financial system. Functions that are expected to enhance the efficient operation of the financial system include: efficient capital mobilization, efficient risk allocation, pooling of resources and diversification of ownership, efficient contracting, transparency and price discovery, better governance and control and operational efficiency.

Chapter 7 is devoted to "Conclusions and the Future of Islamic Finance". The subtitled contents of this chapter include: the future of globalization, the evolution of financial globalization, the expansion of risk-sharing and the likelihood of convergence.

Conclusions and the future of Islamic finance constituted the main content of the last chapter 7.

An extensive and relatively updated reference list (23 pages) terminates the book contents.

I must confess globalization as a concept perplexed me, especially when applied in reality to the financial sector, whether Islamic or conventional. Detecting whether a financial activity is globalized or otherwise is not an easy task. The recent international financial crisis and the advent of the domino effect of financial activities across borders is a clear example of how globalized is the financial arena. The benefits and desirability of such development is much a controversial issue. While some would argue that globalization contributed to a great extent to the movement towards regulation and supervision of the

financial sector, more transparency and governance in the financial institutions, others would argue that globalization has reflected negatively on the international financial scene in terms of side effects which include:

1. Income disparities.
2. Imported inflation and swift capital movements harmful to national economies.
3. The domino effects of the recent international financial crisis.

Globalization may be slowed down by several factors prominent among which are: adverse effects on income distribution within countries which were most exposed to globalization, growing nationalism and fear of outside cultural and social effects, failure to achieve considerable gains in the WTO trade liberalization negotiations (Doha Trade Round) and the contagion cross-border effects of the international financial crisis.

However, globalization is expected to proceed . though with different paces and higher doses of supervision and regulation, particularly in the financial front.

The issue of convergence or divergence between Islamic finance and conventional finance is a legitimate one. When we diagnose the subtlety of the issue , we are faced with questions like which one is converging into the other or diverting from it and the extent of the role of globalization in facilitating such movement. No informed person on the history of Islamic finance versus conventional finance can deny that the process of convergence is more prevalent. However, the reasons behind such advancement is not easy to identify clearly. Though globalization may have contributed to such proximity, economic pragmatism and opportunism have been more detrimental. Recent tendency of international conventional finance to rely more on equity financing and risk-sharing schemes, innovations in financial instruments and the benefiting of Islamic financial institutions from conventional financial research and techniques are just few significant factors that facilitated the process of convergence.