DE-SECULARIZING FINANCE: ISLAMIC BANKING IN PAKISTAN

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Abstract

by

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Finance is conventionally associated with modernity and secularization, yet in recent decades Pakistan has seen the institutionalization of *shari'a* – observant, desecularized banking services. How and why did Islamic Banking and Finance emerge in Pakistan? How did Islamic economic theory begin to challenge conventional economic theory, and what were the barriers to its implementation? What role did various religious groups play in this process? How does Islamic banking function, and what does it mean to Islamic bankers themselves? I explore these questions using content analysis of the earliest publications of Islamic theory, semi-structured interviews with Islamic bankers and *shari'a* board members, and participant observation at an Islamic bank.

I found that there were two historical cultural discourses that gave rise to two norms of exchange. The first norm was to strive for *halal* income for individual Muslims. It was generated by the traditional Islamic discourse focusing on following the eminent Islamic jurists of the past and deliberately avoiding engagement with Western thought. The second norm was to provide a socially just economic system. This norm was formed by non-traditionalists who also take into account the spirit of the law and directly

engaged with the West, albeit in a reactionary manner within a colonial context. The traditional approach has successfully institutionalized because it was able to align smoothly with the conventional financial system. There are a number of implications of these observations. Although political concerns play an important role, they work alongside cultural processes. De-secularism does not work if it is enforced but, as a social process, it takes a pragmatic and non-confrontational route. Period and level of analysis are important for any understanding of de-secularization processes, as Pakistan's economic system has been secular, de-secular, then re-secularized in the past three decades. Now, Islamic finance is successfully institutionalized at the meso-level i.e. the market. As well as studying institutionalization at the macro level, I examine institutionalization "on the ground". The form focused industry is primarily institutionalized by regulative mechanisms like *shari'a* audits but some normative aspects exist. IBF is a modern institution that enables Muslims to lead a meaningful life while participating in the un-precedently globalized world.

This dissertation is dedicated to my wonderful parents and to my husband, Khurram Janjua, who raises the bar for what marriage should be all about.

CONTENTS

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CHAPTER 1:

INTRODUCTION

1.1 Overview

Late 1970s saw the rise of a unique entity, the Islamic bank, in the Middle East as well as in East Asia. This concept of an Islamic financial organization was so successful that it quickly expanded to a $700 billion industry and has now become a relatively stable institution with major hubs in the Arabian Gulf, East Asia and UK. In the private sector, there are Islamic financial companies that handle commercial and investment banking, mortgage lending and insurance agencies, and there is also a multilateral development bank. Dow Jones has created an Islamic index to help investors keep track of Islamically tradable companies. Many governments have recently issued Islamic bonds and this market has taken off to a great start. This tremendous growth has prompted the creation of various transnational regulatory agencies whose function is akin to Basel and International Accounting Standards (IAS) (Smith 2007). This vibrant niche industry is based on certain *shari'a* (Islamic law) derived principles. It is theoretically characterized by the absence of interest-based financial contracts and doubtful transactions in Islamically unlawful products.

Standard economic modernization frameworks derived from classical sociological theory (Marx 1976; Weber 1991), lead us to expect increasing differentiation between the religious and economic realms as well as an increasing autonomy of economic pursuits from religious values and goals. The recent rise and diffusion of Islamic banking defies these expectations on several fronts, and it is one of the aims of this project to explore the theoretical implications of this development. The core theoretical concern is with the specific way in which Islamic financial institutions deploy particular discursive and practical strategies of action in order to contest and challenge the established financial practices inherited from the West, as well as how they negotiate and adapt to the institutional cross-pressures that emanate the economic and religious realms[1].

I approach these theoretical concerns by observing the institution of Islamic finance in Pakistan. In 2002, Pakistan's first Islamic bank came into existence. The timing of its creation was interesting from two perspectives. Firstly, it was late by two decades considering that Islamic banking and finance (IBF)[2] was thriving in the Arabian Gulf, Malaysia, and it even had presence in UK and North America. Secondly, Pakistan's first Islamic bank was formed not under the Islamist military dictator, General Zia-ul-Haq, but under the "modern" "enlightened" military dictator General Musharraf. These anomalies beg a deep investigation into the rise of IBF in Pakistan. Drawing on in-depth interviews with IBF professionals in Pakistan, two month participant observation in an IBF institution, content analysis of Islamic finance literature produced in Pakistan, as well as secondary literature, I examine the formation of this industry and the functioning of this sector.

The complex interaction amongst the forces of post-colonial ideational movements, international and domestic political events, and the role of the state and

[1] Thanks to Omar Lizardo for this phrasing

[2] I will follow Maurer (2005) and shorten the reference to IBF throughout this dissertation

market institution provide a particularly illuminating instance of the development of a de-secularized institution in contemporary times and its subsequent institutionalization. Included in my analysis is the deep sense of unease felt by ordinary Muslims about not being able to avoid violating a fundamental prescription of their faith in their day to day financial dealings. IBF in Pakistan serves as an important cultural institution in providing its participants the repertoire to deal with their religious obligations and livelihood concerns.

1.2 The Islamic Financial Industry

The Islamic finance industry experiences the same sort of perceptions that are faced by Islam in general. In a survey, European and American bankers were asked what ideas and notions come to mind with Islamic finance, the following were cited: 'monolithic', 'rigid', 'anti-Western', 'incompatible with modern finance', 'archaic', 'oil-money', 'BCCI', 'terrorism', 'Arab' (Warde 1997). Needless to say, these standard stereotypical responses do not reflect the immense diversity of regions, cultures, political and historical trajectories within the Muslim world in general and the IBF in particular. Ibrahim Warde (2000) rejects broad generalizations describing the industry because:

> Islamic financial institutions come in all shapes and forms: banks and non-banks, large and small, specialized and diversified, traditional and innovative, national and multinational, successful and unsuccessful, prudent and reckless, strictly regulated and freewheeling, etc. Some are virtually identical to their conventional counterparts and some are remarkably different. Some are driven by religious considerations, others use religion simply as a way of attracting customers (Warde 2000, 2).

1.2.1 Islamic Financial Institution (IFI)[3]

An Islamic financial institution is a financial institution that performs its functions following certain Islamic principles in one form or another. IFI's services are the same as those performed in any conventional financial institution and include banking services of checking and saving accounts, "loans", as well as mutual funds and insurance companies. The stated goal of these institutions is to provide *halal* (Islamically permissible) earnings to its customers.

If one could make an ideal type of an Islamic financial institution, its basic features would be (Bahrain Monetary Agency 2002 in Ahmad 2007):

1. Prohibition of Islamically un-lawful financing arrangements and business practices. The most important prohibition in Islamic finance is the prohibition of *riba* (interest or usury). This means not only that financing transactions are structured differently than in conventional finance, but also that the asset structure of the institution is based entirely upon tangible assets and partnership arrangements instead of on interest-based financial assets. *Gharar* (speculation) and *maysir* (gambling) are prohibited, as well as trading in *haram* (Islamically forbidden) goods such as alcohol, pork, pornography, casinos and owning equity in *riba*-based institutions (Lewes and Algaoud 2001).
2. The presence of a *shari'a* advisor or a *Shari'a* Supervisory Board (SSB) composed of Islamic scholars. The purpose of the *shari'a* advisor or the SSB is to insure that Islamic law is being followed accurately in the business practices and

[3] The following analysis is informed by Ahmad (2007)

financial arrangements of the IFI. A member of the SSB (called a *shari'a* scholar) has been trained formally in Islamic law, but is not necessarily an expert in finance. A separate financial standards board evaluates the efficacy of financial transactions, just as it does in a conventional institution, and the two boards often work together (Ahmad 2007).

1.2.2 A Contemporary Industry

The Islamic injunctions on which the Islamic economic theory is based were revealed to Prophet Mohammad, almost 1400 years ago at the advent of Islam. However, there were no financial institutions at the time and the type of finance that was conducted was trade finance, where the individual merchants would satisfy the financial needs of the community. This arrangement was very similar to the practice of merchant lending that was being practiced in Europe at the same time (Udovich 1979). Mohammad was a trader by profession and was employed by Mecca's wealthy business woman Khadija. Thus trade and commerce was the chosen profession of Muslim's most revered personality, the ideal-type of a practicing Muslim's imagination. Trade and commerce flourished during the height of Islamic civilization and a large body of *fiqh* (jurisprudence) has been produced by Islamic jurists concerning the regulation of these economic activities; however, these rules did not give rise to an Islamic financial system until the 1970s (Kuran 2004).

Windfall profits from the 1970s oil boom in some of the Arabian Gulf states are considered to be the major cause of the establishment of the first Islamic banks. The 1980s saw mushrooming of IFI all across the Muslim world and 1990s saw the emergence of these institutions in the West, with the UK vying to establish itself as the hub of IBF.

1.2.3 A Growing Industry

In the past three decades, there has been a tremendous boom in the Islamic finance industry. The approximate numbers of Islamic financial institutions stand at around 300. They are operating in at least 23 countries and have more than US$200billion in deposits with an incredible growth rate of 15% a year (Nasr 2009). Not only are there indigenous Islamic financial institutions owned and operated by Muslims, but mainstream institutions like the City Group, HSBC, UBS, and Deutsche bank have very vibrant Islamic finance divisions (Haniffa 2007). The potential clientele is a billion Muslims. Those offering Islamic financial services have a diverse religious and institutional background. It is significant to note in this regard that the cutting-edge Islamic economic theory is primarily being developed in Western academia (Warde 2000).

1.3 Research Agenda

I pursue two main research questions in my dissertation. First, what are the factors and mechanisms that influence the emergence of a de-secularized (market) institution in the contemporary modern world in general and Pakistan in particular? In what ways are modernization theories challenged by this emergence and how do the de-secularized institutions make their mark in contemporary times? The two salient factors are noted to be cultural frameworks and political processes. It is one of the major arguments of this dissertation that the Islamic financial institution would not have emerged in absence of the strict Qur'anic injunction regarding *riba* (usury/interest). Another point that comes to the foreground is that some sort of political patronage is essential for the establishment of an Islamic finance institution, but forced conversion of a conventional economic system into an Islamic one is not long-lasting in Pakistan's context. Lastly, I show how cultural discourses and political processes play their role in the re-secularization of the state but de-secularization of an industry, dispelling the blanket statements depicting Pakistan to be an 'Islamist' state. The historical perspective emphasizes that Pakistani state policies in *economic* realm have been changing: secular at the time of independence, de-secular in 80s, secular and oppositional to the Islamists in 90s, and patronizing private sector de-secularization in the new millennium.

The second research aspect that I attend to is the functioning of the Islamic bank. I ask as to how this institution is surviving in a dominant conventional banking environment? To what extent do the Islamic bank and its members follow the institutional logic of the Islamic finance industry? And most importantly, what does this organization mean to its members? In this regard, I find that the bank is largely following the institutional logic of focusing on the letter of the Islamic law, rather than the substance of the law. One of my main contentions in this research is that we can predict that the Islamic finance industry will survive in the long run because it is fulfilling the spiritual need of Muslims to adhere to the principles of Islam at least in letter, even if the spirit of the law is lacking. Most mid-level Islamic bankers realize a disconnect between Islamic economic theory and its practice and have formed their assessment of this anomaly.

In the remainder of this chapter I will first explain why the prohibition against interest is significant in a Muslim's imagination. Next, I will introduce Islamic economic theory and practice. Since my research site is Pakistan, I will briefly relate why I choose Pakistan as the study location. The subsequent section is on methodology. I will conclude by giving a summary of the remaining chapters.

1.4 *Riba* Prohibition- A Triggering Factor for IBF

Four instances where *riba* is mentioned in the Qur'an[4], have formed the cornerstone of Islamic economic theory and I contend that without these verses, there would not be such an elaborate Islamic economics theory nor, consequently, an Islamic finance industry. The social, political, historical, cultural, and economic intricacies related to the emergence and evolution of this economic theory and its practice will be detailed in the next sections. For now, I will relate the standard methodology used to study Islam, the basic tenents of Islam that form the foundation of Islamic economics and how Islamic economic theory compares with conventional economic theory.

Pious Muslims believe that the Qur'an (lit. The Recitation) is the word of Allah (God). Rather than any person taking the supreme religious authority, this word of God is placed at the highest level of authority. Muslims believe that the original Arabic text of the Qur'an is the exact word that was revealed to Mohammad in the 7th century Arabia. This text remains exactly the same as it was some 1400 years ago among a billion

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[4] Qur'an 2:275-81, Qur'an 3:129-30, Qur'an 4:161 and 30:39. Also see Rahman (1964)

Muslims today[5] (Esposito 1992, Euben 1999). Since Arabic is the native language of only 15% of the Muslims, the Qur'an is translated for the vast majority of non-Arabic speakers. Scholars versed in the history, culture and language of 7th century Arabia, translate the Qur'an in their local language. As with any text, interpretation is variable and many times contested. This process has been going on throughout the Islamic history, as each scholar interprets the Qur'an according to their understanding of the circumstances at the time. Many of the traditions and events mentioned in the holy books of the other two Abrahamic religions of Judaism and Christianity are narrated in Qur'an as well. For example, the Qur'an includes the stories of Noah and Moses, as well as the story of Jesus's birth (Ahmad 2007).

Aiding in the process of interpretation are the *hadith* (reported practices and sayings) of Mohammad which stand at the second highest order of canonical authority. The reason for this high regard is not just because of Muslims' belief that Mohammad was a prophet and God's messenger, but also because the Qur'an was revealed over 23 years of Mohammad's life, depending on the prevailing circumstances in his life. Thus the study of Mohammad's personality, his life history, practices, and sayings are deemed by the mainstream to be an essential component to understand the meaning of the Qur'an. One of the most significant problems in this endeavor is that Mohammad's *hadith* are not as thoroughly preserved as the Qur'an. Whereas there are no differences amongst the

[5] The understanding of the Qur'an as the eternal, literal and uncreated word of God has been central to "mainstream" Islam – although not without dissent. This is why the *Encyclopaedia of Islam* suggests that the "closest analogue in Christian belief to the role of the Kur'an in Muslim belief is not the Bible, but Christ"("Al-Kur'an," *The Encyclopaedia of Islam* : New Edition, 426-27). An *Atlantic Monthly* writer put it, if "Christ is the Word of God made flesh, the Koran is the Word of God made text" (Toby Lester, "What Is the Koran?", 45)

hundreds of groups within Islam over Qur'anic text (though many differences exist over the translation), one can find variation and disputes over the authenticity of the prophetic *hadith.* Nevertheless, a vast number of the *hadith* are considered authentic, but again the process of translation of 7th century Arabic language and its varied interpretations make drawing conclusions a complex process (Esposito 1992).

To reiterate, for pious Muslims, the highest authority is that of the Qur'an, believed to be the absolute word of God, and then comes the authentic *hadith,* sayings and practices of God's prophet. Given this deep regard, strongly worded finance related Qur'anic verses and specific authentic *hadith* about certain financial transactions are viewed with deep moral seriousness.

Lastly, analogical deductions are employed from these main sources for contemporary issues that are not directly mentioned in those sources but have similar characteristics to those that existed in the past. This intellectual reasoning is incumbent upon every Muslim to solve for solutions of his or her life in the light of Islam. When a large majority of Muslim scholars reach a consensus on a certain issue, it is highly valued, the understanding being that there would be "theological safety in numbers" (Ahmed 2007). It is believed that there is less chance for a large majority of Islamic scholars located in vastly diverse cultures to concur on a wrong interpretation of Qur'an or *hadith*[6]. We will see that it is this methodological rule of consensus that is employed to legitimate the translation of the Qur'anic prohibition of *riba* to financial interest. At the

[6] "My community shall never agree on *dalalah* (an error)" is the most frequently quoted *hadith* in support of *Ijma.*

same time, there is a vibrant discourse employing the third source of "analogical deduction" which concludes that *riba* is usury rather than simple interest (Esposito 1992).

The word *shari'a* (sacred law or Islamic law) is often used to describe what these Islamic scholars are devising in the financial realm, but in actuality they are essentially *interpreting* the sacred law, which is known as *fiqh* (jurisprudence). Mainstream Islam distinguishes between *fiqh* (deep understanding, discernment), which refers to the inferences drawn by scholars, and *shari'a*, which refers to the principles that lie behind the *fiqh*. "Scholars hope that *fiqh* (jurisprudence) and *shari'a* (law) are in harmony in any given case, but they cannot be sure" (Souaiaia 2005, p.5).

For the jurisprudence related to Islamic finance, two main approaches can be discerned. The first is the 'traditionalist' approach and second is the 'modernist' approach. Keeping in mind the complexities of labels[7], I will venture to make some generalizations regarding these two interpretation styles. The emphasis of the traditionalists is more on a literal reading compared to the modernists. They place limits on rationality in case a verdict contradicts the canonical texts of Qur'an and authentic *hadith*. In most cases, they regard the jurisprudence of the eminent Islamic scholars of the pre-modern era to be as applicable today as they were in their times. There is a reluctance to openly admit 'non-Islamic' innovations as they insist on Islamic tradition providing all solutions. The modernists also look towards the canon to formulate their solutions to social issues, but they emphasize the spirit of the law rather than the letter of the law.

[7] On the complexity of assigning labels, especially those pertaining to Islam see Euben 1999.

Modernists contend that Islamic jurisprudence has always benefited from the knowledge of the day, and the same principle of openness should be applied today (Esposito 1992).

Warde (2000) presents a pertinent example of derivatives in the IBF industry. The traditional approach would consist in breaking them up into all their components and seeing what the pre-modern Islamic jurists have to say about each of these components. The modern approach would rely on the basic principles and on the moral economy of Islam. The second chapter in this dissertation will detail the emergence of Western trained Islamic economists with limited knowledge of Islamic jurisprudence representing the modernist approach, in contrast to the traditionalist *ulama* (theologians) providing important Islamic jurisprudence expertise that led to developing Islamic financial contracts serving the same purpose as the conventional finance contracts. It is my contention that the modernist approach alone would have yielded a different institution than the contemporary IBF. It is because of the traditional approach that the industry is booming and providing a vast number of observing Muslims the opportunity to practice and satisfy their unease in financial matters.

1.4.1 *Riba* Prohibition and Its Significance in a Pious Muslim's Mind

Riba literally means, increase, addition, expansion or growth in Arabic. Since increase itself would not be prohibited due to the disabling effect on trade, over centuries, a vibrant discourse has emerged in Islamic jurisprudence circles about the contextual meaning of *riba*. There are those who translate the term to usury (predatory lending), but the majority of contemporary Islamic jurists translate it to be interest, a moderate, economically justified remuneration of capital. Thus, although there is no contention that usury is unquestionably forbidden, and is in the category of *haram* (an act that is forbidden in Islamic law: doing so constitutes a sin and abstaining is rewarded in the hereafter), there is a difference of opinion on translating it to interest (Vogel and Hayes 1998).

There is a significant implication of this difference of opinion for today's economic system. While usury is deemed a wrong practice and is unlawful in many states even in the U.S, financial interest is an integral part of the mainstream economic system. Since financial interest occupies such a critical dimension of the conventional economic system, a complete economic theory had to be devised by Islamic economists, which explained how an economy could operate without interest (El-Gamal 2006). To understand why *riba* occupies such a prominent place in Muslim imagination, we have to review the authoritative sources.

There are four instances in the Qur'an that are invoked regarding the '*riba*' prohibition[8]. The consistent theme in earlier verses pertaining to economic dealings is to address the general economic injustices of Meccan society, the greediness and stinginess of the rich, and their commercial practices of cheating in weights and measures (Rahman 1964). As with other prohibitions, the Qur'anic injunctions on *riba* become progressively stricter during the revelation period of twenty three years. Monzer Kahf (1997) describes the stages, starting with the first which builds moral resentment against taking *riba*. In these verses, God enjoins Muslims that you may practice *riba* hoping to increase your wealth, but it will not increase God's consideration and will deprive the wealth from God's blessings (Qur'an 30:39). In the second stage, riba is condemned by equating it

[8] (Qur'an 30:39). (Q. 4:161). (Q. 3:130-132).

with the wrongful appropriation of property (Qur'an 4:161). The next stage categorically prohibits *riba* for the sake of Muslim's own welfare (Qur'an 3:130-132). The last set of verses not only re-iterates the prohibition and establishes a clear distinction between *riba* and trade, but declares a war from God and His messenger for those indulging in it (Haniffa 2007, Rahman 1964, Saeed 2004). The Qur'anic verses that are at the heart of the interest/usury debate are:

> Those who swallow *riba* cannot rise up save as he ariseth whom the devil hath prostrated by (his) touch. That is because they say: Trade is just like *riba*; whereas Allah permitteth trading and forbiddeth *riba*. He unto whom an admonition from his Lord cometh, and (he) refraineth (in obedience thereto), he shall keep (the profits of) that which is past, and his affair (henceforth) is with Allah. As for him who returneth (to *riba*) - Such are rightful owners of the Fire. They will abide therein. *276* Allah hath blighted *riba* and made almsgiving fruitful. Allah loveth not the impious and guilty. *277* Lo! those who believe and do good works and establish worship and pay the poor-due, their reward is with their Lord and there shall no fear come upon them neither shall they grieve. *278* O ye who believe! Observe your duty to Allah, and give up what remaineth (due to you) from *riba*, if ye are (in truth) believers. *279* And if ye do not, then be warned of war (against you) from Allah and His messenger. And if ye repent, then ye have your principal. Wrong not, and ye shall not be wronged. *280* And if the debtor is in straitened circumstances, then (let there be) postponement to (the time of) ease; and that ye remit the debt as almsgiving would be better for you if ye did but know. *281* And guard yourselves against a day in which ye will be brought back to Allah. Then every soul will be paid in full that which it hath earned, and they will not be wronged. (Ali 1934)

This threat is like no other in the Qur'an (Kahf 1997). While the punishment for other sins like lying, cheating and even denying God is prescribed to be hell fire, only for those who devour *riba*, will there be a war from God and His messenger. Additionally, an extremely strongly worded *hadith* regarding *riba* is popularly cited, that there are seventy levels of *riba*, the lowest being equivalent to the sin of a person committing adultery with his mother (Ibne Majah 2265)[9]. Because the mainstream consensus of the *ulama* (Islamic theologians) is that *riba* equals interest, the image of God and His messenger waging war, as well as the harsh saying of the prophet, evoke very strong emotional feelings within a Muslim that s/he is so blatantly and outrageously disobeying a religious commandment. In past centuries, because of a lack of access to education, it was the scholars who would have actually read the translation of the Qur'an and its commentary (Zaman 2002). It was through these scholars, that Islam was disseminated to the general population. Thus it was this process of diffusion through the scholars, that the prohibition of *riba* was known to the masses as a general prohibition, that *riba* is *haram*[10] (an act that is forbidden in Islamic law: doing so constitutes a sin and abstaining is rewarded in the hereafter); the actual Qur'anic and prophetic depiction regarding *riba* were not necessarily present in the ordinary Muslim consciousness. With the advent of education for the masses, many educated practicing Muslims have read the whole Qur'anic translation or have read parts of it (Zaman 2002). That extreme sensitivity which was previously felt by the scholars for abstaining from an act that is prohibited in such emphatic terms, is now also felt by some of the ordinary educated practicing Muslims. I must repeat here that the esteem with which the authoritative texts are held by most practicing Muslims, is critical to our understanding of how *riba* became the triggering factor for the development of Islamic economics. It should be pointed out that *Riba* is prohibited not just for those who are financing, but also for those who consume those loans, but the Qur'anic verses

[9] See Farooq (2009) for a critical reading of this *hadith*.

[10] In Islamic jurisprudence deeds are not categorized as binary opposites of permissible and prohibited, but are situated on a continuum: *wajib* (obligatory), *mustahabb* (meritorious), *mubah* (morally neutral), *makruh* (reprehensible), or *haram* (forbidden).

specifically target the money lenders (rather than the borrower) about not charging *riba*, forging *riba* on earlier transactions, receiving only the principle amount, and giving time to the borrower if he is experiencing hardship in returning the amount (Qur'an 2:275). This helps us understand why so many of my interviewees, who were professional bankers, primarily involved in lending, mentioned the Qur'anic verses and prophetic sayings. It is my assertion that the Islamic finance industry provides a way to relieve the burden of lending without *riba*, for a practicing Muslim banker. One senior banker explicitly mentioned the Qur'anic verses in one of my interviews:

> people are flocking to start Islamic Banking…. when one knows that an enemy is outside their home, they will instantly prepare to save themselves. We know that there will be war from Allah and His prophet if we deal in *riba* so when people find out, they take action.

Prominence of the Qur'anic verses is readily seen here, at the same time, how the IBF saves an individual from the dire consequences is also very clear to him.

1.5 Financial Interest and Other Abrahamic Faiths

Ibrahim Warde details how debates about interest are not unique to the Islamic tradition. The Hamurabi code of the 1800BC ancient Mesopotamia did not allow compound interest (interest on interest). Similarly, the Romans regulated interest rates. Aristotle's objection to interest is probably the first recorded instance. Interest has been condemned and prohibited in all the three Abrahamic religions of Judaism, Christianity and Islam. Warde (2000) summarizes Judaism and Christianity's three stages in the history of money, especially that of interest. In the first stage, interest was generally forbidden based on canonical law[11]. In the second stage, excessive interest known as usury remained prohibited, but a small rate of interest, regulated by the authorities was permitted. Certain strict commands were ignored and those passages of the gospels that emphasized the need for wealth to fructify were emphasized. The final stage either got rid of the caps on interest rates, or raised the ceilings significantly (Warde 2000).

Muslims had been thoroughly involved in trading from the time of Mohammad who himself was a trader. The Qur'an itself stresses that despite the superficial resemblance, profits from trade are fundamentally different from lending profits (2:275). In the following centuries of Muslim golden years (roughly the seventh to tenth centuries in the Middle East, and eleventh to fourteenth centuries in North Africa and Spain), business activities grew in size and complexity. Early Islamic jurists developed an impressive array of contracts to accommodate Islamic injunctions on *riba*. Some of these contracts were in fact so clever so as to be considered a ruse or wile; that is, lawful means used, knowingly and voluntarily, to reach an unlawful objective (El-Gamal 2006). Some of these ruses were adopted by the Christian theologians during the medieval period,

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[11] Leviticus 25:36 'You shall not charge your brother interest on a loan, either by deducting it in advance from the capital sum, or by adding it on repayment'.

Deuteronomy 19:19 'Do not charge your brother interest, whether on money or food or anything else that may earn interest'.

19:20 'You may charge a foreigner interest, but not a brother Israelite, so that the Lord your God may bless you in everything you put your hand to in the land you are entering to possess'.

Luke 16:13 'No servant can be the slave of two masters; for either he will hate the first and love the second, or he will be devoted to the first and think nothing of the second. You cannot serve both God and Money'.

6:34-35 'And if you lend only where you expect to be repaid, what credit is that to you? Even sinners lend to each other to be repaid in full. But you must love your enemies and do good; and lend without expecting any return; and you will have a rich reward'.

helping them to counter the very negative impression of trading in their tradition (Warde 2000). But with the advent of the modern economic system, religion's role in financial matters was minimized. Economic matters were secularized in Europe as classical social theorists such as Weber argued.

During Western modernization, the Islamic world was suffering through its dark ages. It was more or less cut off from European influences. European colonization brought about the first real interaction between the two worlds. It is this context of the colonial encounter that introduced capitalism. Warde summarizes the changes that were encountered not just by Muslims, but the non-Western world in general:

> By the nineteenth century, most of the Islamic world was brought into a Western-imposed economic order for which it was ill-prepared. Between the golden age of Islam and this encounter, the world of ideas and institutions had changed dramatically. Most institutions with relevance to finance that exist today – capital markets, corporations, etc. – did not exist in the early days of Islam. Equally important though less visible were changes in mindsets – new understandings of cause and effect on matters of wealth creation; new empirical and normative perspectives on debt, risk, wealth, etc. … new attitudes toward risk made possible by new discoveries in mathematics and probabilities in due course revolutionized finance. Along with economic and political transformations came new perspectives on debt and indebtedness. Then, following the rise of capitalism and industrial revolution, credit acquired a positive connotation. (Warde 2000, 25)

In pre-modern era, financial interest was generally considered to be morally offensive, but that understanding has changed significantly for Christianity and Judaism in contemporary times. I have illustrated the basis on which majority of Muslim scholars take a theologically safer literalist interpretation of *riba*. The third chapter will delineate how this reliance on tradition has actually served to Islamically legitimate IBF, which is operationally very similar to conventional banks. The next section will provide a background of the emergence.

1.6 Islamic Economic Theory

1.6.1 Origins

It was a Muslim intellectual Sayyed Abul Ala Maududi (1903-1979) who, for the first time, developed an Islamic economic framework by integrating Islamic economic injunctions with the prevalent economic system (Kuran 2004). During the early 20th century, there were various revivalist movements within the Muslim population of India with varying emphasis on issues such as the role of Islam in politics, taking part in British education system and so forth. Maududi was troubled by the state of Muslims in India and sought to uplift their conditions. His prognosis of the problem was that Muslims are very far removed from Islam as their minds are occupied by the British, and that the solution was to adopt Islam in every sphere of life, bringing freedom and independence. Maududis' quest was part of many anti-colonial independence movements that inspired some groups to look towards Islamic history for their motivation. Timur Kuran (2004) proposes that Islamic revivalism within Muslim communities was the key factor in giving them hope of independence and the will to govern with their own set of rules and regulations and not just blindly follow the West.

Since Islam had the answer to every aspect of life for Maududi, it also included instructions in the economic realm. While there was so much historical Islamic jurisprudence material available on trade contracts, there was almost no work that had developed a coherent blueprint of an Islamic economic system (Kuran 2004).

Internationally, besides the political turmoil caused by the First World War, and the collapse of the Ottoman Caliphate, it was also a time during which socio-politico doctrines of socialism, fascism, communism, and capitalism were being debated and contested. Scholars who have studied the life of Maududi have noted how he was influenced by some of the dominant Western theories and articulated his own theory by using the Western framework as well as applying Islamic concepts (Tripp 2004, Nasr 1996). His vision was to fashion the political system, judicial institutions and economic system according to Islamic principles. He believed that economic activity and technology was crucial for the survival of Muslims in the modern world and he was dedicated to providing Muslims in India with economic opportunities that allowed them both to function in the 20th century and to remain close to Islam. To date, many Muslims did not participate in conventional finance due to its basis in interest (Tripp 2004). Maududi himself adhered to that view as he opined that interest can erode communal bonds between men. Nevertheless, Maududi believed that it was detrimental to the Muslim community in India to abstain from banking activities. He believed that it was possible and desirable for Indian Muslims to embrace systems and institutions of Western modernity while at the same time adhering to the teachings and practices of Islam (Ahmed 2007). The economic aspect was picked up by Muslim social scientists who developed the theoretical foundation for Islamic economics (Kahf 2004).

Here I would like to add a caveat about the Islamic economics literature, primarily that produced in Pakistan, but many aspects may be common with other regions. Much of the literature is of sub-standard quality because the authors are the product of a developing world's educational system, thus lacking a rigorous scholarly approach.

“Many of the writings are repetitive, uncritical and rhetorical/ideological” (Warde 2000, p.9). This body of work is produced by those who are primarily religious scholars, but may be affiliated with a financial institution or have a background of conventional economics. On the other hand, there is a small but growing body of work that is at the cutting edge of Islamic economic theory which is largely produced in the Western academia. While this later group of scholars will not disagree with the formers’ conceptualization, they will however introduce a more in-depth historical, economic, juridical, theological understanding. The following summary of Islamic economic theory is based on the latter work.

1.6.2 Theory

Even though the canonical factor for the development of Islamic economic theory is the strict prohibition of *riba* (interest/usury), *riba* is not the first point mentioned in the standard literature. Islamic economic theory usually begins with the notion of *tawhid*, the oneness of God and His sovereignty. That God’s dominium is in the heavens and the earth. The consequence of this assertion is that everything belongs to God and human being is deemed to be a vicegerent on the earth. According to Islamic economists, a sacred trust has been bestowed upon the human being by the Creator and his duty is to take the utmost care of that trust by responsibly fulfilling God’s commands. The second important theological concept of Islam that is employed by the Islamic economists is *adalah* (Justice). Whereas *tawhid* is primarily about the relationship between human being and God, *adalah* refers to the relationship amongst men. The understanding is that God can forgive negligence on His rights (*haquq-ul-Allah*) but He will not forgive injustice perpetuated on another human being (*haquq-ul-ibad*). Islam shares with other religious traditions the utmost importance of equity, justice, morality and social welfare and also an admonition to not let the love of wealth enter ones heart (Balala 2011). In terms of defining the rules of conduct other than *'ibadaat* (rituals), a general juristic principle is that of permissibility of anything and everything, unless there is an explicit prohibition in the canonical texts. Thus for economic matters, gains through fair trade are legitimized in the canon but are off-set by the prohibitions of *riba* (interest/usury), *maysir* (gambling) and *gharar* (excessive risk or uncertainty) (Vogal and Hayes 1998). Therefore, "the principle of contractual fairness counterbalances the principle of permissibility with the objective of attaining social justice or equity between the parties" (Balala 2011 p.65).

Contemporary Islamic economic theory is defined in terms of the underlying basis of *shari'a* (Islamic law). The derived jurisprudence derived from the *shari'a* is divided into "jurisprudence for conduct in the civil arena" and "jurisprudence of worship" (DiVanna 2006). "Jurisprudence for conduct in the civil arena" is associated with formal legal theory and application of Islamic law, while God is deemed the arbiter in matters of worship for "jurisprudence of worship".

Standard Islamic economic texts frequently introduce the theory by referencing the Qur'anic aspect of the role of human beings on earth as vicegerents of God. Human beings are given the responsibility to govern God's other living and non-living creations, and that man will be rewarded or punished in the hereafter according to the fulfillment of this duty. From this perspective, humans are not seen as the absolute owners of wealth and property but rather as trustees (Naqvi 1981, 87). In this regard, establishing a just and honest society is at the highest priority level. It is here that the Qur'anic instructions about the elimination of financial interest are brought into the discussion and the argument develops as to how an economic system that is based on interest is a completely unjust system.

Since interest on lending was the starting premise many seemingly economic claims were made, the most popular of which was that making the fund-user-entrepreneur bear all the risks of business and allowing fund owner and bank claim a predetermined return was regarded to be unjust[12]. Further on, if the environment in which productive enterprise was conducted did not guaranty a positive return, hence there was no justification for lenders claiming a fixed rate of interest irrespective of the results of the enterprise, it was argued. It was also argued that most, though not all the other problems of capitalism were rooted in the practice of lending on interest. Among these problems were unemployment, inflation, poverty amidst plenty, increasing inequality and recurrent business cycles. These problems could be solved by abolishing interest and replacing it by profit sharing. With this went the arguments showing that it was possible to have banking without interest and that it would not adversely affect savings and investments. Some even argued that abolishing interest would boost investments leading to increased production. The focus at this stage was largely on pointing out the deficiencies of capitalism and linking them to the institution of interest, among other things (Siddiqi 2006). These claims were not substantiated by economic analysis but were thought experiments at best or polemical at worst.

[12] This para is based on a review article by one of the earliest Islamic economists, Siddiqi (2006).

Muhammad Siddiqui has reviewed the Islamic economic literature and has summarized some of the major Islamic economic values (Siddiqui 1981, p.36):

- A person should be a "God conscious" human being. He or she should practice *tawhid*, or unity, at all times. This means that all earthly actions must be pleasing to the will of Allah.
- Economic enterprise is encouraged as long as moderation is practiced and special attention is paid to social justice.
- Ownership has both an individual and communal component. Private property ownership is encouraged but it is a human responsibility to make sure that all humans have their basic needs met.
- Humans are encouraged to cooperate with each other in production relations, rather than to compete (i.e., as in capitalism).
- Economic development is a necessary human condition and must be undertaken in the spirit of social justice.

Actual examples of communism, socialism and capitalism are explored and critiqued by Islamic economists to prove that all these systems are man made, and the extent to which they are flawed. In contrast, the unique Islamic system is presented as the perfect solution prescribed by God that combines the best aspects of socialism and capitalism (Siddiqi 2006).

As noted earlier, it is instructive to remember how Islamic economic theory developed alongside the Western discourse on the same subjects. In the 1970's, there was much acceptance of communism and its many similarities with Islamic economics (Benthall and Bellion-Jourdan 2003). Today, communism is not engaged by Islamic economists, rather the dialogue is with capitalism. In the book *Islamic Roots of Capitalism: Egypt 1760-1840,* Gran (1979) demonstrates that Islam is a capitalist religion with support for two key tenets of capitalism, the concept of the market, and the defense of private property, both of which are safeguarded in the Qur'an and *Hadith* of the Prophet. In support of this perspective:

> Most of the contemporary writings of self-designated 'Islamic economists' are far from antagonistic to business. There is also respect for private property rights, which are an essential prerequisite for the *shari'ah* law on inheritance to be applied. Most Islamic economists view markets favourably and there is a *verse* in the Koran that depicts trading as a virtuous and desirable activity. The main concern of Islamic economists is to regulate markets to eliminate fraudulent transactions and prevent the exploitation of monopoly power rather than abolish market activity (Uddin 2003 cited in Wilson, 2006, 110).

There are components of Islamic economics that resonate with both capitalism and socialism. It has been noted that Islam has an ambiguous relation with capitalism, on one hand supporting wealth creation and class structures, yet opposing excessive wealth and exploitation (Dean 1997, p.203). The distinguishing factor between the two systems of capitalism and Islamic economics is claimed to be the role of values (Siddiqi 1981). However, many scholars have noted the underlying assumptions and normative values of capitalism (Tripp 2006, Chapra 19). Some see these differences in assumptions as completely rejecting the prevalent system while others take a conciliatory approach and perceive the Islamic economic system as very similar to classical economics, but with an addition of certain moral values.

1.6.2.1 Economic Institutions in an Islamic Economic System[13]

The primary institutions of the Islamic economic framework are proposed to be *zakat*, *sadaqa*, *waqf*, *qard-ul-hassana*, and Islamic finance. These institutions are intended to operate in conjunction with one other to prevent exploitation of the poor.

Briefly, *zakat* is the third obligatory pillar of Islam, coming only after the declaration of the faith, i.e. the oneness of God, and the ritual prayer to be performed five times a day. The word *zakat* appears in 82 verses of the Qur'an and literally means purity, development, blessings and praise, but in practice is translated as alms. A Muslim is required to pay 2.5% of the year's net-income as *zakat*. It is thought of as a way to spiritually cleanse oneself and purify one's money (Kuran 2003, p.283). *Zakat* requires that a donor's intention of giving be solely as an act of piety.

Sadaqa, is translated as "benevolence" and it is the wider umbrella of non-obligatory charity (as opposed to the compulsory charity of *zakat*), under which *waqf* (endowment), *qurd al-hassan* (interest free loan), and *sadaqa jariya* (sustainable giving) each fall. It is an act of personal devotion and piety; giving purifies the giver when performed with the sole intention of serving God. According to the Qur'an (2:271; and 2:272), charity should be given for the sake of God and will be repaid bountifully. Another form of *sadaqa* is *qurd al-hassan*, which means benevolent loan or gratuitous loan. It is an interest free loan, where the principle is returned to the lender after the end of an agreed upon period. It is mentioned several times in the Quran, where it is indicated that Allah rewards this loan in multiples (see Qur'an 2:245; 64:17). *Waqf* is a form of

[13] Major themes of this section are informed by Atia (2008)

sadaqa jariya (sustainable giving) which is normally performed for the deceased loved one. For example, a school, pharmacy, benches in parks are such works that benefit the humanity. The concept of endowments comes from this practice.

Lastly, Islamic finance deals with the part where Islam encourages economic activity. According to the pre-1980s Islamic economic texts, there are only two equity based ways to earn an Islamically legitimate monetary profit; first, when profit is proportional to the risk taken and second, when profit is in relation to the effort spent. Theorists linked the canonical economic prohibitions of *riba* and *gharar* with issues of in-equality and social harm (Siddiqi 2006). However, 1990s onwards debt based instruments were also being included as they became tremendously popular with the practitioners. A prominent absence of the social justice theme was noted while listing the details of the debt based instruments. In my third chapter which looks at the factors behind the rise of the Islamic banking institution, I elaborate on this aspect of focusing on debt based instruments by the practitioners instead of equity based ones proposed by the Islamic economic theorists, as one of the leading cause of the emergence of the industry. The guidelines employed by the IBF take into account the following restrictions:

Prohibition of *Maysir* (gambling) and *Gharar* (excessive risk or uncertainty)

The essence of this prohibition is to disengage from any form of speculation which is the prime feature of gambling. This has deterred many Islamic financial institutions from participating in derivative transactions. *Gharar* includes uncertainty, speculation, excessive risk, ignorance and generally hints at consumer/investor protection (Balala 2011).

Prohibited Transactions/Investments

Certain transactions are strictly avoided that involve Islamically prohibited products like alcohol, pork, armaments, activities involving financial speculation, gambling and sexually explicit entertainment industry.

Hoarding

Islamic economics recognizes that trade and enterprise generates wealth for society and is encouraged between people in any profit and loss sharing capacity. Hoarding, on the other hand, in whatever form, is strictly prohibited as it creates a sense of lack and erodes social welfare (Balala 2011).

Financial Assets

Money and financial assets in general are supposed to be a medium of exchange, not a property. The sale of currency is therefore prohibited (both as a medium of exchange and/or a highly speculative investment) (Balala 2011).

1.6.3 Islamic Financial Practice

In 1960's, the first practical examples of Islamic banks were seen in Malaysia and Egypt. The reason for starting these enterprises was primarily the complete prohibition of interest. The earliest supporters who provided the capital for these Islamic banking projects were individual entrepreneurs from the Middle East who had the relatively new wealth of petro-dollars gained through the oil embargo of the 1970s (Kahf 2004). Kahf states that the one thing that can be said for sure is that Islamic banking was not considered to be linked or aiding the Islamists or their claims even though the idea may have germinated from their thought. El-Gamal (2008) proposes that the collapse of the Ottoman Empire had liberated the Arab world. It was within this framework that "Islamic finance" was born in the mid-1970s, backed by a series of juristic rulings from various international juristic councils, as well as national councils and independent *shari'a* supervisory boards (El-Gamal 2008).

The next phase was the start of the private banking industry in the 1980's. This is the time when the theory and practice started showing real constraints. Today, there is widespread critique that most Islamic banking operations do not conform to the principle of avoiding financial interest. The Islamic economists argue that the primary tool to avoid interest and earn legitimate profit is through *musharaka* (venture capital) and *mudaraba* (silent partnership), which constitute a very small percentage of the contemporary IBF contracts. Some may go as far as rejecting the current Islamic banking operation as a ruse, but as Warde (2000) also notes, one should be very weary of generalizations as there are variations in the Islamicity based on geographic regions, banks, and even various instruments within the banks. Islamic banking can not be rejected because even though it may not be implementing *musharaka* and *mudaraba*, the instruments of choice, it is heeding other prescriptions of avoiding usury, excessive risk and not investing in *haram* (Islamically unlawful or prohibited) categories of business dealing for example intoxicants, sexually explicit entertainment, weapons manufacturing and so forth[14].

[14] Islamic economists critique that there is an undue concentration on re-engineering and Islamicizing existing financial instruments, with the result that there have been very few real innovations in banking products and services in the past thirty years (Rice and Mahmoud 2001).

Till now, I have explicated some of the important concepts necessary to understand my empirical case. I have also given a brief description of the background conditions that factored in the rise of the industry. In the next section, I will provide my reason for choosing Pakistan as the location to study the rise of Islamic finance industry.

1.7 The Rationale for Conducting Research in Pakistan

We are witnessing a unique phenomenon in the institutional logic of capitalism in the form of Islamic banking. There are regional variations in the theoretical as well as practical application of Islamic banking throughout the world. The main regions maybe categorized to be the Middle East, Malaysia, Pakistan/Iran and UK.

My research aims to focus on the Islamic banking sector in Pakistan. The reason for choosing Pakistan is to understand and highlight the internal dynamics of a country, which is economically unstable and is struggling but at the same time is home to a growing number of foreign as well as local Islamic banks. State Islamization during the military dictatorship of General Zia-ul-haq in the 1980s is usually seen to be the defining moment that gave birth to Pakistan's rampant Islamic militancy (Iqtidar 2011). Given this view of the mainstream academic research, the decision by the Supreme Court of Pakistan to declare Zia-ul-Haq's economic Islamization to be un-Islamic (1999) is an unexpected development. Additionally, the first Islamic bank was created in 2003, with full patronization of the "enlightened" military dictatorship of General Musharraf. Resolving this apparent anomaly will help us gain a deeper understanding of Pakistan.

Emergence of the Islamic finance industry in Pakistan went through two distinct phases of implementation. The first phase was the state level attempt to change Pakistan's conventional economic system to an Islamic economic system in the 1980s. In 1977, Zia-ul-Haq brought a military coup, deposed the elected prime minister and installed himself as the president of Pakistan. One of his early directives to the Council of Islamic Ideology (CII) was to prepare a blue-print on how to Islamize the economy of Pakistan. The project was implemented in the 1980s but was heavily criticized by the religious community as woefully falling short of the CII's instructions. Although on several occasions the Islamic Ideology Council (IIC) was called in by the government itself to give opinions on economic questions and to suggest Islamic solutions, the Pakistani government gave the State Bank of Pakistan a free hand in interpreting the opinions of the IIC, and in drawing the procedures for the Islamization of the economy. With the death of Zia-ul-haq in 1989, the supreme court of Pakistan was engaged during the 1990s in cases that challenged the Islamic authenticity of the system. In 1999, the court ruled against the government of Pakistan as it declared the non-interest banking ordered the state to eliminate interest from all its financial operations.

Maulana Maududi, one of the earliest proponents for the establishment of Islamic financial system was from what is now Pakistan and his legacy continues today in the form of numerous publications as well as in the political arena. Pakistan is home to other contemporary Islamic economists like Maulana Taqi Usmani, a highly respected name in the Islamic banking world. There is a vibrant debate on the theoretical as well as technical aspects of Islamic finance in Pakistan that has not been explored sociologically.

The central bank of Pakistan, State Bank of Pakistan (SBP) has published a few aspects of its operation on its website. Islamic Banking Department was established on 15th September, 2003 and has been entrusted with the task of promoting and developing the *shari'a* Compliant Islamic Banking as a parallel and compatible banking system in the country. SBP's Islamic Banking Department consists of four divisions: Policy Division, *Shari'a* Compliance division, Business support division, and *Shari'a* board secretariat. There are six licensed Islamic Banks and twelve conventional banks with standalone Islamic Banking Branches with the total branch network of over 140 branches operating in twenty-three cities of all the four provinces in Pakistan (SBP website, 2007). Applications for few more players are under consideration (SBP website, 2007). Meezan Bank, BankIslami Pakistan Limited and First Dawood Islamic Bank are based in Pakistan, while the rest are based in the Middle East.

1.8 Methods

The fieldwork for this qualitative case study was conducted in Pakistan between 2009 and 2011. My research design incorporates a range of data sources consisting of personal interviews, participant observations, published proceedings of court cases, Islamic finance conferences, newspaper articles, documents/publications of banks and Islamic economists, and finally, the secondary literature on Islamic finance in Pakistan.

Personal interviews were conducted with key actors including bank management, *shari'a* board members, Islamic economists, judges and lawyers involved in the Supreme Court case, and ex-finance ministers. I conducted 20 formal interviews which were recorded on digital recorder. The interviews were primarily conducted in Urdu, the national language of Pakistan, and the transcription was done in English by myself. Gaining access was not a problem because of personal contacts in Pakistan's banking sector. My identities as a 30yr old female, married, living in the west, doctoral researcher at a US university, speaking in a mix of Urdu and English, wearing traditional dress of shalwar qameez and covering my hair were all part of the impression of an upper class, fairly religious, independent/non-traditional person. This impression generally proved to be useful at putting the respondents at ease and with the exception of one person, all the rest were fairly candid in their responses. I did not experience gender bias as such; however, I felt that because a large majority of the work-force was male, I may have gained better access if I were a male. I do not think it made specific difference to the aspects I analyzed. My age, knowledge about Islamic finance and my PhD program generally portrayed a sense of maturity, and generally respondents were very helpful in giving their time for research. Typically, the interviews would be around an hour long. The interview format was semi-structured, the transcript is attached as appendix A. I had the questions in hand and would follow the general outline, but would also follow-up on the respondents' lead, as well as add/delete some queries according to the individual's role.

The second major data source is that of participant observation. The reason for pursuing this line of action is the opportunity it would provide to observe the actual daily practices of an Islamic bank. This bank is a subsidiary of a conventional bank. The Islamic bank had a branch network of --- spread all across Pakistan. I applied for an internship at the Islamic bank's group head office. The group head reports directly to the board of directors. This group was primarily independent of its conventional bank as far as the finances are concerned. Some services of the conventional bank like internal audit, marketing, and human resource development were utilized by the Islamic bank. The bank building had two floors. It had a modern interior with large windows, well-lighted, plants and a clean and open environment. The first floor was a main bank branch and the second floor was divided in two portions. On one side, the group office was located which included the office of the Islamic banking group head, this portion also had a conference room. Other managers of credit risk etc had open cubicles with two chairs in front of the desk. The cubicles were four feet high so they did not seem congested. On the other side of the second floor sat the branch office personnel. Bulk of the branch officers sat on the first floor. On the first floor, there was one glass office of the manager, and another of credit marketing manager. The blinds were usually drawn and shut, but the main door would be kept open most of the times. The rest of the cubicles were like the ones on the second floor. The cashiers were located behind closed glass counters.

Another source of data were the documents and publications (including website) of banks and Islamic economists. I consulted around five hundred pages produced by the banks which included training material for newly hired personnel, employee evaluation forms, contracts with various clients, memos, and circulars. Additionally, I collected around a thousand pages of articles produced on Islamic banking by various Islamic groups. I also looked at the published proceedings of court cases that were brought before the Federal Shariat Court as well as the Supreme Court of Pakistan. The secondary literature on Islamic banking in Pakistan, as well as the political history were valuable sources to construct the emergence.

Finally, I attended two international conferences on Islamic finance held in Lahore and Islamabad. The one in Lahore was arrange by AlHuda Center for Islamic Banking and Economics. This two day conference was presided over by the deputy governor of the State Bank of Pakistan. There were about three hundred participants.

About 150-200 of the participants were students from local universities. The Islamabad conference was arranged by Rifah International University, Rawalpindi. These conferences gave me a chance to interact with not only the leading names in Islamic economic within Pakistan, but I also got a valuable chance to interview one of the founding members of Islamic economics, Abbas Mirakhor.

1.9 Chapter Summaries

In chapter 2, my intent is to theoretically ground the case at hand. I will first look at the ways standard modernization frameworks have been normatively used to analyze and promote the European experience as the universal model. The persistence of religion, social justice movements and the "cultural turn" in social sciences contested this view of modernization. Multiple modernities thesis is presented here as a corrective to some of the ideological assumptions of modernization theories. I developed a framework to answer the two main questions for my dissertation. First, what are the factors that play a role in the emergence of a de-secularized financial institution in a non-Western society? For this, I note that ideational or meaning seeking aspects, combined with political processes play a leading role in the emergence of a market institution. This shows that constructive as well as structural features play their own particular role in the establishment of an institution. The second theoretical aim was to see how this de-secularized institution effects the organization as well as the individual.

Chapter 3 provides the emergence account of Pakistan's Islamic financial institution. Anti-colonialism combined with the struggle to define an Islamic stance for modern times were the germinating factors of Islamic finance theory as a social movement. This section also highlights how certain events like the oil embargo and domestic politics became a push factor in the actualization of theory into IBF practice in the Arabian Gulf. This emergence was aided by the *shari'a* specialists who started providing a form focused narrative to the industry that gelled more with conventional finance than with the social justice focused Islamic economists theorists. The second critical factor is the role of the state. Pakistan's Constitutional history, nationalization of the 1970s, combined with state Islamization program in the 1980s delayed the emergence of Islamic banks in Pakistan.

In Chapter 4, my theoretical aim is to analyze how an institutional logic actually seeps down to the organizational level with regard to its operation and perceptions of the employees. This chapter is divided into two main sections. The first section explains how Islamic banks function compared to IBF's institutional logic. The second section in this chapter will detail how the institutional logics and structural features are understood by those working in the institution.

The concluding chapter will consolidate the findings and theorize on modernity and contributions to economic sociology as well as institutionalization literature.

CHAPTER 2:

LITERATURE REVIEW

2.1 Introduction

The main theoretical concern of my research is to understand the factors that led to the emergence of a de-secularized economic institution in contemporary times. The purpose is also to delineate the specific way in which Islamic financial institutions deploy particular discursive and practical strategies of action in order to contest and challenge the established financial practices inherited from the West, as well as how they negotiate and adapt to the institutional cross-pressures that emanate the economic and religious realms.

In this chapter, I will first examine the concept of modernity and how modernization was utilized to view economic history. The second part will consist of detailing contemporary scholarship's challenge to the proposed economic modernization theories. I will present various frameworks that help in our understanding of IBF emergence without the modernization givens. The last section will discuss how we can make sense of the impact (or not) of the institutional logic on the actual practices as well as the member's understandings.

2.2 Theories of Modernity

Until recently, standard Western modernization frameworks have associated modernization with an inevitable process of progress and development that had Western origins but had universal application. Social sciences were pre-occupied with the characteristics of the pre-modern/modern divide and regarded differentiation, urbanization, economic growth, rationalization, and individualization as the defining features of modernity (Smith and Vaidyanathan 2010). More attention was paid to the political and social transformations of modernity, compared to the cognitive and intellectual transformations (Habermas 1984 in Zaidi 2006).

Recent scholarship has challenged these understanding of modernization theories and has recognized the concomitant complexities of modernity itself, as well as the experience of modernity by non-Western societies. It is now being asserted that the presence of modern institutions in non-Western societies has as much to do with external imposition by Western colonial powers as with some magical process of "convergence" between the West and the non-Western societies. Additionally, more attention is being given to the underlying assumptions about modern human beings, their rights and agency, thus providing a holistic analysis of the modern condition (Eisenstadt 2000; Gole 2000; Wagner 2000; Martin 2005).

In the older frameworks, an important signifier of modernity was the extent to which a society has been secularized. It was posited that as non-Western societies progressed, religion would become rationalized, its public role would be minimized, and hence religion would be relegated to the private realm. Most of the secularization thesis' critics point to contemporary resurgence of religion, not only in non-Western societies, but also in the West, as the decisive blow to the thesis. However, Casanova (1994) and others have taken up more nuanced stances that retain some of the useful aspects of the secularization thesis, like rationalization of religion. The pervasiveness of Western epistemology means that secularity is still a relevant subject to study, one that has become salient after the end of the Cold War, and especially for Muslim societies after the start of the War on Terror.

I employ Humeira Iqtidar's (2011) important distinction between secularization and secularism. While secularization is a social process linked to modernization, secularism is an ideological and normative project (Salvatore 2005). In this light it becomes clearer that secularization theories have been delineating specific Western historical experience (Iqtidar 2011). Talal Asad also alerts us to this aspect, that is, some early modernity's specific historical realities gave rise to the need to separate the Church and the state, facilitated by the on-going processes of differentiation and rationalization. This social process of secularization was driven by "increasingly mobile poor in the city and countryside, to govern mutually hostile Christian sects within a sovereign territory, and to regulate the commercial, military, and colonizing expansion of Europe overseas" (Asad 2003: 192).

Explanation of secularism as a project is presented to be a result of state power and capitalism (Salvatore 2005). In the European context, secularization process led Church's property into private hands and market circulation. The treaty of Westphalia in 1648 led the increasingly sovereign states to take over Church's property in the material realm, and Church's authoritative role in the symbolic sense. Thus state formation and its associative power structures play a decisive role in defining religion and its limitation

(Asad 2003, Iqtidar 2011). A clearer example of the project of secularism can be witnessed in the colonial context where the relatively fragmented power holdings were replaced by a pervasive state machinery, imposing its notions of modernization (Iqtidar 2011).

One of the consequences of secularity was to view religion as "illogical and superstitious". Homera Iqtidar evaluates the underlying reasons for this strong association of religion with the irrational to the specific European trajectory.

> The history of a particular type of secularization in Europe has meant that religion has been removed from the domain of rational discussion. The suppression of freedom of thought, creative expression, and critical thinking that was closely associated with the Inquisitions, the wars of religion, and the particular relationship between society and the Catholic Church in European countries have conditioned this understanding. Readily available cultural material in the form of stories such as Galileo's fate after placing rationality above church dogma tends to draw attention away from the fact that many of the scientists – representatives of rational thinking – during the Enlightenment era were, in fact, believing men who often attempted to harmonize their finding with their faith. (Iqtidar 2011, 19)

As religion came to represent the irrational and enchanted, modern discourse espoused the binary opposite approach of empirical-rationalism (Zaidi 2006). The next few paragraphs will detail how this empirical-rational view impacted the field of economics. At the end of this section on modernity, I will consolidate the discussions on secularization and economic modernization theories through the concept of multiple modernities to suggest that religion could play an 'effective' role in "societies that had no need for the kind of secularization that insisted on a sharp division between the church and the state, the public and the private that occurred in Europe at a particular historical juncture" (Iqtidar, 22).

In economic modernization theories, there were two main streams of thought. The first contended that pre-modern societies were heavily embedded in social relations but that they became much more autonomous with modernization. This view saw the economy as an increasingly separate, differentiated sphere in modern society with economic transactions defined no longer by social or kinship obligations of those transacting, but by rational calculations of individual gain (Granovetter 1985, Zelizer 1989, Biggart 2002). The first significant corrective to this view was introduced by Granovetter in the concept of "embeddedness" to convey that economic action was seeped in social relations rather than on pure rationality. It is the character of those relations that will influence how people behave in the economy. Granovetter posits that by examining the distinctive character of an actor's social relations, one can see the influence of society without assuming an undifferentiated social effect.

Relatively contemporary form of the widely held view of 'uniquely' Western rationality can be discerned from Huntington's "Clash of Civilizations" (Huntington 1996). Huntington may present Islamic finance as a positive case study of the thesis that secular West and Islamic civilization operate on opposing understandings of the role of culture and religion in a society. From this view, Islamic finance's insistence on relying on pre-modern sacred texts to develop a finance institution in contemporary times is a testimony to an irreconcilable gap. In this way, IBF presents an interesting case study to unpack the complexities inherent in the dominant approaches to modernity.

A second aspect in economic modernization theories viewed economic action to be 'natural'; that human beings are inclined to truck, barter and exchange one thing for another (Smith [1776] 1976). Smith assumed that since labor was the only factor of production in primitive society, goods must have exchanged in proportion to their labor costs, which consequently meant that the labor costs were just and fair. "The argument that the economic market model that we see today is 'natural', that it has evolved to be the way it is due to the inherent characteristics of human beings, has given rise to the notion that the capitalism we see today is the only capitalism possible" (Granovetter 1985, p.482).

The inevitability of modern capitalism is still espoused for example in Fukoyama's (1993) "End of History", contending that the Western politico-economic model is the best evolved form of social organization. He argued that the past century has proved that this model can be adapted successfully by various cultures and societies. Mimicking of conventional finance by Islamic finance would prove his assertion that capitalism is inevitable for the societies outside the West.

Economic sociology has challenged these assumptions for the past two decades. Granovetter's programmatic statement was elaborated and viewed from a broader perspective so that the focus on structural factors like networks became one factor in a theory that would also take into account the institutional, political, and cultural aspects (Fligstein 1996, Krippner 2001, Spillman 1999, Zelizer 1989).

Fligstein (1996) and Block (2002) both challenge the evolutionary model of capitalism by arguing that this system is a social construction. Fligstein points to the role of state politics in consciously establishing a vibrant economic system suited to their own societies and problems. Block looks at the various forms of economic models like the Japanese or the European. He insists that both within societies and as an international system, capitalist arrangements are not natural but need to be constantly constructed and reconstructed. “Capitalism cannot rely on simple continuity over time because it is continually generating new conflicts and contradictions that have to be resolved or contained through conscious activity” (Block 2002, 94). In the next section, I examine the theories dealing with the emergence of an economic institution in detail and propose a framework that is helpful in a nuanced understanding of the capitalistic system.

The critical turn away from a normative perspective in sociology is also reflected at the meta theoretical level in a recently introduced concept of multiple modernities. Eisenstadt (2000) delineates this thesis by first noting the characteristics of modernity. The first dimension is the reflexivity that led not only to alternative interpretations of society but also to questioning of accepted norms. “[This cultural program] gave rise to an awareness of the possibility of multiple visions that could in fact be contested” (Eisenstadt 2000, 4). An important dimension of this awareness was the emphasis:

> on the autonomy of man: his or her (in its initial formulation, certainly “his”) emancipation from the fetters of traditional political and cultural authority. In the continuous expansion of the realm of personal and institutional freedom and activity, such autonomy implied, first, reflexivity and exploration; second, active construction and mastery of nature, including human nature. This project of modernity entailed a very strong emphasis on the autonomous participation of members of society in the constitution of the social and political order, on the autonomous access of all members of the society to these orders and to their centers. (Eisenstadt 2000, 5)

Eisenstadt highlights various protest movements, including the communist, fascist and fundamentalist ones to show that modernity has taken various shapes and forms from its inception in Europe and that counter movements continue to this very day. The consistent thread running through these movements is the quest to tackle the core concerns of modernity. Multiple modernity contends that there is no final answer to the questions posed by the modern, and that every society will come up with its own solutions according to its history and circumstances.

Christian Smith and Brandon Vaidyanathan have noted five aspects that are deemed essential in their view to the multiple modernities conceptualization. The first assumption challenges the inevitability of modernization theories thus emphasizing agency and freedom at various analytical levels. The second feature it highlights is the cultural and cognitive aspect that is present alongside structural and institutional changes in modernity. Thirdly, the presence of conflicting, ambiguous and contradictory processes and concepts is stressed. In this context, early sociologists are mentioned who were perceptive of some of the associated complexities. Fourth, a critical realism approach is suggested that needs to replace the implicit positive-empiricist model of social science. Lastly, a call is made to adopt a relatively more objective and analytical understanding rather than the normative and ideological basis of the old modernization framework (Smith and Vaidyanathan 2010).

Even though I agree with the aforementioned prescription, however, I must contend that multiple modernities grants immense agency to the non-Western societies. In my view this is problematic because the perspective ends up underemphasizing the imposition and hegemony of the modernization project. Thus while there is much emphasis, in fact, the core argument is that modernity will always involve movements addressing modernist themes, it must be kept in mind that some of these themes are still organic for the Western societies, as compared to the non-Western societies due to the particular historical circumstances mentioned above. The understanding of modernity developed under the colonial machinery can not be really compared to the European experience.

Having said this, I will still opt to utilize the multiple modernities perspective because the broad theoretical issues raised by this perspective are important for identifying aspects that my empirical case of Islamic banks might confront. More specific analysis requires the mid-range theoretical tools of economic sociology. I will be paying particular attention to detangling the project and process knots at various analytical levels throughout this dissertation.

In the next section, I will analyze various economic sociology frameworks that have been proposed to study the emergence of alternative forms of economic institutions to discern which best satisfies the concerns raised by multiple modernities thesis. The section following the emergence will utilize institutionalization framework to discuss some theories that explain how an organization deals with the macro institutional logics (capitalist and religious) in my case. Additionally, I explore how these institutional aspects are understood by the individuals working within. This exercise will shed light on the extent of agentic possibility in an economic institution with in a particular context.

2.3 Economic Sociology

As mentioned in the previous section, economic sociology has questioned economic modernization theories on two major grounds. The first challenges the inevitability and universal application of European model of economic modernization. Secondly, economic sociology critiques the notion of pure rational motivations of human beings who are involved in economic action. Both these correctives are very much within the multiple modernity agenda. I will detail these aspects in the context of the emergence of a de-secularized finance institution and its structural and symbolic functioning.

2.4 Emergence and Formation of New Markets

Sociological literature on markets is rich with explanations of how a market emerges. The discussion is usually framed in a chronological manner in which the first theory that is presented is about how economists saw the market as a rational/means-end driven endeavor. It goes on to relate how this approach was critiqued by sociologists who brought the economic discussion back into the social realm and looked at the factors of networks, politics, culture and institutions. I want to present the existing theories of market formation as a continuum, along the scale of whether emergence is a consciously constructed activity or not. The advantage of this presentation is to discern an important dimension underlying various theories i.e. agency vs. structure. I will give a brief summary of the classical as well as contemporary theories of market creation on this continuum and give reasons as to how my empirical case of the rise of Islamic banking in Pakistan, informs this debate.

2.4.1 Natural Evolution of Markets

The first view corresponds with the predominant understanding in classical economics based on a particular interpretation of Adam Smith's economic theory. As mentioned before, in this reading, economic action is 'natural', that human beings are inclined to truck, barter and exchange one thing for another (Smith 1976). "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own self-interest. We address ourselves, not to their humanity but to their self-love," wrote Smith in one of the most cited passages of the *Wealth of Nations* (p. 14). Fourcard and Healy (2007) trace contemporary perspectives in economics back to Adam Smith and Leon Walras. According to Smith, the reason that 'self-love' is not destructive is that there is an element of mutual dependence through commerce. The survival of the species is dependent on the reciprocity of politeness, serviceability and honesty (Fourcarde and Healy 2007).

In contrast to this view, Fourcarde and Healy note another perspective that does not take capitalistic market creation to be the ultimate fate of all societies. Certain cultures are more amenable to capitalistic market formation than others. Weber's argument is a classic example of this perspective. Most contemporary sociologists would not venture to make a strong claim that culture is the major cause of economic success or failure, however, various economists continue to make such linkages (Fourcarde and Healy 2007).

The prevalent theme in the above cited works is the unconscious capitalistic activity that goes on as the force of history, a classic example of economic modernization theories.

2.4.2 Markets are Consciously Constructed

Fligstein (1998) and Block (2002) both challenge the evolutionary model of capitalistic market creation by arguing that this system is a social construction. Fligstein points to the role of state politics in consciously establishing a vibrant economic system suited to their own societies and problems.

There are three main streams of arguments that make a point that the economic system has been created consciously. The first view is firmly rooted in the Marxist tradition, that the economic arrangements that we see today are an exploitation of the workers and are controlled by the bourgeoisie, leading to commodification and alienation (Marx 1976).

The second view is labeled the voluntarist approach by Fourcarde and Healy (2007) and in this framework, theorists suggest various ways that capitalism can be established through political interventions. Various institutions identified for successful market development are property rights, common law system, well developed and transparent financial markets, and specific models of corporate governance. According to economists, these areas can be monitored and controlled by macro institutions like the state, or World Bank. Thus, markets are independent from culture and can be formed through the right policy making and implementation.

The third perspective on market creation presented by Fourcarde and Healy (2007) is how moral and scientific projects are hidden behind the categories of efficiency, productivity or social justice. In this regard, Zelizer's (1985) work demonstrates how substantive cultural and moral effort was put into the success of the life insurance industry. Biggart and Delbridge (2004) also make a case for the rise of ethical consumerism and the emergence of environmental and labor certification industry largely as a result of underlying moral conviction of certain groups.

In these latter perspectives, there is an emphasis on agency and the self capacity of various groups and national entities to consciously construct an economic system.

2.4.3 Markets Develop Through the Interaction of Various Factors, Some Conscious, Some Consequential

Noting the limitations of the perspectives that fall at the two ends of the continuum which is based on whether economic activity is deliberate or not, I propose a middle ground which takes into account the factors mentioned in the alternative readings noted above. I will highlight the role of political processes, social movements, culture and market institution in the emergence of a de-secularized financial institution in Pakistan.

2.4.3.1 Political Economy

The focus of this approach is how governments, laws and politics at the domestic and international levels influence the creation of markets (Fligstein and Dauter 2007). This area has been developed substantially by scholars from the political science, sociology and economics. Fligstein (1996) proposed a framework to include the effect of states on markets in economic sociology. He noted that the state affects three market factors, which are: property rights, governance structures and rules of exchange.

But what causes the state to use or restrict its capacity to influence the market? The four main causes that impact a state are: social movements, a state's position in the world order, domestic power structure, and larger institutional logics (international norms/conventions, globalization influences). Other aspects like political system (democracy/authoritarian) and economic developmental levels may also be important in the development of a market (Vasi 2009).

2.4.3.2 Social Movements

Markets are locations of moral conflict and political struggles (Foucard and Healy 2008). Social movements are a concrete manifestation of these conflicts and struggles. From this perspective, markets are not created by natural processes but are a result of socio-political, cultural and economic resource mobilization (Weber et. al. 2008). Social movements are a prominent factor in effecting a state's capacity to either directly to cause a change in public policy through lobbying and litigation, or by impacting the state through larger cultural understanding resulting in regulative changes (Fligstein 1996, Vasi 2009).

A second way that social movements can affect the market is to engage with the incumbent organizations from within as well as from outside (King and Pearce 2010). This engagement can either be direct (picketing, advertisement campaigns) or indirect through the development of transnational regulatory frameworks.

Lastly, King and Pearce (2010) note social movements make a space that creates market alternatives for entrepreneurs through mobilizing resources and identities, thus legitimating new categories (Weber et. al. 2008).

2.4.3.3 Institutional

Institutional analysis is an anti-reductionist approach that highlights the impact of macro-level societal processes on lower level entities (Schineiberg and Clemens 2006). This approach explains the formation of meso-level societal bodies. Neo-institutionalists, or "cultural frame institutionalists" focus their attention on the cultural and ideational elements like the rationalized myths, legitimacy and taken-for-grantedness of institutions

(Suddaby 2010, Bartley 2003). Institutions are not just the rules of the game that constrain and proscribe but are also “constitutive and prescriptive” (Clemens and Cook 1999 in Bartley 2003). Institutions are “supraorganizational patterns of human activity by which individuals and organizations produce and reproduce their material subsistence and organize time and space. They are also symbolic systems, ways of ordering reality, and thereby rendering experience of time and space meaningful” (Friedland and Alford 1991, 243). New institutional forms are a result of actors drawing on, copying, or recombining existing cultural models (Bartley 2003).

The concept of logic generally refers to broader cultural beliefs and rules that structure cognition and guide decision making in a field (Lounsbury 2007). Institutional logics are historically variant and are shaped by economic and social structural changes (Fligstein 1985, 1987; Fligstein and Brantley 1992; Barley and Kunda 1992). As mentioned before, social movements may also shape institutional logics. Thornton and Ocasio (2008) list four areas identified by scholars that are affected by institutional logics: collective identities and identification, contests for status and power, classification and categorization, and attention.

Having highlighted the inadequacy of theories that fall at the two ends of the economic activity continuum, I detailed certain factors that play important role in accounting for the emergence of a market institution under capitalistic and religious logics. From this analysis, I have identified three factors that are salient in analyzing the multi-dimentionality in my empirical case of de-secularized market building: political processes, social movements, and cultural processes.

My follow-up theoretical interest is to see how a newly emerged Islamic finance industry is institutionalized at the organization level as well as the individual level. In the upcoming section, I will employ institutional theory to develop some of the tools that will help me in answering such concerns.

2.5 Institutionalization Processes

As the first Islamic bank was established in Pakistan, both modernization theory and the mainstream institutional literature would predict that this new industry will be subjected to isomorphic capitalistic logic. Moreover, it is highly likely that the Islamic bank will present an image that would be very similar to the dominant institutional logic of conventional banking but its core activities may differ. However, I witness a diversity of images that are presented by the IBF depending on the audience. Why and how is this achieved will be the subject of this section.

The second part of this section will look at the individual level response of the bankers to the institutional pressures. I ask how do the institutional narratives present at the time of the creation of the industry seep down to the practitioners. What does Islamic finance mean to those who are working in this industry.

2.5.1 Institutionalization at the Organizational Level

Organizations face pressures from their institutional environments and the study of how and why these organizations react to these pressures is a central theme in organizational analysis. How does an organization react to its environment? In the seminal article by Meyer and Rowan (1977) they noted the presence of a disconnect between the efficient operation of an organization and its image. Organizations would develop loose coupling between its core operations and those external practices designed to maintain a certain impression to the audience. Kraatz and Block (2008) note that the earlier formulations of institutional effects presented a picture of coercive or impinging of pressures on an organization. These earlier studies assumed that the institutional pressures were so strong that the response choices were very limited. Scott (2008) also observes that in some quarters, institutional effects became equated with superficial conformity. Today, however, theorists recognize the complexity involved and take into account the depths and intensity of conformity (Scott 2008). In their major work, DiMaggio and Powell (1983) did not agree with Meyer and Rowan's conceptualization of loose coupling and in contrast, they theorized that there would be substantial internal changes that correspond to the ceremonial practices, thus creating greater homogeneity and less variation and change. This statement was given in passing and they did not elaborate on the details. One of the first studies that does detail the agentic possibility of the organization was by Oliver (1991), in which she presents categories of "strategic" responses by an organization to its institutional environment. She showed that decoupling or symbolic conformity is one out of five strategic responses.

Even though the question of decoupling and loose coupling is central to the institutional literature, there have been few works that look closely at the phenomena (Scott 1995, Westphal and Zajac 2001). According to some scholars, decoupling is more likely to happen when and where organizations face conflicting expectations from environment, or environmental pressures toward conformity meet resistance within organizations. Resistance to or avoidance of regulation is not the only source of decoupling. Ambiguity in the meanings of or inaccuracy of information and knowledge about the institutionalized practice or programs can induce decoupling (Han and Koo 2002). In a series of studies by Zajac and Westphal (1994) and Westphal and Zajac (1998), the executive incentive programs in corporations were researched. The researchers developed a socio-politico perspective and presented evidence that firms were more likely to decouple incentive programs for chief executive officers (CEOs) from actual practice when CEOs were relatively powerful in comparison to their board of directors. In their 2001 study, Westphal and Zajac find out that prior experience and knowledge about the possibility of disconnecting policy with actual implementation also contributed as a factor predicting decoupling. Further more, Edelman (1992) observes that decoupling could trigger subtle internal changes in actors' perceptions, and could lead to substantial changes later on.

Kraatz and Block's (2008) main argument is that there are multiple sources of institutional pressures on an organization and consequentially, there is complexity associated with its response. Most of the studies on decoupling conceptualize a holistic response by an entity, i.e. the entity in question will exhibit a homogeneous reaction to the institutional pressures. However, it is equally plausible that due to the multiple institutional pressures, an organization conforms to some institutional demands, while it maintains a symbolic commitment for others. The picture becomes more complicated if one sees institutional effects as suffusing the organization, and not just impinging on it.

The follow-up question is *why* does an organization respond to its institutional environment one way or another? Rational action theory would suggest that efficiency is the fundamental goal of an organization in its bid to secure scarce resources. The dominant position in the neo-institutional literature would concur with the resource based theory that organizational survival is the goal of an organization. An organization will strive to stay in business in the face of the many challenges it encounters. The difference lies in how that survival goal is achieved. Neo-institutional theory suggests that the foremost hurdle to cross is the challenge of legitimacy, rather than efficiency, productivity, and such.

One of the prominent contributions of Meyer and Rowan (1977) was to bring the issue of legitimacy of an organization to the forefront of discussion. If organizations are to survive, they must convince the larger publics that they are legitimate entities, worthy of support. Meyer and Rowan's article linked the need for an organization to have a favorable impression to its dependence on the environmental resources (Mizruchi and Fein 1999). This view of an organization's need to satisfy certain audience with the goal of extracting a resource is close to Pfeffer and Salancik's (1978) resource dependence model. The second major article in institutional literature by DiMaggio and Powell (1983) observed that a large number of organizations within the same field are very homogeneous. The proposed explanation was the process of isomorphism consisting of coercive isomorphism, mimetic isomorphism and normative isomorphism. Through these institutional mechanisms, organizations attained a legitimate position in their environment.

While most of the literatures' empirical cases are about an already established organization, my case is about an industry that is emerging. DiMaggio (1998) has also stressed the importance of studying emerging institutions compared to the existing ones.

> that institutionalization is a product of the political efforts of actors to accomplish their ends and that the success of an institutionalization project and the form that the resulting

> institutions takes depend on the relative power of the actors who support, oppose, or otherwise strive to influence it. (p.13)

I will be studying how a recently formed de-secularized industry increases its chances of survival, and the role of legitimacy in attaining success. Deephouse and Suchman (2008) trace the development of a concept that is used often, but defined less. Legitimacy has been defined by Suchman (1995, p. 574) as: "…. a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed systems of norms, values, beliefs and definitions". This version of the definition delineates two basic perspectives, that of an institutional view which emphasizes how constitutive societal beliefs become embedded in organizations, and a strategic perspective emphasizing how legitimacy can be managed to help achieve organizational goals (Deephouse and Suchman, 2008).

Islamic finance organizations in Pakistan have come about in a unique way and their early trajectory and structure is linked to their historical founding. I study decoupling in a wholly original context (i.e., Islamic finance industry) not previously examined in the organizational literature. Developing frameworks for establishing both the antecedents and consequences of symbolic and substantive conformity appears to be an important first step toward gaining a greater understanding of its relevance.

2.5.2 Institutionalization Processes at the Individual Level

Most neo-institutionalists would agree that an organization is a cultural entity, or a meaning system interacting with its environment. In fact, Spillman (2011) categorizes neo-institutional perspective as a variant of the "cultural production" aspect in economic sociology. Scott defines organizations as coalitions of interest groups, functioning within the institutional environment (1992, p.26). Greenwood and Hinnings (1996) envision an organizational form as “the instantiation of structures and practices given substance through underlying values regarded as appropriate in an institutional context. It is this notion of appropriateness in a cultural meaning system that an organization strives to achieve, rather than efficiency, productivity, rationality, or resource acquisition” (p.58).

Friedland and Alford (1991) introduced an important concept of institutional logic, which they define as “a set of material practices and symbolic constructions – which constitutes its organizing principles and which is available to organizations and individuals to elaborate”. Thornton and Ocasio (1999) elaborate on this definition and propose that logics are “the socially constructed, historical pattern of material practices, assumptions, values, beliefs, and rules by which individuals produce and reproduce their material subsistence, organize time and space, and provide meanings to their social reality”. Friedland and Alford’s (1991) main contribution was to conceptualize society as an inter-institutional system. They locate key institutional sectors with their specific institutional logics in the western world: the capitalist market, bureaucratic state, democracy, nuclear family, and Christian religion. The noteworthy feature of logics is their interplay (Thornton and Ocasio 2008). Kraatz and Block (2008) take this further to see how an organization deals with multiple institutional logics. They contend that most of the times heterogeneity in the institutional realm is associated with conflict and friction, but it could also be a source of opportunity (Kraatz and Block 2008). Kraatz and Block focus on the effects of the multiple institutional logics on an organization, but not on the individual.

However, organizations are not just the susceptible entities which are influenced by changing or heterogeneous institutional contexts. Organizations are composed of actors who are shaped by the institutional logics but also play a role in constructing an organization in a particular way (Binder 2007). Oliver (1991) and DiMaggio (1988) introduced agency theory in institutional analysis. Zilber (2002) contends that agency remains a narrowly defined concept and is restricted to the introduction of, or resistance to change. She goes on to say that meaning is excluded from the discussion, along with the role of non-managerial members of the organization. Binder (2007) focuses on the effects of multiple institutional logics on individuals and their responses. She follows the "inhabited institutional" approach proposed by Hallet and Ventresca (2006) in which they "argue for seeing individuals and groups in organizations as both locally and extra-locally embedded in meaning systems, as opposed to any single meaning system" (Binder 2007). The data collected from my field work in Pakistan's Islamic banks through participant observation and in-depth interviews with Islamic bankers will help me gauge how the larger institutional logics operate at the individual level.

2.6 Conclusion

In this chapter I looked at some of the themes of an inevitable and rational conception of the dominant modernization theories in the religious realm as well as in the economic realm. Multiple modernities framework was introduced to counter some of these normative assumptions, but a more detailed account was sought at the meso-level.

Since the first empirical question was to understand the emergence of an alternative financial institution in Pakistan, various economic sociology theories that dealt with the formation of a market were looked at. In this view, even-though the involuntary and universalistic assumption was corrected, there was still a stream that over emphasized the constructed aspect of a capitalist market. A middle path was taken to highlight both deliberate as well as consequential factors of culture, social movements, political processes and market institution. I will focus on the interplay of these four elements while analyzing the rise of an Islamic finance industry in Pakistan.

The second empirical question was about Islamic finance institutionalization at the organizational level as well as the individual level. Institutional analysis was utilized in this regard to note decoupling and legitimacy as the theoretical constructs which will help in answering the questions of how and why organizations react to institutional logics one way or another. Lastly, I also sought to find out how this institution is understood by those working in this industry and the extent of their agency.

In the concluding chapter, I will deliberate on how these theoretical findings influence the multiple modernity thesis generally, and secularization thesis in particular.

CHAPTER 3:

EMERGENCE OF IBF IN PAKISTAN

3.1 Introduction

In this chapter, I will focus on delineating the factors that led to the creation of the institution of Islamic banking and finance (IBF) in Pakistan. In order to understand the emergence of IBF, I argue that it has to be contextualized not only within certain international events and movements, but also within the history of Pakistan. A historical perspective is critical in highlighting the deep cultural models that have been aiding and guiding the development of Islamic norms of exchange. I will show how eventually one normative version of finance is institutionalized rather than the other. This chapter is organized in accordance with what I see as two distinct phases in the development of IBF in Pakistan; the first is the emergence of Islamic economic theory and the second is the creation of Islamic banks and other Islamic financial institutions. I highlight two factors that played their respective roles in both these phases: political processes and cultural. Specifically, I show that the emergence of IBF was shaped by the traditional Islamic theologians' (*ulama's*) focus on micro level reform, derived from interpreting Islam in letter-of-the-law rather than an Islamic economist's approach which focused more on the substance of Islamic law. I argue that this distinction is missed by those studying IBF's creation as they lump it with the emergence of Islamic economics as a reactionary force amidst anti-colonial struggle.

3.2 Development of Islamic Economic Theory

Maulana Sayyid Abu'l-A'la Maududi, a native of the Indian Sub-continent, was the first person to introduce and articulate a theory of Islamic economics. However, Maududi was not an economist but a social critic and an ideologue (Nasr 1996). In a biography written by Vali Nasr, Maududi (like other Muslim leaders) is shown to be deeply troubled by the position of India's Muslims in the early twentieth century. Most analysts attribute the roots of this frustration to Muslim's loss of authority and their struggle to deal with an imposed European modernity in South Asia.

The Muslim Mughal Empire ruled over India for 300 years from 1526 to 1858. By 1700, this empire had started to crumble internally. At the same time, the British East India Company, the mega corporation of the time, started making inroads into the region. By 1850s, this corporation, acting more like a state, had occupied most of South Asia. A popular uprising in 1857-58 by the locals against colonial rule was ultimately crushed by the British Crown which then took over direct control of India by dissolving the East India Company. The Muslims were singled out for punishment for this uprising by the British. Akbar Ahmad (1997) writes, "after the abortive uprising, at one stroke Muslims of India lost their kingdom, their Mughal Empire, their emperor, their language, their culture, their capital city of Delhi and their sense of self". Subsequently, British colonial rule introduced many legal, political, social, and economic changes that impacted the local populations in all aspects of their lives (Zaman 2009, Iqtidar 2011).

Homera Iqtidar notes that the Muslim community reacted to these new circumstances of the "colonial encounter" primarily through revivalism. A majority of the traditional theologians (*ulama*) were engaged in this revivalism. These *ulama* were averse to engaging with Western thought and were either not exposed to the British educational institutions, or consciously avoided them. They rejected Western civilization because in their view, it had brought moral depravation. Instead, they embraced familiar cultural forms without pursuing change (Kuran 1997). Metcalf (1982) notes an emphasis on the reform of the individual: the *ulama* "fostered a kind of turning away from issues of the organization of state and society, towards a concern with the moral qualities of individual Muslims" (p. 351). Zaman (2009) contends that this change was brought about by the loss of active engagement of the *ulama* in the juridical process. The British had established the secular Western legal system, leading to the relegation and confinement of the existing Islamic jurists to the private affairs (marriage laws etc.) of their own community. The result was that Islamic jurists were not able to actively deliberate on societal concerns like economics and other policy arenas. The loss of social position through colonization coupled with the internalization of this role by the *ulama* led initially to their complete disengagement with economic concerns. However, I will show later that with the project of Islamization of Pakistan from 1980's onwards, the *ulama* did attempt to re-engage at the macro level. In fact, a varying degree of focus on the state over the self can be observed throughout this project depending on the prevailing circumstances of the historical period considered (Zaman 2002).

Most Muslim leaders and thinkers of the Sub-continent favored Hindu-Muslim unity till 1930 as there was no demand for an independent state of Pakistan for Muslims till then. Together, Muslims and Hindus were struggling for an independent India. However, a number of events and actions in the 1920s disillusioned the Muslims who started asking for their communal rights which led to the demand of a separate state of

Pakistan for Muslims. At this time, the main focus and activism of Muslims was directed at the impact of colonialism, modernity, and non-Muslim cultural influence, Western and Hindu (Iqtidar 2011). Sayyid and Tyrer (2002) argue that as Britain was out to crush the Ottoman Empire, Muslims of India launched a movement to put pressure on Britain so as to prevent the marginalization of Khilafat (the leadership of Muslim) as it was based in the Ottoman Empire. This movement was not out to gain Islamic political power but "rather to hold on to the one that seemed to be crumbling in the wake of the Ottoman defeat in the First World War" (p 60). Subsequently, Turkey's Mustafa Kemal abolished the Ottoman Caliphate, institutionalized secularism and purged Turkish society of its Islamic identity. Sayyid and Tyrer argue that Islamism emerged as a response to the "discourse of Kemalism that begins to hold sway over the Muslim world after 1924" (p. 60).

This contextualization of Islamism[15] as an attempt to bring into existence a new relationship with the colonial, that is, Western modernity, is important to understand the economic thoughts of Maududi, who is considered one of the most influential Islamist of the 20th century. Vali Nasr argues that unlike some reformers, Maududi was not concerned with soothing Muslim anxieties about modernity but with pressing them on towards the adoption of modern thought and abandonment of the past. He was very critical of the *ulama* and blamed their approach of *taqlid* (uncritical following of one's legal school) for the current state of Muslims (Iqtidar 2011, Nasr 1996). His developing of Islam as a system, and his emphasis on the harnessing of religious energy to politics

[15] A social ordered centered around Islam (Sayyid and Tyrer 2002 pg 58)

was a deviation from traditional Islam, and especially from the devotional forms of Islamic thought that have flourished in South Asia since at least the thirteenth century (Nasr 1994, 1996; Robinson 2000). Nasr also differentiates Maududi's mission from that of other Islamic modernists in that, while the latter accepted modern scientific thought and attempted to interpret Islam according to it, Maududi wanted to appropriate modern rationalist thought and Islamize it (Jamal 2009). "The modernists wanted to modernize Islam whereas Maududi wanted to also Islamize modernity" (Nasr, 1996: 53).

Maududi presented a holistic Islamic social order by appropriating a significant amount of theory and praxis of the Western civilization, and infused as well as elaborated it with Islamic concepts. Timur Kuran (1997) notes two aspects that were essential for Maududi's thought: the first was his concern for God's sovereignty (negating the 'man made' systems of the West), and second was the belief that Islam was a comprehensive way of life, encompassing public and the private spheres. Kuran and Iqtidar both note that Maududi anticipated Thomas Luckmann's (1967) "religious privatization" thesis - that as Western religion got pushed from public domains to private, it would become less of a constraint on individual religiosity and lifestyle. Maududi's insight was the realization of the comprehensiveness of the modern state. His quest was then to propose a system based strictly on Islam which would necessarily be superior to the Western system. Thus the perceived threat to religion (specifically Islam) from Western materialism, and from the long arms of the state, prompted Maududi to elaborate an Islamic political theory while adhering largely to a literalist interpretation of the Islamic canonical texts (Kuran 2004). In this regard Maududi writes:

> The conceptualization of the state by the nineteenth-century scholars of politics is now utterly outdated. ... Gone are the days

> when if the state presented its economic, educational, industrial, or social scheme people made fun of it by calling it grandmotherly legislation. The situation has completely changed. Now the state's arena has almost become as all-encompassing as that of religion. Now it also decides what you are to wear or what not to wear; whom you are to marry and at what age; what you are to teach your kids and what mode of life you are to choose; ... what language and script you are to adopt. So, the state has not left even the most peripheral issues of life independent of its ultimate right to intervene (*Tarjuman*, March 1938: 5).

Maududi critiqued the prevalent economic theories of Capitalism and Socialism and proposed that the solution to Muslim's economic backwardness was rooted in an Islamic economic system (Nasr 1996). Kuran (2004) notes that Maududi was the first Muslim to discern that with technological progress, economics was indeed becoming increasingly important to daily life everywhere. Nasr (1996) summarizes Maududi's understanding that both capitalism and socialism were extreme systems which were bereft of ethical values and were callous towards individual rights and needs. Based on this understanding, Maududi proposed an Islamic economic system that embodied the best of both the systems but purported to have none of their faults. Maududi proposed that there were two main components of an Islamic economic system: first was the institutionalization of *zakat* (mandatory alms) which would lead to the elimination of poverty, and the second was the elimination of *riba*.

Apart from an innovatively modern reading of Islam, another distinctive feature of Maududi's interpretation of Islam was his adherence to the traditional stance while giving a rational explanation appealing to the sensibilities of the modern times. Nasr contends that Maududi paved the way for the Islamic economic discourse to become centered on *riba* even though he had the option of taking various other routes (Nasr

1996). I argued in the first chapter that that the extreme terms used for *riba* prohibition in the Qur'an led Maududi to base his economic theory on elimination of interest. Hence, Maududi's interpretation did have aspects of a somewhat literalist reading. In fact, Maududi was not apologetic about orthodox stances even though they may have been unpopular.

As an illustration of ascribing to a literalist reading in spite of an anti-populist stance is on the issue of land reforms that were to redistribute lands from the feudal lords to the laborers. Iqtidar (2011) provides us with the details of this increasingly populist demand. Maududi's party, the Jamaat, was in a conundrum. The right to private property is a fundamental tenet in Maududi's theory of Islamic economics in which only the owner has the right to dispose off his property. Additionally, the laws of inheritance are clearly stated in the Qur'an[16]. Maududi opted to adhere to the safe and literalist reading of the canonical texts and decided to oppose land reforms, which meant going against the populist demand. His party consequently paid the price for this decision in the elections of 1970 and failed to acquire any seats in the parliament (Iqtidar 2011).

Maududi's writings became very popular throughout the Muslim world. His ideas on Islamic economics were taken up by Western trained Muslim economists. Islamic economic theory was thus elaborated and explained with more sophistication by the emerging Muslim economists. The strong link between the prohibition of *riba* and equitable distribution of income and wealth established by Maududi was maintained by

[16]According to the Qur'an, the first right on the property of the deceased is that of the creditors. After the payment to the creditors, any will made by the deceased is executed. The remainder of the property and assets of the deceased, if any, shall be distributed among the inheritors in the specified proportions to the family.

these economists. However, the Islamic economists prominently lacked training in Islamic theology and were inclined towards a rational, substance based approach. I will show later that this lack of expertise in Islamic theology in addition to Islamic economists' insistence on following the substance of *riba* prohibition led to a significant limitation of their role in the establishment of an Islamic finance institution. IBF was supported by certain *ulama* who were concerned less with economic justice and more with avoiding *riba*. The next section will present a basic overview of the role of Islam in the constitutional history of Pakistan and illustrate the significance, or lack thereof, of certain Islamic principles in the creation of a de-secularized financial institution.

3.2.1 Pakistan's Creation and Constitutional Development

Pakistan's founding father, Mohammad Ali Jinnah's vision for the newly formed state was neither secular, nor a theocracy. Jinnah had demanded a separate homeland for the Muslims of the Sub-continent after realizing that Muslim's rights in a Hindu dominated state would not be guaranteed. Consequently, Jinnah's vision for Pakistan insisted on equal and just fundamental rights for its citizens, regardless of their religious affiliations. We can discern his interpretation of Islam from the speech given during the inauguration of the State Bank of Pakistan (SBP) in July 1948:

> I shall watch with keenness the work of your research organization in evolving banking practices compatible with Islamic ideas of social and economic life. The economic system of the West has created almost insoluble problems for humanity and to many of us it appears that only a miracle can save it from disaster that is not facing the world. It has failed to do justice between man and man and to eradicate friction from the international field. On the contrary, it was largely responsible for the two world wars in the last half century. The Western world, in spite of its advantages, of mechanization and industrial efficiency is today in a worse mess than ever before in history. The adoption of Western economic

> theory and practice will not help us in achieving our goal of creating a happy and contended people. We must work our destiny in our own way and present to the world an economic system based on true Islamic concept of equality of manhood and social justice. We will thereby be fulfilling our mission as Muslims and give to humanity the message of peace which alone can save it and secure the welfare, happiness and prosperity of mankind.

Most of the Islamic groups, including Maududi, had opposed Jinnah and his idea of a separate homeland for Muslims because in their view a territorial entity would undermine the stance of a united Muslim body. After the creation of Pakistan, however, many Islamic leaders chose to live in Pakistan and they also started asserting their voice in shaping Pakistan's ideology. Their stance was, that since Pakistan is a reality, and it was created for Muslims in the name of Islam, thus it should be an Islamic state. Maududi and his party were at the forefront of this assertion.

One of the primary concerns of the Pakistani state at the time of its creation was to formulate the Constitution. The first Constituent Assembly, created under the Indian Independence Act, 1947 was charged with drafting of the state's constitution. This assembly adopted the 'Objectives Resolution' on 12th March, 1949 with the following provisions regarding Islam:

> The government of Pakistan will be a state…
>
> Wherein the principles of democracy, freedom, equality, tolerance and social justice as enunciated by Islam shall be fully observed;
>
> Wherein the Muslims of Pakistan shall be enabled individually and collectively to order their lives in accordance with the teachings and requirements of Islam as set out in the Holy Qur'an and Sunnah.

The Objectives Resolution had come about as a result of an intense debate between the modernists and the Islamists. The Islamic activists in general and the Jamaat in particular challenged certain Western political concepts like "sovereignty" and proposed changes based on the principles of Islamic theology (Binder 1963). This activism proved to be a successful endeavor for the Islamists later on in the 1990s, when the Objective Resolution was utilized as the basis for the Supreme Court's judgment prohibiting financial interest in Pakistan's economic affairs.

The next step in formulating the Constitution of Pakistan was to utilize the principles defined in the Objectives Resolution to work towards the actual details of the Constitution. Among the main opposition groups that were preventing a consensus were the Islamic groups. Though small in numbers, they had a vociferous presence (Binder 1963). It took Pakistan nine years to adopt its first Constitution on March 23, 1956. The Objective Resolution was made a preamble of this constitution. It remained so, i.e. as preamble to the Constitutions of 1962 as well as for the Constitution of 1973. In 1985, General Zia-ul-Haq made the principles and provisions of the Objective Resolution a substantive part of the Constitution of Pakistan (Ayub 2002). We will see later that this inclusion further enabled the Supreme Court of Pakistan to order the elimination of *riba* (financial interest) from Pakistan's economy in 1999.

Since the beginning of the Constitutional debates, one of the central demands of Islamic groups was the elimination of *riba*. In this regard, Binder (1963) argues that even though Islamic groups were a potent force in the constitutional debates, the actual "Islamic provisions in the document were left intentionally vague or weak". Article 28 of the first Constitution of Pakistan in 1956 called for the elimination of *riba* "as early as possible" (p. 128). The 1962 Constitution also had similar provision in its principles of policy that "usury" should be abolished; similarly for the 1973 Constitution. "But, in none of these instances were mechanisms introduced designed to realize such objectives" (Binder 1963 pg. 128).

An important advisory body which played a significant role in the establishment of the Islamic financial institutions was the Council of Islamic Ideology (hereafter CII), established by the 1962 Constitution. Its role was to peruse the existing laws and advise the legislature whether or not any law is repugnant to Islam. CII submitted a number of recommendations regarding Pakistan's economic system, that it was based on *riba* and that it was forbidden in Islam. It called for a complete abolition of *riba* from Pakistan's economy (Ayub 2002, Kennedy 1992). Kennedy (1992) argues that these recommendations had no substantial consequence either during the tenure of Zulfiqar Ali Bhutto in 1970s, "nor by the framers of 1973 Constitution" (p. 128). The 1980s was the first time that the state, under the military rule of General Zia-ul-Haq, vowed to actively pursue an Islamization of economy policy and asked the CII to advise on how best to "eradicate the curse" of interest from Pakistan (Kennedy 1992, p.128). Zia created two constitutional bodies: the Federal Shariat Court (hereafter FSC), which was to examine legal petitions questioning whether or not any law or provision of law is "repugnant" to the injunctions of Islam, and the Shariat Appellate Bench (SAB) of the Supreme Court of Pakistan which would hear appeals from the FSC. These two state institutions were important as symbolic markers of Zia's Islamization program, however their jurisdiction was severely curtailed during Zia's regime. SAB and FSC were able to perform their function after Zia's death and I argue that these institutions actually delayed the establishment of the Islamic financial institutions.

The persistent pressure by the Islamic groups to include Islamic principles within the Objective Resolution, and Objective Resolution's subsequent inclusion in Pakistan's Constitution in 1980s were prominent factors in FSC and SAB's verdicts forbidding financial interest on the basis of Islamic prohibition of *riba*. These verdicts appear to be milestones in the Islamization of Pakistan's constitutional and legal arenas and in the de-secularization of its economic realm. However, I argue that, on the contrary, these Islamic constitutional inclusions and the court cases did not make much difference in the formation of an Islamic finance industry (IFI) and actually delayed its creation in Pakistan. I point out certain other factors, particularly the political processes and Islamic interpretation approaches that were critical in IFI's establishment. But first, I will now detail important political events that propelled Islamic economic theory into a practical venture.

3.2.2 Domestic and International Politics During 1960s and 1970s

General Ayub Khan ruled Pakistan in 1960s as the first military dictator of Pakistan. The two defining features of Ayub's regime were the economic and religious programs. Internationally, it was a time of leftist politics and Cold War, and its influence was being felt within Pakistan. A mass agitation for democratic rights ensued against Ayub Khan and he had to relinquish his post in 1969. As the protests were going on, Zulfiqar Ali Bhutto, the foreign minister of Pakistan resigned from the government and formed Pakistan's People Party (PPP) to contest the upcoming elections.

Bhutto's PPP took power in 1971 and embarked on "Islamic Socialism" rhetoric. Bhutto was blatantly insincere about the Islamic element of this ideology but it was a politically expedient exercise given the rising movement of political Islam (Cohen 2004).

He cultivated strong links with Muslim governments and was at the forefront in Third World Forums. In this regard, Pakistan hosted many important conferences and meetings like that of the pan-Islamic Organization of Islamic Cooperation (OIC).

Internationally, 1970s was also a time of non-aligned movement (NAM) that purported to being neither with the West, nor with the USSR. Bhutto's stance in the early 70s reflected that of the NAM, even though Pakistan formally joined NAM in 1979. Domestically, Bhutto nationalized major industries and the banks but his popularity declined dramatically because of the ill effects of economic policies, succumbing to the opposition which included a significant number of religious parties. Bhutto was removed from power through Pakistan's third military coup led by his favorite General, the pious Mohammad Zia-ul-Haq, who took charge in 1977. Here it is pertinent to note that till Zia-ul-Haq, previous leaders were paying mere lip service to the cause of the Islamization of Pakistan. Pakistani establishment had been largely modernist Muslims, if not secular. Zia-ul-Haq was the first ruler who attempted to institutionalize Islam at the state level (Kennedy 1992).

Internationally, early 70s also witnessed the oil embargo through which the Arab nations found unprecedented wealth leading to a feeling of self-confidence in their chance to negate the hegemony of the West (Warde 2000). As a result of these developments, an Islamization of Knowledge (IOK) movement was started whose aim was to "de-colonize social sciences from Western and secular hegemony and present contemporary knowledge based on Islamic principles" (Euben 2002). There were two major strands of this movement. The first was associated with the Al-Attas school that sought to critique the epistemological foundations of contemporary knowledge. The second school was that of Faruqi that sought to empirically change the disciplines to Islamic sociology, Islamic feminism, Islamic Economics etc. Many Pakistanis played a prominent role in the Islamic revival of knowledge movement and the physical manifestations of this effort can be witnessed in the two Islamic International Universities in Islamabad and Malaysia founded in 1980 and 1983 respectively. There are many research institutions dedicated to Islamization of knowledge, not only in the Muslim majority countries but also in the West.

One of the most significant areas of focus of the Islamization of knowledge movement was Islamic economics. Late 70s and early 80s produced a large amount of Islamic economic literature. Warde (2000) refers to the Islamic economics stream as the second “aggionomento”, propelling the theorization of Islamic economics by Western trained economists as opposed to the social critics of an earlier generation like Maududi. Kuran (1997) notes that the academic credentials of the Islamic economic theorists led to a perceptibly positive development in Islamic economic theory. Many prominent Islamic economists were from Pakistan, for example, Khurshid Ahmad, Munawwar Iqbal, Sayed Hussain Naqvi. These pioneers who formulated the aggionomento are popularly and nostalgically referred to as the “first generation” of Islamic economists; nostalgic in a sense that their intentions and direction is seen exemplary by the contemporary Islamic economists (Ahmad 2006). In 1974, the first Islamic bank started its operations in Dubai, and the first Islamic multi-lateral bank, Islamic Development Bank (IDB) was also established.

Thus, 1970s proved to be an important decade for Islamic economics as this was the first time the theory was actually applied and, influenced by important international events and social processes, led to the emergence of the first Islamic financial institutions in history. Important aspect to note at this point is the impact of these international processes and events on the two approaches of Islamic interpretation noted above. Those taking the non-traditional approach were engaged at the global level, forming networks amongst themselves, as well as interacting with other global actors and ideas. IOK formed the core of this loosely connected group. As independence from the colonial rule gave the first boost of confidence to Maududi, the group inspired by Maududi (non-traditional Islamists) was given a second boost by the oil embargo and Iranian revolution. The traditionalists were only engaging with Maududi. Their economic concerns were very limited till the end of 1970s. The extensive research, seminars, conferences, institutes working on Islamic economics could not be ignored by the traditionalists and some amongst them started working in this field bringing with them their form centric approach and methods. The traditional approach of devising Islamic economic solutions linked particularly well with mimicking the conventional banking instruments. The next sections will show that appropriate political context will propel the IBF industry to form in Pakistan.

3.3 From Theory to Practice

3.3.1 Zia's Islamization of Economy Program

Zia-ul-Haq was the first ruler who was devoutly religious himself and formed bonds with the Islamic parties, especially with the Jamaat. He was also the first head of state who took concrete steps to undertake Islamization of economy. As soon as Zia-ul-Haq came to power, one of his first acts was to ask parliament's advisory body, the

Council of Islamic Ideology (CII), to work on a blueprint for Islamizing Pakistan's economy. Due to a lack of economics expertise, CII, under the chairmanship of Dr. Tanzil-ur-Rahman, convened a panel of bankers and economists to work on a blueprint to Islamize Pakistan's economy.

3.3.1.1 Report of the Council of Islamic Ideology on Elimination of Interest from the Economy

The panel convened by the CII included banking professionals, academics and Islamic economists. It worked enthusiastically and submitted its report to CII. The CII made minor changes to the report and presented an Islamic economic framework to the government in 1980. This report is widely regarded to be the first comprehensive attempt to eliminate interest from the banking and financial sectors of an Islamic state (Khan and Bhatti 2008). Burki (1986) sets out some of the major recommendations by the CII. The first of these was to avoid a revolutionary shift and to make the implementation of the Islamic system gradual so as not to cause disruption and hardship for the state as well as for the people.

> Since Pakistan's economy had evolved essentially on capitalist lines and, therefore, had many features that were not Islamic. True the institutions will change under the impact of Islamic Reform, but that takes time. A beginning has to be made and at this stage the institutional constraints are overwhelming. The point of contact of the Islamization process will be the present socio-economic set-up, which, being a hard reality cannot be ignored (pg iii).

According to Burki (1986), authors of the report took an even more radical step by rejecting the notion that Islamization of the economy only entailed the establishment of an interest-free system and the introduction of *zakat* (obligatory annual alms of 2.5%

on wealth for Muslims). The authors of the report commented that there was “an undue obsession with only these two elements of the Islamic reform”. Eliminating financial interest may result in an “un-Islamic rise in the overall level of economic exploitation of the poor by the rich” (pg. iv). The main objective of an Islamic economic system was purported to be the achievement of *al-adl wal-ahsan* (justice and kindness) brought about by providing universal education, improvement of the quality of life through availability and easy accessibility of basic consumer goods, and an increase in the level of employment (Burki 1986). The report was quick to note that “these are objectives of any economic system; but that does not disqualify them from being the objectives of the Islamic economic system as well, particularly as they follow directly from Islam’s own distinctive economic philosophy (pg 8)”.

Detailing other features of the report, Burki (1983) contends that profound change would have occurred in the structure and growth pattern of Pakistan’s economy, had the government implemented the committee’s report in its entirety. However, Zia’s government chose to concentrate only on those elements that were popularly perceived as Islamic i.e. the issue of *riba* and *zakat*, but were clearly singled out by the CII report as the non-crucial elements for the introduction of an Islamic economic system (Burki 1986).

3.3.1.2 Non-Interest Based System

The government of Pakistan embarked upon changing its economic and financial system in the light of Islamic prescriptions through the implementation of non-interest based (NIB) system. Those who would be responsible to administer the system would be the economists, bankers, politicians and bureaucrats. The government assigned this task to the Ministry of Finance and asked the ministry to start implementing the recommendations of the CII report. The Ministry of Finance in turn delegated the State Bank of Pakistan (SBP) to take necessary steps to fulfill the technical details of the CII report. The Ministry of Finance also asked one of its special body, Pakistan Banking Council (PBC), to suggest the legal reforms related to banking and finance that were needed to implement the non-interest based (NIB) financial system in Pakistan (Bhatti and Khan 2008, Ayub 2002).

Khan and Bhatti (2008) have given an in-depth account of the legal changes made in the conventional banking laws for the functioning of the non-interest based system. The 1962 Banking Companies Ordinance (BCO) is the primary source of legal provisions for Pakistan's banking practice. The State Bank has discretionary powers to regulate Pakistan's banking and financial institutions under this law. In 1982, this law was amended to add certain functions that the banks would have to perform while operating in the Islamic mode. The conventional banks were not allowed to trade in physical assets or be involved in manufacturing. Manufacturing and trading activities under the Profit and Loss Sharing (PLS) system, mark-up in price, leasing and hire purchase were facilitated under the promulgated law. In the new NIB system, the debtor was now a business partner, thus the definition of creditor and borrower was changed accordingly. The definition of finance was extended to include finance provided on the basis of PLS, mark-up in price, leasing and hire purchase. Other necessary changes were made in the legal framework to provide smooth functioning of the new non-interest based system. Furthermore, the 1984 Banking Tribunal Ordinance was formulated to establish Banking

Tribunals for expediting legal judgments on banking cases and thereby ensuring a speedy recovery of banking funds from defaulting customers (Khan and Bhatti 2008 pg 107). Ayub (2002) notes that the term ‘interest’ had not been defined in either the Tribunals Ordinance or the Banking and Financial Services (BFS) Ordinance. The precise definition of this critical term was found only in one legislative document, Balochistan/NWFP/Punjab/Sindh Moneylenders Ordinance 1960, (now repealed).

The seven laws amended through the BFS Ordinance include: i) Banking Companies Ordinance, 1962; (ii) the Companies Ordinance, 1984; (iii) Establishment of the Federal Bank for Cooperatives and Regulation of Cooperative Banking Act, 1979; (iv) Registration Act, 1908; (v) Partnership Act, 1932; (vi) Wealth Tax Act, 1963 and (vii) Income Tax Ordinance, 1979 (Ayub 2002 pg 272).

Zia’s government heeded CII advice that recommended gradual adoption for institutionalizing the Islamization program. As the first step in this regard, affairs of National Investment Trust, the House Building Finance Corporation, and the Investment Corporation of Pakistan were to be run on an interest-free basis through the adoption of profit-loss sharing (PLS) (Kennedy 1993). The second step was a directive by the SBP to all banking institutions to open interest-free Profit and Loss Sharing (PLS) counters in 7,000 domestic branches across the country in 1981. At this point, SBP advised the banks to invest in non-interest based institutions and to keep the Islamic funds separated from the conventional funds. The depositors were given free choice to either stay with the conventional banking counters or to convert their accounts to the PLS ones. The public gave an enthusiastic response and many switched voluntarily (Faruqui and Habibullah 1983). In 1984, SBP took the final step by mandating the conversion of all financial transactions to interest-free modes it had been recommending for the past four years. The clients were given the option of withdrawing their accounts if they did not want their account to be on PLS basis.

Throughout this process, CII critiqued and offered alternative solutions for a number of contentious issues. However, SBP and its affiliated organizations rarely sought CII's advice and disregarded the recommendations repeatedly. As an illustration, the SBP set up a documentation committee to prepare the draft documents for practicing *murabaha* financing on the pattern followed by most international Islamic banks under the guidance of their *shari'a* advisory board. However, even though CII approved these documents, PBC disapproved them without giving any plausible reason. Afterwards, PBC developed its own documents for practicing mark-up financing with a buy-back agreement, without seeking any advice from the CII. The result being that IBF practice in Pakistan was confined to the mark-up banking practice. The CII had recommended the use of mark-up financing under special circumstances and with strict precautionary measures so as to avoid its degeneration into an interest-based activity. However, SBP allowed banks to rely heavily on mark-up financing (Khan and Bhatti 2008).

SBP did not offer any advisory role to the CII in the process of transforming country-wide banking and financial system on Islamic lines. The CII, on the other hand, continually warned the SBP about substantive procedural shortcomings in adopting IBF practice. The Ministry of Finance always dealt with such objections by reassuring the CII that it was only for a transitory period in which the banks would be largely relying on mark-up financing; the ministry was working on devising concrete plans that would ensure a greater application of the PLS system and would only make rare use of the mark-up system in the long run. After some time, however, PBC argued that it was an absolutely utopian idea for over 7,000 branches of commercial banks countrywide in Pakistan to use PLS financing and to sort out the terms and conditions of loan applications on a case-by-case basis which was required by the Islamic system (Rahman 1997).

Majority of Islamic scholars had serious reservations about the practice of mark-up financing in Pakistan. Lashkar (1991) critically remarked that the practice of mark-up financing in Pakistan amounted to hypocrisy. S M Ahmad (1992) pointed out that interest-based banking in Pakistan had not been eliminated but rather replaced by a higher interest-yielding system as the cost of borrowing rose from 14 percent to 17.15 percent after the introduction of NIB. Kadri (1996) stated that mark-up financing was a concealed form of charging interest on banking transactions. Uzair (1997) showed his contempt for mark-up financing by saying, “A new word came into use, i.e., mark-up, which is just a mark-up for the word interest”. Zaidi (1991) a senior banker in Pakistan observed that the present form of the banking and financial system was based on simple interest and that the government had eliminated only compound interest from the economy of Pakistan.

Very soon both the government camp and the Islamists realized that there would be very little headway in the implementation of the Islamic economic system. Maneuvering the debate to revolve only around the issue of *riba* and *zakat*, Zia’s government rightfully concluded that a genuine interest-free system cannot be implemented because CII was unable to present a detailed blue-print for this effort. At the same time, Islamic economists were discouraged by the lack of sincere intention from the government.

First Maududi and now Zia, were involved in popularizing a *riba* centric discourse. For Maududi, it was primarily a quest to reconcile religious commandments in an anti-colonial struggle, but for Zia, *riba* centering was an unintended consequence of his political maneuvering. Even though Zia's strategy to employ the rhetoric of establishing an interest-free economic system may have resulted in some increase in popularity, but it also narrowed the scope of Islamic economic discourse to the debate on *riba* rather than economic justice stressed by the Islamic economists. The *ulama* were highly critical of the government's cosmetic changes but they also got embroiled in the naïve debate on how this system was not able to shun *riba* instead of pursuing social justice discourse of the Islamic economists. Mawlana Taqi Usmani voiced these concerns on a number of forums but I do not observe a concerted call for the government to ignore the problematic issue and concentrate on the social justice aspects of the recommended reforms by the CII.

3.3.1.3 Political Processes and the Judgment Banning Financial Interest

Adding to the mistrust between the Islamists and Zia's government was another constitutional strategy impacting Islamic economics, designed by the government to enhance its public appeal but lacking in substance. The Federal Shariat Court (FSC) was grafted onto Pakistan's constitution in 1985 by Zia. FSC either through its own initiative or through the petition of a citizen of Pakistan or Government may examine or decide the question whether or not any law or provision of law is repugnant to the injunctions of

Islam as laid down in the Qur'an and *hadith*. However, its jurisdiction was curtailed and it could not examine:

> … the Constitution, Muslim personal law, any law relating to the procedure of any court or tribunal, or any fiscal law or any law relating to the levy and collection of taxes and fees or banking or insurance practice and procedure. (1985 Constitution, Article 203-B)

It is clear that the actual intention behind the juridical bar was to prevent the FSC from challenging any fiscal law (amongst others) on the basis of the prohibition against *riba* (Kennedy 1993). This bar originally imposed for three years was extended three times, till 1990. As soon as the period expired in 1990, 115 petitions were filed with the FSC challenging 20 separate laws violating financial interest. After lengthy deliberations, FSC gave its judgment in November, 1991 (Ayub 2002) deeming several federal and provincial laws repugnant to Islam as detailed below.

Apart from the legislation strategy chosen by the Islamists, political utilization of Islamization of Pakistan by other groups remained strong even after Zia's death in 1988. Various ensuing governments employed Islamization rhetoric and took hollow steps to bring about an Islamic system. As elimination of *riba* had become the center stage of an Islamic economic system, various committees and working groups were formed by the state to work on proposals and blue-prints. A number of coincidences occurred in 1990 that marked the future direction of the elimination of *riba* movement. First, the government of Benazir Bhutto failed to extend the restricted jurisdiction of the FSC, opening the way for the petitioners to bring cases pertaining to financial laws to the court's attention. Also, the then president Ghulam Ishaq Khan appointed Justice Dr. Tanzil-ur-Rahman, the prime author of the CII's report on the elimination of *riba* from the economy, as the Chief Justice of the FSC. Additionally, Objective Resolution had recently been made as part of the Constitution, binding all laws to be in the light of the Qur'an and *hadith*. As mentioned before, the plaintiffs made a case against the government that the financial provisions were supportive of interest and that it is "repugnant" in the eyes of the constitution. Justice Tanzil-ur-Rahman reproduced substantial portions from the CII report in his FSC's judgment that declared provisions of twenty federal and provincial laws dealing with *riba* as repugnant to Islam, and ordered the government to take legislative action to revise them by July 1, 1992 (Kennedy 1993).

The government of the time, led by Nawaz Sharif had acquired electoral victory by claiming that Benazir's government opposes the implementation of the *shari'a*. Nawaz Sharif was leading the coalition of Islami Jamhoori Ittihad, IJI (Islamic democratic Alliance) whose prime demand was the establishment of an Islamic system. Zaman (2002) notes that "Nawaz Sharif actively pursued and sponsored the Enforcement of Shariat Act, not to empower the religious leaders in the functioning of the state, but rather to largely consolidate powers with the federal executive branch (and consequently with his own person), as against the judiciary and against the provinces" (p.). Nawaz Sharif had also taken concrete steps to privatize, liberalize and de-regularize Pakistan's economic system. His government had organized many investment conferences in Washington, London, Tokyo and Los Angeles to provide accurate information to prospective foreign governments and investors on investment opportunities in Pakistan (Khan and Bhatti 2008). However, FSC's verdict against *riba* placed the government in a conflicting position, between its Islamization rhetoric and actual policies. Prospective international investors took a precautionary step back from investing in Pakistan because of the unclear repercussions of an Islamic economic system. “There was a sharp decline in the flow of foreign investment, aid and loans into Pakistan, and progress on more than 204 major debt projects was stalled due to the FSC judgment” (Khan and Bhatti 2008 pg. 131). Sharif’s government promised the foreign businesses that the implementation of the judgment would not affect international financial dealings and contracts, but the business climate that would bring in foreign capital, technology and entrepreneurship into the market, had been harmed.

Nawaz Sharif faced a conundrum of keeping true to the Islamization rhetoric by not appealing against the FSC decision as well as supporting a conducive business climate. However, he found an expedient way out by asking a semi-government institution, the Agricultural Development Bank, to file an appeal before the Shariat Appellate Bench (SAB) of the Supreme Court challenging the FSC decision (Kennedy 1993). Thus conventional market forces continued to exert its influence on the Islamization of the economy.

The appeal against the FSC judgment was to be heard by the SAB of the Supreme Court. After a delay of seven years, the political stand-off between Nawaz Sharif and the Chief Justice of the Supreme Court propelled the *riba* case to be heard in February 1999. General Musharraf’s military coup in October 1999 distracted the government that had used various tactics so far to delay or derail the case. Because of this lapse by the government, the SC issued its verdict in December 1999, upholding the FSC decision of declaring the present financial system to be abolished as it is “repugnant to Islam”. The judgment made many propositions on how to implement an Islamic financial system and advised the government to make appropriate committees and task forces to work on a plan to operationalize the system by July 2001. The government appealed that even with much hard work, it would not be able to complete its study of the proposal and asked for a five year extension. The Supreme Court refused the five year extension but granted one year's instead. Dr. Ishrat Hussain, then governor of the State Bank of Pakistan (SBP) assured the judiciary that all efforts will be expended on converting the current economic system to an Islamic one. In September 2001, an inter-Ministerial meeting was chaired by General Musharraf in which the implementation of the SC verdict was discussed in detail. The prospect of a complete overhaul of the system along Islamic lines was rejected. The insider story is that the then chairman of CII suggested at the meeting to open private Islamic banks as it was common in many Muslim countries. The proposal coming from a legitimate religious authority was taken up instantly by the government and in December 2001, the SBP issued detailed criteria to set up a private Islamic bank. This was a discernable change in the government's attitude since the previously antagonistic state now fully patronized private Islamic banks.

Explaining this strategy of Pakistan's government, World Bank in its Pakistan Development Policy Review of March 2002 observed: "The government's vision for a market-based financial system proposes the approach to provide a choice to the people and let the market work, so that those who want Islamic instruments can easily get them while those who are more risk-averse and want to assure capital preservation can likewise have access to such instruments."

To summarize, the political utilization of Islamization did not die with Zia's demise in 1988 but instead played out quite prominently. Various ensuing governments employed rhetoric and took politically expedient steps to bring about an Islamic system.

As the elimination of financial interest had become the center stage of the Islamic economic system, various committees and working groups were formed by the state to work on proposals and blue-prints. After the Islamic activists won the legal battle through the Supreme Court verdict to eliminate interest from the economy, the government tried all possible tactics of appeal, delay or denial but to no avail. Meanwhile, the banking industry in Pakistan had been undergoing a transformation as well. Until the early 1990s, the banking industry of Pakistan had mainly comprised of five major nationalized banks enjoying a market share in the country in excess of 92 percent (Khan and Bhatti 2008). This situation had gradually changed after rigorous moves by the government of Pakistan since the 1990s to privatize and deregulate the financial market. Consequently with the Supreme Court's verdict, the eventual choice of action for the government turned out to take the free-market route and promote private Islamic banking. Hence, rather ironically, it was the liberal, secular-minded Musharraf regime that ended up implementing these private Islamic banks. Furthermore, antagonism between the government and the Islamists on the issue of interest elimination changed completely thereafter as well. The next section will describe how two groups emerged out of the Islamist movement and their subsequent influence on the institutional logic of the Islamic banking industry.

3.4 Two Groups in Islamization of Economy Movement

The first group was that of Islamic economists who remained loyal to Maududi's vision of eliminating all forms of *riba*. It has already been shown that Maududi is credited to have developed a strong link between *riba* and injustice which was maintained and elaborated by these Islamic economists. The objective of this macro level focus was to bring a change at the systemic level so that economic exploitation could be rooted out. Their literature frequently mentions austerity measures, limits to profits, elimination of poverty, fulfillment of basic human needs, inculcation of elements of contentment and reduction of moral corruption due to greed and unlimited acquisition. This group also expressed a concern that despite the Islamic legality of the proposed instrument, its end results were virtually similar to those of the conventional, interest based instruments. This unease is conspicuously absent in the second group.

The second group was that of the Islamic financial advisors. By far, the leading figure in this group was Mawlana Muhammad Taqi Usmani, an *aalim* (singular of *ulama*) trained in a prominent *madrasa* (a school of higher Islamic learning) (Zaman 2002) who had also obtained Masters and LLM degrees from mainstream educational institutions. Usmani was a member of the CII committee which issued the report on the Islamization of the economy in 1980 and was a judge in the FSC from 1980 to 1982 and also a member of the Shariat Appellate Bench of the Supreme Court of Pakistan from 1982 to 2002. Taqi Usmani was a vocal critique of the applied non-Interest based banking during the Zia era whose role was crucial in the judgment against *riba* in 1999. He has been involved internationally at the highest level of *shari'a* consultancy and advisory since the early 80s. He also established Center for Islamic Banking and Economics (CIBE) in 1995 to train the *Madrasa* students in economics in general and Islamic finance in particular. CIBE was the only resource available to supply the Islamic finance industry with trained *shari'a* advisors. During 80s and 90s, Taqi Usmani was the only prominent traditionally trained *aalim* in Pakistan who pursued conventional financial knowledge and was involved in the highest positions deliberating the *shari'a* aspects of Islamic finance.

The first aspect to note for my analysis is Usmani's involvement both at the state as well as pan-Islamic institutional level. Usmani was fully aware and deeply involved in a highly lucrative, international Islamic finance industry of the 1990s while his focus for Pakistan was to pressurize the state to bring about a systemic change. As shown previously, a pragmatic change in the government's stance in 2001 led to its decision to create private Islamic banks. Taqi Usmani and the State Bank of Pakistan (SBP) started working very closely to set up Pakistan's first private Islamic bank. The most important facet to note here is Usmani's view that the main objective for an Islamic Finance institution is to provide *halal* income for Muslims. Islamic finance thus became a micro focused endeavor aiming to provide salvation to the individual Muslim. Concerns dealing with economic justice, elimination of income inequalities, reducing poverty are conspicuously missing in Usmani's writings. Where Usmani does address these issues, he frequently resorts to the Qur'anic verse "... they say trade is just like *riba*, but Allah has allowed trade and has prohibited *riba*" (2: 275). Usmani explains it:

> They intended that if a profit claimed in a transaction of sale [trade] is just and lawful, there is no reason why an interest claimed in a transaction of loan is held to be unjust and unlawful. In answer to this argument of theirs, the Holy Qur'an could have mentioned the difference between interest and profit in pure logical manner, and could have explained how the profit in a sale is justified while interest is not. The Holy Qur'an could have also spelled out the evil consequences of riba on the economy. But this line of argument was intentionally avoided, and the brief and simple answer given by the Holy Qur'an was: Allah has allowed sale and has prohibited interest. The hint given in this verse is that the question whether these transactions have an element of injustice is not left to be decided by human reason alone, because the reason of different individuals may come up with different answers and no absolute conclusion of universal application may be arrived at on the basis of pure rational arguments. The correct principle, therefore, is that once a particular transaction is held by Allah to be *haraam*, there is no room for disputing it on the basis

> of pure rational argumentation because Allah's knowledge and wisdom encompasses all those points which are not accessible to ordinary reason. If the human reason was fully competent to reach the correct decision unanimously in each and every issue, no divine revelation was called for. There is a wide area of human conduct in which the Creator did not give a specific command. It is this area where human reason can well play its role, but it should not be burdened to play the role of a rival to the express divine injunctions (p 87).

The important aspect to note here is the effort by Usmani to offer an Islamically legitimate explanation to ease the discomfort felt by Islamic economists over the issue of virtually identical results of many Islamic contracts with those of conventional finance.

On another front, a transformation of the relationship between Usmani and the state can be clearly observed. Seeing the bleak prospects of institutionalizing an interest-free system at the state level, the choice strategy for Usmani became to espouse the private Islamic banking initiative. Usmani played a key role in its development in Pakistan from 2002 onwards. Thus there was a continuous change in the concern for the state, or the self by the *ulama*, depending on the prevailing circumstances of the historical period considered and the particular sub-group that is studied. The focus on micro level individual salvation and *halal* profit became the dominant institutional logic within Islamic banking industry. In the next chapter, I will examine the extent to which this logic has influenced the banking practitioners, compared to the Islamic economists' logic of social justice and welfare.

3.5 Conclusion

In the previous chapter, I elaborated on how the standard explanations for market emergence presented their analysis on a time-line, starting from the theory proposed by

Adam Smith that capitalism was the result of a natural process of human interactions. The theory would then present the next phase of capitalistic development that would relate capitalism as a deliberately constructed institution brought about through rules and concrete policies. The third definitive phase was the sociological contribution by Granovetter who triggered the importance of social networks, political interests, and cultural processes back into the picture. I proposed that the emergence of market institution was composed of elements that were constructed and deliberate, but there were also some aspects that were consequential. My case study shows this at multiple instances. The political processes specifically depict the constructed and conscious efforts. The state is the most prominent entity that took a leading role in the establishment of the IBF industry. But why did the state not create this industry sooner and rid itself of the continuous pressure it faced to eliminate *riba*? Why did the state have an antagonistic attitude towards *riba* elimination throughout the 90s compared to the patronizing and facilitating attitude 2000 onwards? The answer is the difference in political situation between 1980s and 2000s. Zia-ul-haq was politically vested in Islamizing the economy at the macro level. His rhetoric had brought Islamization of the economy to mean the elimination of *riba*. Any course of action that would not solve this issue was not considered acceptable. Private Islamic banks would not satisfy the demand for a systemic change in the economy. Focusing on economic justice and equality as suggested by CII would not eliminate financial interest and thus also not live up to the Islamization rhetoric. As a result, regulatory steps were taken that would appease the pressure but it failed to institutionalize economic Islamization at any level. Musharraf, on the other hand was free of these self-imposed constraints as he made no claims to change the system to an Islamic one. IBF creation was a pragmatic move which resulted in Islamization at the meso-level and also satisfied (at least for the time-being) the state's constitutional mandate to eliminate *riba*. It is important to note that previously contentious religious groups were accepting of this solution (Taqi Usmani's group in particular, and Jamaat to certain extent).

The main consequential aspect to note for my analysis is the alignment of traditional approaches to Islamic interpretation with the conventional banking approach. An observation that has been missed by most analysts studying the emergence of IBF in Pakistan is the important consequence of two historical discourses that led to the formation of two norms of exchange, one of which was successful at institutionalization due to its alignment with the conventional financial system. Two groups emerged during the early twentieth century with a distinct approach to Islamic interpretation. First were the traditionalists who were dis-engagement with modern Western thought and the second were the non-traditionalists who engaged with Western ideas and debates. Maududi represented one stream of the later, a stream in which contentiousness and identity politics played a definitive role. Two major Western ideas were present at the global stage during Maududi’s time. Informed by his reading of the Qur'an, Maududi chose the largely anti-capitalistic and pro-equality/social justice reading and gave concrete proposals for a viable Islamic economic system. The euphoria of freedom from colonial rule and the hope for an ideal Islamic system in an independent state led Maududi to formulate an Islamic economic system that would be free from all "corruptions" of the capitalistic system as well as Socialist system. Islamic economists were influenced by Maududi's model and elaborated it, focusing on social justice.

Traditionalists would engage with Maududi's vision and appropriated his stances selectively, without acknowledging. Stance on *riba* being equal to financial interest and state imposition of Islamic rulings were some of the common grounds between the two models. Traditionalists maintained their Islamic jurisprudence knowledge based on *taqleed* (rulings on precedence). Traditionalists got involved in economic issues in the late 70s developing financial instruments by imitating earlier pre-modern Islamic juristic rulings. Traditional approach was very successful in mimicking the conventional system in spite of Taqi Usmani's pragmatic and rational approach since he derives legitimacy by citing earlier rulings.

Oil embargo and Iranian revolution gave a boost of confidence to Islamic groups who became more forceful in their demand for an Islamic system. When the political processes mentioned above curtailed the opportunity for maro-level religious system in Pakistan by the end of the 20th century, the traditionalists opted to work with the state since their priority then became to provide solution for individual salvation.

CHAPTER 4:

INSTITUTIONALIZATION

4.1 Introduction

In the previous chapter, I explained how the Islamic banking (IB) institution in Pakistan arose out of political and cultural processes in a national context. Certain international events, pressure groups and neo-liberal market globalization trends impacted the political and cultural framework, thus contributing indirectly to the rise of Islamic banking in Pakistan. Specifically, the political ambitions of Zia-ul-Haq's Islamization program in the 1980s inadvertently led the discourse to be centered on the elimination of financial interest rather than getting rid of social inequalities. The role of the traditional *ulama* (theologians) was highlighted and contrasted with the Islamic economists to understand that it was the form focused approach and the specialist knowledge of the *ulama* acquired at the seminary, which was critical in providing the tools to launch the Islamic banking industry.

In light of institutional theory, the prediction for IBF industry would be that it is highly likely to de-couple its structure with actual operations (Meyer and Rowan 1977). Moreover, because of the dominance of conventional banking institution, IBF will conform to conventional banking only ceremonially while its internal workings would be loosely coupled or significantly different (Meyer and Rowan 1977). However, my observations are somewhat contrary to the theoretical predictions. I find that the IBF operations i.e. the actual financial instruments and processes generally mimic the larger conventional ones, and that it is the "myth and ceremony" which is different. A concrete example would be through looking at the industry label. Labels such as ethical banking, or interest-free banking could have been used, but instead, Islamic banking is predominantly employed by the industry members. A religious label in the larger secular financial industry would not increase legitimacy, in fact may reduce it, especially because of the War on Terror is largely associated with Islam. At the same time however, IBF had to de-couple its overt religious image with its day-to-day activities and processes which are very similar to conventional banking. Han and Koo (2002) point to two factors that could induce de-coupling. The first is to avoid or resist regulation, and the other is an ambiguity of information and knowledge about the institutionalized practice or program. Certainly conforming to regulations is at work in my case, but a tentative explanation regarding structural conformity rather than ceremonial conformity seems to be that Meyer and Rowan and subsequent research generally looked at the mainstream organizations whereas my empirical case is of a niche industry whose interest is in creating an oppositional image to conventional banking.

Now that we have looked at institutional emergence within a dominant institution, the next step is to analyze the consequences of IBF's institutionalization within, i.e. at the organizational level as well as the individual level. I ask whether and how do the form-focused institutional narratives present at the time of the creation of Islamic finance industry impact the operations and processes of IB organizations? To what extent are the Islamic bankers committed to the form focused logic of IBF i.e. are they thoroughly vested in following the letter of the Islamic law or rather engage with it for instrumental and/or superficial reasons? [17]

Scott (2008) provides a useful framework to analyze institutionalization by delineating regulative, normative and cultural-cognitive as the three components of institutions. Employing this framework for my analysis I will first present various scenarios that can be hypothesized. The main body of this chapter will then focus on assessing the empirical evidence leading us to dwell on theoretical contributions in the conclusion section.

The first aspect of institutionalization is the regulative "pillar" (Scott 2008). If Islamic banks were to be regulatively institutionalized, we would expect to see an organization in which there are clear lines of authority (religious, state, banking institution) with accompanying checks and balances. The pre-dominant basis of compliance is expedience which would be achieved through instrumental functioning. The organization and its members understand that the only viable path to survive in the banking industry is to observe the Islamic law on *riba* only in letter of the law by applying the dictates of the *shari'a* board. Islamic bank realizes that it will be coerced into following the institutional rules and be penalized through sanctions. Those working in the regulatively sustained Islamic banks would be scared to break a rule, whereby the only route to survive is to observe all instructions. All minor details will be in the form of a rule (Scott 2008).

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[17] Thanks to Omar Lizardo for his suggestions on improving the questions as well as to utilize Scott's (2008) formulation.

A second scenario can be constructed by seeing IB to be resting primarily on a normative pillar. In this conception, the institution creates such a moral discourse that the organization and its members are obliged to follow the expectations set by some legitimate entity. If there is a circumstance in which a legal action can be performed that would be beneficial to professional goals but will break the institutional norms, then that act will be avoided at all costs to avoid the shame. In this normative case, the concern for religious obligations is so strong that the practitioners do not break the established norm even though they may not agree with it. For example the religious obligation to avoid *riba* is such that once they join, leaving the bank becomes very difficult. There are no written rules and laws per se, but aspects such as how to conduct personal behavior, how to deal with a customer etc. are well known throughout. There is no need for memos or circulars here. Other conceptions of Islamic banks will be frowned upon and labeled as “un-Islamic”. Some practitioners may be aware of the problems within, but are accepting of the short-comings for the greater good.

The last hypothetical scenario is that of an Islamic bank resting mainly on cultural-cognitive institutional pillar. Here, the organization will mimic the larger institution of Islamic finance. Islamic banking witnessed by them will make sense to the practitioners and it will satisfy them. The bankers will not feel the need for another model. As Lizardo (2008) suggested, if the practitioners see another form of Islamic banking being practiced, it will not appeal to them and be meaningless. At the same time, if they do not come across a different model then it would be extremely difficult to conceive of another model.

In the next section, I will first detail my observations of the on-the-ground functional and operational processes and individual's understanding in the Islamic banks I studied. I find that the strong version of a pure institutionalization process is absent, but instead, a combination of regulative and normative aspects inform the Islamic banks I studied. Cultural-cognitive features were lacking generally.

Since one of my focuses was to understand the effects of institutionalization at the individual level, I saw that the everyday practices of Islamic bankers were not so much about asserting Islamic identity or attaining spiritual satisfaction, rather, they were about mundane and professionally expedient concerns that had to do with getting the job done, to get more clients, complete the paper work, to ultimately show a profit on their profile. Capitalistic logic was present in their practice. However, during in-depth interviews with the bankers, I found them to be cognizant of the critiques regarding Islamic banking. These practitioners had pondered on the prevalent critiques of IBF and would provide reasoned explanations about Islamic legitimacy, defying the capitalistic and IBF institutional logic at many instances. However, the bank employees utilized the means provided by the institution i.e. the *shari'a* advisor, to shift their client's concern for an Islamically legitimate income, from their own selves to the *shari'a* advisor. Thus one can say that the bankers selected certain institutional aspects to satisfy their personal salvational concerns and they do not blindly rely on the *shari'a* advisor for the stamp of legitimacy for their own selves, but they are using this provision to satisfy their customers. Lastly, even though these practitioners were critically aware of institutional practices, they were not able to bring about a substantial change in their practice.

I will start explaining what Islamic finance is by giving an overview of Islamic banking operations and its popular instruments. Then I will show what an Islamic finance institution actually means to the people who are working in this industry. Lastly, I will present my findings conducted during my field research and interviews of Islamic bank's management in the conclusion section.

4.2 Structural and Functional Features of IBs in Pakistan

4.2.1 *Shari'a* Supervisory Board

All Islamic Banks have either an individual *shari'a* advisor or a *Shari'a* Supervisory Board (SSB) whose role is to ensure that any new formulations are in line with *shari'a* principles and are within Islamic norms. This board is in addition to the conventional Board of Governor. The individual advisor or the SSB has the highest executive level and reports directly to the BOG. El-Gamal (2006) notes that the SSB is one of the prime aspects that is looked at by the potential clientele because respected and well-known scholars lend legitimacy to the bank's Islamic operations. This is the reason that an IB vies to include reputable Islamic jurists or *shari'a* experts in their SSB. Membership of SSBs is often drawn from the professional specialists of Islamic jurisprudence (*ulama*) and they perform all or some of the following duties: setting the *shari'a* rules for the conduct of banking business; examining all or part of the bank's transactions to ascertain whether there have been breaches of the *shari'a* rules; and issuing a statement in the annual report of the bank as to whether or not the bank has conducted its business in compliance with the *shari'a* (Karim 1990). Hanifa and Hudaib (2007) contend that:

> Confidence in the *shari'a* scholars is the bedrock of Islamic banking and any doubts concerning their integrity and ability to handle complex financial systems and keeping the operation Islam compliant may lead to a loss of confidence in the system.

Kahf (2004) notes the concomitant changes in other aspects that were caused by *shari'a* advisors being recruited by commercial banks. For one, their income by far exceeded what they were used to. A new lifestyle was introduced that included air travel, sometimes in private jets, staying in five-star hotels. Besides the life style advantage, there is also a visible increase in their social prestige as their views on serious financial matters are listened to, and in fact sought after.

In Pakistan, Taqi Usmani and his students are represented in most of the *shari'a* board of the six independent Islamic banks and till recently constituted a numerical majority within the board. Interviewing the founding executives of an Islamic bank I asked how they came to choose the present *shari'a* advisor. They said that they were open to any qualified scholar and interviewed many including some Islamic economic graduates from the International Islamic University of Islamabad. They found that those who were most competent and knowledgeable were affiliated with the Islamic economic institute set up by Taqi Usmani, the Center for Islamic Economics in Karachi.

Taqi Usmani himself is a contentious personality. During an interview, the respondent mentioned that the *shari'a* advisor for the first Islamic bank of Pakistan was not Usmani, but rather, his son. Usmani was seen to be inflexible and difficult to influence whereas his son's approach for financial matters had a softer reputation and was thus chosen as the go-to person for day-to-day issues. Usmani remains as the *shari'a* supervisory board member.

Recently, Burj bank has recruited Munib-ur-Rehman who is a highly prominent *alim* (singular of *Ulama*, scholar) of brailvi sect. Brailvi and deobandis are the two major sub-denomination/sect within sunni Muslims in the South Asia region. Majority of Pakistan's population would be characterized as brailvis. Thus the inclusion of a brailvi *aalim* is a strategically advantageous move by the bank. This highlights the place of the *shari'a* adviser for marketing within the Islamic banking industry.

El-Gamal (2006) identifies a second group important in the Islamic banking structure, the legal experts. These lawyers work with the *shari'a* experts to devise such changes to an existing financial instrument that would make it Islamically valid, at least in structure, as well as comply with the mainstream banking regulations. Also, lawyers strive to make reengineered products as efficient as possible. El-Gamal goes on to detail the process of Islamicizing a conventional finance instrument.

> Discussions between bankers, lawyers, and jurists commonly start with an existing conventional product for which no Islamic alternative is available. The three groups then engage in a process of financial reengineering of the product, replacing its various conventional components that are deemed un-Islamic with others that can be presented to the public and defended as Islamic. An important stage of the product development and marketing is the naming of the new product. The industry norm is to employ Arabic terminology from the pre-modern, classical texts of Islamic jurisprudence so as to lend authenticity to the instrument, for instance, "*ijara*" instead of the equivalent "lease," or "*murabaha*" instead of the equivalent "cost-plus sale (El-Gamal, 2006).

The process is similar to what happens in Pakistan's Islamic finance industry. The resulting instrument is almost the same as the conventional instrument, generating criticisms of bank's dishonesty in portraying themselves as purely Islamic in order to make money. Perhaps, this is the reason of a recent distinction between '*shari'a* best banking' and '*shari'a* compliant banking within IBF in Pakistan. The term *shari'a* best banking is employed to suggest that the same practices are there which were used by the Prophet Mohammad, some 1400 years ago. S*hari'a* compliance on the other hand, would be the practices which would at the very least fulfill the basic requirements for a *halal* transaction i.e. avoiding the *haram* (prohibited).

The most significant aspect to note for institutionalization is the regulatory power given to the *shari'a* board. A bank goes through various regular audits. An internal audit conducted by the bank itself, an external audit conducted by a private accountancy firm, and a governmental audit. For Islamic banks, these three audits are increasingly being introduced specifically to judge to what extent do the Islamic banks conform to *shari'a*. The internal *shari'a* audit is conducted under the supervision of the banks' *shari'a* advisor. A private audit firm may be recruited to analyze as a third party. Lastly, the State Bank of Pakistan is training its staff to conduct a formal *shari'a* audit. A later section will show us that these regulatory measures are burdensome for the practitioners, especially because of the perceived (and real) sever consequences.

4.2.2 Islamic Finance in Practice

The rules described above form the foundations of Islamic economics, but how are they to be implemented? The implementation was the work of primarily the Islamic economists as well as the *ulama* (plural of *aalim*, an Islamic theologian). These *ulama* were familiar with the rich collection of Islamic jurisprudence of the past 1400 years. Traditional financial instruments that were meant for commodity-linked trade economies of the pre-modern times were utilized to work with the new environment of capital accumulation and capitalist investment (Smith 2007).

The initial challenge was to design a meso-level Islamic financial institution which would be functionally equivalent to a bank. A number of Islamic economists proposed ideas. The form that was eventually implemented was first proposed by Maududi (Siddiqi 1980). The devised formula was to envision a bank as a two-tiered entity called a "two-tiered *mudaraba*". The first tier is created when the depositor turns money over to the Islamic bank, fund, or financial institution which acts as the *mudarib* (working partner). The financial institution then invests these deposits with entrepreneurs (or borrowers in conventional bank) by means of the second-tier *mudaraba*. Any profit from these enterprises is then shared between the financial institution's shareholders and depositors. Thus the underlying principle of Islamic banks is envisioned to be profit sharing, not interest. An important distinction between the Islamic bank and conventional bank, at least in theory, is that the depositors in Islamic financial institution know that their funds are at risk. If the bank fails or its projects do not make money, this should be reflected in the returns given to bank depositors. Those wishing to keep their money in complete security can choose to leave it in current accounts which do not pay dividends (El-Gamal 2006, Smith 2007).

On the asset side, the Islamically optimal mode of Islamic financing would be *musharaka* (joint ventures) and equity investments reflecting Islamic economists' emphasis on profit and loss sharing. In contemporary practice, only 5-10% of the investments are in *musharaka*. Islamic economists claim that the low level is due to the lack of moral infrastructure in the society since venture financing is risky and requires a high level of trust and honesty to serve a large population's financial requirements. The most widely used instruments that the Islamic banks have relied upon to extend funds to borrowers and investors are the *murabaha* (cost-plus sale or trade finance) and *bay mu'ajjal* (deferred payment contract) (El-Gamal 2006, Smith 2006).

In classical, pre-modern Islamic juristic texts, the trade instrument of *murabaha* was a simple sale transaction in which the seller is bound to disclose the cost at which he bought the commodity and let the prospective customer know the profit he proposed to add (Zaheer 2011). In case of agreement, the buyer would pay the amount and complete the transaction. This instrument on its own is not useful in contemporary times because a client approaches the bank due to his inability to pay lump sum for a required asset. Another transaction found in classical Islamic jurisprudence was *bay mu'ajjal*. This was simply a credit sale transaction. The borrower was allowed to pay the original amount in installments (Zaheer 2011). The problem for contemporary times was that the bank would not be able to make any money from this transaction, in fact, would lose some because of inflation. Contemporary Islamic jurists combined the two, *murabaha* and *bay mu'ajjal*, with the resultant transaction looking the same as a short term financing instrument, but with an Arabic name.

Murabaha involves a simple mark-up on a sales price. Henry and Wilson (2004) illustrate it this way: the bank buys you a car for $30,000 and you owe the bank $33,000 a year from now. To an outsider this looks to be a simple loan at 10 per cent interest. Repaying by five yearly installments of $7,913.92 would be equally acceptable and also implies an interest rate of 10 per cent. The main condition that the contract has to meet in the above example from the Islamic perspective is that the bank actually has to own the car to undertake the risk of damage and then sell it to the client, rather than merely advancing him or her funds to pay the car dealer. It is the assumption of risk which entitles the bank to earn a profit in an Islamically legitimate way (Henry and Wilson 2004).

The critical group within the *ulama* community contended that there is no precedence of the combination of *murabaha* and *bay mu'ajjal* in the history of Islamic juristic texts and that it was devised as a ruse to circumvent the *riba* prohibition. The proponents reason that since the increase is not on money, but on real asset i.e. a sale transaction, thus there is no legal binding which prohibits this transaction. The aspect to note here is the attention to following the rules of jurisprudence (precedence, analogies) by both groups of the *ulama.* Taqi Usmani can easily refute the Islamic economists who stress on following the spirit of the law but the other *ulama's* critiques need special rebuttal because it is based on pure Islamic jurisprudence and thus challenges Usmani's Islamic legitimacy. *Ulama* of the rival faction have published a 400 pages book proclaiming the existing Islamic banking practice to be *haram* with Taqi Usmani taking the brunt of the accusations. Usmani also published a book "Non-Interest Banking – research into related jurisprudence and examination of the critiques" which is a response to this critique and addresses the issues raised point by point. In this book, Usmani's stance is generally according to the traditional approach of providing rulings from authentic sources (that could be from any period in the 1400yrs of Islamic history) to bolster his argument. However, he also uses the realities and constraints of contemporary times to appeal for certain pragmatic steps to be taken. On the question of *murabaha,* there is an extended debate on its permissibility on Islamic legal grounds within the rival *ulama* groups. Near absence of social welfare concern in this discourse is probably the most prominent feature to note for my analysis.

During my internship I realized just how detailed and tedious an operation can get if one is to satisfy all the legal conditions for a *shari'a* valid transaction. For instance, a *murabaha* contract is to follow the exact specified procedure to qualify as a legitimate transaction, otherwise it will be rejected by the bank's *shari'a* supervisor and all income will be given to charity. A major issue in the procedure is of writing down precise dates because that documents the risk taken by the bank (by storing or holding a commodity) and this is what entitles the bank to claim a profit. Practically, it becomes very difficult for a businessman to come to the bank for every commodity purchase as there could be multiple transactions in a day. To ease this tedious detail, Islamic banks take the signatures of the businessman on a number of contracts and then fill in the appropriate dates themselves. This satisfies the *shari'a* audit requirement but the bankers are aware that this practice could be made into a big deal. And in fact, Taqi Usmani's opposing camp does present similar technical issues to be contributing to the illegitimacy of Islamic banking. The conundrum is that they take Usmani to task for these details because he himself insists that such details are what distinguish an Islamic operation from a conventional one. At the same time, Usmani appeals for patience for this nascent industry to take small uneven steps to mature into properly functioning system.

Similarly, another interesting case is the issue of charging late fees from a client. Taqi Usmani acknowledges that during the time of the prophet, when an individual was not able to return the principle amount, he was charged extra. This practice has been emphatically condemned throughout the Islamic history and the consensus of the legal scholars is that charging late fees is not allowed. However, Usmani then points to the contemporary problem of willful default and raises an issue of injustice for the financier.

He then goes on to suggest a creative solution: that the amount be given to charity instead of the late fee payment accruing as the banks profit. Usmani invites his peer *ulama* to contemplate on this possible solution. Allocation of late fees to charity is the practice of Islamic banks. The contending *ulama* group raises this practice to be a flagrant violation of the Islamic rules.

The form focused IBF logic is not only followed in practice but the portrayed image is also consistent with this logic. Islamic banks do not portray themselves as having a social justice element. Most advertisements portray how the customers will earn a *halal* income. One newspaper ad carried the picture of fire, depicting that Islamic bank will save its customers from hell-fire. Joining an Islamic bank is portrayed to be a way to relieve oneself of the burden of *riba*.

Probably the most consistent prohibition that is being followed is the rejection of financing the prohibited products like alcohol products, explicit entertainment, casinos, conventional financial institutions and weapons industry. I have to add here that IBs do not have to make a huge moral sacrifice because these prohibited industries do not exist on a large scale in Pakistan.

In sum, IBF in practice takes the course of least resistance and operates within the capitalistic logic. Innovative theological approaches are employed, but so as to offer parallel paths towards the conventional logic. IBF does not take it to be its mission to curtail the ill effects of wealth as specified in Islamic ethos. Absence of these aspects as well as the social justice concern is now being taken by an upcoming Islamic micro-finance industry. Islamic micro-finance is a hot topic in contemporary Islamic finance conferences and seminars. Even though the study of this new industry was not part of my research objective, at the most basic level it offers an empirical case for heterogeneous responses to the IBF logic.

This section dealt with the structural and functional features of Islamic banks. The focus was on the operations and processes. The next section will seek to understand the influence of IBF's institutional logic at the micro level.

4.3 Islamic Finance as a Cultural Institution

I will use the concept introduced in two studies conducted in the Arabian Gulf region which envision IBF institution as a cultural institution. I too found IBF in Pakistan to be a cultural institution providing its members more than just a means to earn a livelihood. I found that even though IBF's participants were associating with the institution in a formal, form focused way, there were also elements of substantial affiliations that made the experience of working there more meaningful.

4.3.1 Formal Association with Islamic Finance Rather than Substantial Affiliation

In January 2010, I took-up an internship for six weeks in a private Islamic finance institution in Pakistan. It was the head office of a conventional bank's Islamic banking division. I got a chance to spend a week in all the main departments including: consumer finance, corporate finance, product development, and HR (human resource). In most of the departments, I was assigned a desk and was provided some documents that were generally used in the specific department I was working with. Even though I was not able to observe the technical details or attend the meetings, I could still interact with others by inquiring about the nature of their work and by asking questions referring to some internal documents or other technical details.

4.3.2 Absence of Overtly Islamic Norms in Daily Practice

While observing as a participant, the Islamic identity of bank's management personnel did not come across as highly visible. If anything, clan associations came up more frequently than Islamic concerns. For example, as I was interning at the Islamic bank, two colleagues were talking about how the senior one should give a treat to his team members because of his recent pay increase and that *aaraein's* (his clan) were supposed to be generous. The person quipped and commented about his colleague's stingy clan. This incidence highlights that religious talk was missing. The same conversation could have been held in Islamic terms, that one should be generous like a 'real' Muslim or something to that effect.

In another incidence when the policy for lower staff members/tea boys was changed because of cost cutting measures, it caused some of them to end up as wage earners. The comments from the junior officers were reflective of class differences: that the higher executives are living a life of luxury and the poor have to bear the brunt of cost cutting. This could also be expressed in Islamic terms; how the top executives are failing to follow the simple life of the Prophet Mohammad, or other Islamic analogies.

I observed that the daily practices were not overly infused with Islamic terms, norms or symbols. I conducted in-depth interviews with Islamic bankers in diverse locations within Pakistan. Most were located in Lahore, but I also visited the cities of Islamabad and Peshawar. I found that Islamic banks were relatively more representative of the wider cultural norms in terms of dressing, gender segregation, and social events, compared to conventional banks. Regarding gender segregation, the norm that is followed in the general urban population of Pakistan is to generally avoid close proximity of the sexes. For example in a certain public transport bus service in Lahore, the section for men and women is separated by a fence. The men sit at the back and the women's section is the front one. However, in vans where the space is much smaller, the front rows may be reserved for women, depending on the rush. During rush hours, a woman's male relative may sit next to her and the other men may sit next to him. If she is alone, a man may sit on the same seat, but at a distance. The point of this description is that segregation is fluid and depends on the context. Women would like to avail themselves of some space of their own if the circumstances allow. In banks, women have a separate pray area for the daily prayers than for males. This again reflects a cultural tradition rather than religious because women and men pray side by side during hajj in Mecca, Saudi Arabia. In most newly constructed mosques in the West, women and men are in the same room but women occupy the back of the prayer hall. Until recently, there was no tradition of women praying in mosques in Pakistan. Given this diversity of practice, it makes sense that the banks also reflected the Pakistani cultural tradition for prayer setting. The Islamic banks I interned in had a designated prayer room for men. The smaller number of women would pray in the conference room. In case the conference room was occupied, they could pray in the office of the division head. This arrangement was due to the lower number of women employees. A larger number would require a more permanent facility.

Alcohol consumption is an extremely rare phenomena in Pakistan, except for in small private gatherings. Conventional banks may serve alcoholic drinks in their internal social functions. This would not be the case for an Islamic bank.

Regarding dressing, the largest Islamic bank of Pakistan has a dress code for women. The female employees are to wear an *abaya* (ankle length over-all) and wear a head-scarf. This dress code is not a common dress in Pakistani culture and one could construe that such prominent display of 'Islamic' dress would elicit greater focus on Islamic characteristics in that bank. However, after spending a week in that bank, the operations seemed to be primarily geared toward serving customers and were not consumed with Islamic ritual observances. Rest of the Islamic banks did not have a specified dress code. Females are encouraged to wear modest cloths worn by the general public. Sleeveless shirts, deep necklines, bare legs and sheer clothing are again an extremely rare sight in Pakistan's public life and are discouraged within an Islamic bank's work force. All Islamic banks have issued either memos or circulars stating these guidelines that are to be observed.

Thus, the daily practices within an Islamic bank maybe more representative of the general social customs and these practices have less to do with Islam per se and much more to do with the larger Pakistani culture (of course many Pakistani cultural practices can be traced to some Islamic values). In this respect, even though Islamic banks were similar to each other, but as a group, they were different than the conventional banks.

4.3.3 Reasons for Joining - Formal Satisfaction

Most of the respondents joined Islamic banking because they felt that it was the right thing to do so that they could practice the commands of their religion. While many respondents stated that they joined because of religious motivation, hardly anyone mentioned any social justice aspect. For example, Rehan started his work at the conventional bank in 1999, but when IB division was set-up, he chose to move to the

Islamic banking division because of “interest issue”. The interviewees also noted that a large majority of their colleagues were here because of the job and it was not really about fulfilling a religious obligation for them. However, they themselves had a non-monetary religious motive to join. There were two respondents who had left a higher position at a conventional bank and joined a lower position in Islamic. Farooq was one of those who was a bank manager at a conventional branch but made a compromise in his professional position so that he could work at an IB. At the time of the interview, he had an offer of a better salary package but did not take it up because of his religious conviction. In his words:

> the reason for joining were, firstly, the *ulama* that I regard highly, dr. Zakir naik, dr. Ghulam murtaza, dr. Tahir-ul-qadri and dr. Israr. All four have unanimously said that you should leave conventional banking, and if you cannot do it immediately, then start looking for options…I was in CB for a long time, but once I got convinced that it is not right then I looked for opportunities and God provided me with an opportunity. It is so clear in surah bakara….. Question: if you are offered a higher position in CB? *alhamdolillah* [thanks be to God] up-till now I’m here. I had better package offers but will not join CB. God has given me the strength to stay firm right now, but can’t say for the future. One thing is there, that as time passes, human beings move from a worldly existence to a spiritual realm. A time comes when one shifts completely (Farooq).

While most of the mid-hierarchical level bankers said that they were religiously inclined to join an IB, I got a contrasting view from the founding members of the Islamic division I was working with. I got a chance to interview the founding members of the Islamic banking division. The most prominent feature to come across was their stated motivation to join the new set-up: to gain better banking experience. The current division head was a regional manager when he was offered the chance to create and supervise the Islamic banking division. “Being a regional manager, my next step in the professional hierarchy would have forced me to choose a particular department, either marketing, risk mitigation etc. The opportunity of heading the Islamic division provided me with a promotion without having to restrict and limit myself in one sub-field". He was very satisfied with that choice as he was able to further polish all facets of his banking expertise and keep the doors open for future promotions. Another member of the initial team spoke of his reason for joining. Similar to the group head, he also wanted to gain over-all expertise by being a member of the core team setting up a new division. This way he would acquire the knowledge of how to handle the legal, marketing, financial, and regulatory issues. The important point for my research is the lack of a religious motivation in this founding team.

It can be discerned from the above paragraphs that even though an Islamic bank's employees did mention religion as a motivational force for joining, it was related more to the form, i.e. to avoid the *riba* prohibition. Hardly anyone mentioned the social welfare aspect. This pattern is similar to the contemporary institutional logic of IBF, where salvational concerns in the here-after are most prominent while economic welfare for fellow beings lacks emphasis.

4.3.4 Work Goals

Another point that became prominent for me was that the prime motivation for the majority of the participants was very similar to the conventional banker's goals, which was to bring in as many portfolios as possible and to make a profit for their institution that would lead to job security. I had a chance to go through the self-evaluation forms of the banks' country-wide employees and found out that the stated objective of the employees was to increase the business of the bank. Out of around 150 individuals, only one person mentioned that he will try to fulfill the Islamic law requirements, but included in his statement his aim to bring in more customers. The rest of the individuals stated a substantial monetary figure that they will be targeting for the upcoming financial year. Some took the names of high net worth companies/individuals and that it was their goal to convince them to do business with their bank.

In both banks I met one or two individuals who were extremely passionate about the Islamic character of their work. These individuals would be curious about my research and went out of their way to discuss Islamic finance related issues with me. They would suggest certain publications or websites for me to help me gain a better understanding about Islamic economics. They came across as strongly opinionated and either spoke of Islamic banking as fulfilling the 'Islamic mission' or being highly critical of it. However, the large majority of the employees were involved in their daily work goals leading to earning a livelihood in a difficult economy and such. They did not seem to be emotionally involved or attached with Islamic finance.

4.3.5 Reliance on the *Shari'a* Advisor

The bank employees had a positive impression of the *shari'a* advisor compared to the mostly unfavorable impression of *ulama* in Pakistan's general urban society. Farooq expressed this aspect in this way:

> yes, the *shari'a* advisor classifies a suspect transaction as non-compliant and that is given to charity which is not good for performance review. In the beginning, *maulvi* [clergy] and the conventional bankers were at 180 degrees, we knew about conventional banking but nothing about *shari'a*, and vice versa for *maulvi*. Now after five years, both have come closer. *Shari'a* advisors are getting to know how banking works so they are better able to keep checks. They can make calls to customers to find out if a transaction was done on a specific date or not. They make

> random checks. If someone [a bank employee] loses trust with the *shari'a* advisor, then the advisor scrutinizes him more. In the beginning there used to be a first warning for non-compliance, but now they penalize straight away. It is about having trust on *shari'a* scholar and it also makes sense financially. Islamic finance is not a "*sahifa*", i.e. it is not divine, and is not the word of God. It is basically derived by human beings. *Ulama* have devised it and they can be wrong. Man is supposed to make mistakes; if he doesn't then he is not man.

Faith in *shari'a* scholars was also important because the respondents could dispose off customers' trust for *shari'a* compliance from their own shoulders to those of the *shari'a* scholar. For Majid, it is a blind trust, "we operate on *shari'a* as all products are developed consulting the *shari'a* advisor"; implying that if the *shari'a* advisor legitimizes a contract, then it is Islamically legal. Bilal was emphatic in stating that the skill set of the *shari'a* advisor is such, that it cannot be reduced, "*shari'a* advisor is indispensable, there cannot be any compromise in this role. *Shari'a* advisor deals with commercial transactions, writes down process flows that are screened". The bankers feel satisfied that Islamic legal details are taken care of by the *shari'a* advisor.

> Now a days, there is a lot of awareness of Islamic banking through the media. Customers say that if you are advertising IB as *shari'a* compliant then the onus of the trust is on you. Q. do you feel this burden? A. yes we do, and our answer is that our products are developed by *shari'a* experts (Rehan)

Here, Rehan is utilizing the means provided by the IBF to dispose of a customer's concern for Islamically legitimate banking onto the *shari'a* advisor. In some cases there may be a need to give a more nuanced explanation. Amir, bank's liaison officer, (working with the *shari'a* advisor) related to me an incident when a widow of an army personnel who had died during a combat operation, came to deposit the compensation amount received by her from the Pakistan army. Amir told me of the widow's concern for the purity of the money and her insistence in asking if it was 100% *halal*. According to Amir "I could not say yes it is 100% *halal*. I had to say to her straight-forwardly that it is not 100% *halal*. But, even though there are some issues, it is still Islamically better than the conventional bank". Amir was relieved by the lady's response that if he had claimed 100% pure Islamic banking she would not have banked with them.

An Islamic finance institution is one of the few domains in Pakistan's urban educated class in which an *aalim* has a positive impression in terms of his honesty and rational approach. An Islamic finance institution also provides its employees the satisfaction of their occupation's Islamic legitimacy. A person could have any particular religious justification for their own selves, but s/he would be hesitant to apply it for others. IBF provides the means to relieve of the responsibility of sanctioning Islamic legitimacy to an operation for someone else.

This section looked at the association of an Islamic banker with the IBF institution and showed how many of the practitioners follow the institutional logic of formal adherence to Islamic law. Everyday practice of an Islamic banker is more mundane than sacred in a sense that Pakistan's cultural norms and IBF's institutional scripts are followed rather than more substantive aspects of Islamic theology.

4.4 Substantive Meaning for Islamic Bank Employees

Given the afore mentioned participant observations, the in-depth interviews were illustrative of a different perspective. As mentioned earlier in this chapter, I was able to conduct the interviews in various banks and in multiple regional locations. The first aspect I noticed was the general similarity with-in this industry. The physical set-up of

Islamic banks was similar to each-other; a modern look with subtle Islamic themes like Arabic calligraphy, or green color. Even though I did not observe all banks extensively or very deeply, my impression was that various Islamic banks followed a similar pattern in-terms of function and structure. I am more confident to assert this observation based on my interviews; practitioners had a similar understanding of their industry across various banks.

Secondly, detailed interviews showed that Islamic bankers were cognizant of the substantial features of an Islamic bank and they had come to terms with the popular critique (that the applied work of an Islamic bank is no different than a conventional banking operation) in various ways. IBF made its employees engage with some substantial aspects of the industry and were not merely following the institutional logic.

Lastly, some respondents were appreciative of the fact that working in an Islamic bank affected their religiosity and that it was an encouraging environment to practice their beliefs. Atiqa and Zulfiqar felt fortunate to be at a place where they could be more regular at saying their daily prayers. Atiqa told enthusiastically that "the atmosphere is amazing during *Ramadan*, we pray together and break our fast all together".

4.4.1 Explaining Difference

4.4.1.1 Insiders Know It

For some respondents, the difference between an Islamic bank and the conventional bank (CB) became clearer after they started working in the institution. It is satisfying for many to know that even though for an outsider, CB and IB may look the same, but they themselves can see the difference. Their understanding is that Islamic banking is not just a change in nomenclature but that it has unique features. Faisal's experience depicts this, "in the beginning it seemed the same, and I felt that only terminologies are different, but after a while, I came to know of real differences".

4.4.1.2 Explaining Difference – Asset Based and Risk Sharing

When asked about the difference between Islamic banking and conventional banking, almost everyone pointed out that Islamic finance was based on actual physical assets and the institution shared business risks with the customers. It is interesting to note that no one mentioned Islamic banking being *riba* free or interest-free. Interest free claim is like opening a Pandora's Box as the inevitable follow-up question is about the same rates offered by the Islamic and conventional financial institutions. Many respondents also noted risk-taking as an essential element of Islamic finance and found it be a just model in which the monetary gains one makes should account for some physical effort expended or some risk undertaken. Riaz, working in the head office of an Islamic bank stated it in this way:

> This model is spreading widely in UK. Japan has banned banking other than asset based. A few days ago, a Dubai construction group came and wanted us to finance the consumer for the 30th story in their building. We refused. We said that first you build 30 stories, and then we'll finance the apartment there. This is the Islamic finance model. He'll build the 30 stories and then he'll be able to sell it. If the asset is physically present, only then it can be sold. What happened in the US, China, Dubai….. xyz company bought land in the dessert, developed it a bit, and announced that they are going to build a high-rise. People invested from all over the world. The crisis that defaulted Dubai was that there was no physical asset. But Islam strictly prohibits this.

Similarly for Bilal:

> Alternate system has been created, whether it is for your ideological satisfaction or for its intrinsic efficiency or justness. It is creating new parameters, new standards. When we go into partnership mode, then IB is taking business risk with the customer. This is a totally new dimension compared to CB. Similarly, IB takes asset risk in *ijarah* contracts. In CB, when a customer leases, then he is not taking the risk of the asset. If his car is not working then he'll just hand-over the car. Certain responsibilities are associated with the IB contract. Both quantitative and qualitative changes are there. Ideological product based on the principle that if you haven't taken any risk then your profit is not legitimate. Risk is related with ownership. This is asset side. On the liability side, IB can't give pre-determined rates of return.

The requirement of a tangible asset compared to the virtual deals of the conventional finance was mentioned most often. Since risk sharing is a controversial subject on many grounds, thus it was mentioned less.

4.4.1.3 Explaining Difference – Ethical

Social welfare was a theme that was also used to explain the difference between the conventional bank and an Islamic one. I did not ask a direct question about it so the interviewees brought it up on their own. Atiqa felt it at a personal level, "I worked in a credit card department and the amount of debt that clients were adding, didn't feel right to me. It was really unfair for the clients. So then I read up on IB, and I transferred".

Similarly for Riaz:

> IB is a very socially responsible banking system. I personally believe that this word 'Islamic banking' should not be there. We should not associate it only with Islam because other communities, as well as within the larger banker community feel that they are being un-Islamic. They could've used any term like asset banking or ethical banking. We practice socially responsible lending. If the payment was willfully stopped by a client, then there will be a penalty. But if there are genuine reasons (electricity supply was stopped, political uncertainty etc.) then we forego the penalty. We

> take decisions case by case. Plus the economy is in such turmoil that all businesses are facing severe difficulty.

These accounts give us an idea of the bankers' understanding of the differences between an Islamic bank and a conventional bank. The categories brought up by them, asset based, risk sharing (to some extent), as well as ethical considerations are substantial aspects of Islamic banking. These issues are not highlighted at the institutional level, but we see that the practitioners take a definite stance on these issues.

4.4.2 Space for Reflection

It is my observation that IBF institution provides a space where the employees encounter questioning or deliberation of certain aspects that pertain to their religion. Given that most of those working in IB industry did not join solely for ideological reasons, this places them in a peculiar situation. One can say that they were aware that there are Islamic issues involved before joining an Islamic bank, but were unsuspecting of the need to take a position on the Islamic authenticity of their work. This aspect is unique to IBF because in no other mainstream profession in Pakistan, a practitioner's actual work is religiously challenged that publicly. Islamic bankers are placed in such a position in which they have to take into consideration issues like, whether their work is really different compared to CB or not, why is there no social impact, how Islamically authentic is the work of their institution, and other such questions. They are placed in a situation in which they have to think-through some theological issues.

4.4.2.1 Reflection – Justifications of the Critiques: Nascent Stage

The most common critique the Islamic bankers have to address is that Islamic banking is replicating the conventional bank. As much as certain ethical or Islamic features are highlighted, the over-whelming impression is that there is no difference. Replication is seen unfavorably by the general public in the sense that it comes across as a sham, as if Islamic banks are merely portraying themselves as Islamic so that they can make money. My interview respondents envision a unique system but they realize that the system cannot be that unique because it is at such a nascent stage. The hope is that given the time, it will be 100% Islamic. Faisal is exposing the reason for the replication to be profit making. He says:

> the starting problem is that rather than going for Islamic products, IB replicated the CB products. This way they captured a lot of clients in a very short time, but at the end of the day, customers started asking questions that terminology has changed even though the products are same, list of pricing is the same, and the rate is same.

Zulfiqar highlights the underlying intention of the IBF project and portrays it as a matter of simple logic as he comparing IBF to a delicate plant:

> Basically, the main difference is the intention. We work on parallel lines. Paradigm shift is there, but we are replicating CB…. We are at a very difficult stage, and the institution needs protection. IB is a very small plant which needs protection.

In Ali's view, replication is not entirely a negative thing, provided that it remains within the limits of the Islamic law.

> IB doesn't have training program because CB is 600 years old and IB has been around for only 25 years….. IB is in a transitional phase, up till now we have been trying to replicate the CB products. We have to see to what extent can it be replicated, considering the *shari'a* laws.

Faisal, Zulfiqar and Ali are fully aware of the wide-scale replication and they employ various justifications to explain this trend.

4.4.2.2 Reflection – Justification of Critiques: 80% *Halal* is Better Than 0% *Halal*

In a similar vein, the respondents admitted that IB may not be 100% *halal* (Islamically legal), but insisted that people should give them some credit for trying because "80% *halal* is better than 0% *halal*". Farooq makes his case in these words:

> A mosque's boundary wall has been created but there's nothing in there. Next doors, there is a well-established casino. If you want to spend your money, where will you spend it? If you keep your money in CB, then that means that you are helping it grow. Even if you don't believe that IB is 100% *halal*, realize that it is a first step towards a positive cause. It is a cause. The intention is there.

Bilal does not endorse the current course of IB but appeals for the critics to look deeper and appreciate the development in-spite of real difficulties.

> … CB could replicate us, and do what we are doing, a half-hearted attempt at IB….. some critics understand the situation well but they don't understand the constraints faced by IBs. If you are 90% or 80% *halal*, then it is better than 0% *halal*.

4.4.2.3 Reflection - Systemic Change

Lastly, another justification used by the respondents as to why Islamic finance is not showing societal results is that it can only work if the whole system is Islamic. Shumaila expressed it in this way:

> There is a difference, but it's not visible because our country's economic system is not Islamic. Unless our economic system is not Islamic, IB can't be effective, or we won't be able to see the results. Our regulatory system is not Islamic. No Islamic capital, money, or commodity markets, no Islamic benchmarks etc.

Ali points to the requirement of a 'moral' society for the Islamic financial system to work.

> The problem is that you are trying to Islamize banks, but the rest of the society is un-Islamic because people cheat and bribe etc. How can one Islamize one's business when the system is filled with such un-Islamic practices?

For Riaz, an indigenous economic model exists that could successfully replace the problematic capitalistic system.

> …And I'll tell you another thing, Qaid-i-Azam's speech at SBP clearly states that this capitalistic system is problematic and we should devise our own system based on Islamic principles of justice and equality. What CB does is that stock market goes up, they invest in the equities, but find out that the xyz company that they invested in, doesn't even exist. Our IB has a whole system in equities.

This section is telling because the practitioners are aware of the criticisms against their industry. These cultural actors utilize various repertories available to them to have an opinion on those critiques.

In the preceding section I noted that according to my observations the everyday routines of the Islamic financiers were consumed by mundane concerns of performing well for their organizations that would ensure survival and a source of livelihood for their families. Strong identification with Islamic matters was absent, however, there was a trend of following some Pakistani cultural norms rather than the western norms institutionalized in other conventional banks. Religious element was present symbolically, focusing more on the form rather than the substance. In this way, the individual practice was isomorphic with the IBF institution. My research methodology also included conducting of in-depth interviews with the bankers. This strategy was very productive as it highlighted the banker's cognitive understanding of the criticisms facing their institution and their various explanations in answering that critique. This aspect leads us to a deeper understanding of the practitioners, who seem to be aware and have an informed opinion regarding issues facing the IBF industry, but these actors are not able to, or are not interested in applying their critique in practice.

4.5 Conclusion

This chapter related the theoretical underpinnings of the Islamic banking industry and some of the technical processes common in the industry. It can be gleaned from this explanation that by comparing the details contract by contract, it would be difficult to detect any difference between the IBF and conventional finance. For technical uniqueness, prohibitions have to be taken into account. This section also detailed the critical role of the *shari'a* advisor and the market factors that contributed to choosing a particular advisor.

The above observations lead us to theorize the institutionalization processes going on within this industry. Regulatory instantiation can be clearly seen through the presence of SSB (*shari'a* supervisory board) as well as the *shari'a* audits. Respondents were acutely aware of the consequences of performing a transaction that would not follow the SSB rules. For example, the earned amount would be given to charity and will not be added up to their portfolio. Consequently, the bankers expressed the additional pressure of religious demands.

Additionally, the interview respondents also maintained that *shari'a* advisors are "indispensable" for Islamic banking. Who else would perform the work they are responsible for? The most qualified people to advise on Islamic matters would be these theological experts. The bankers are mostly pursuing an Islamic banking career as a moral obligation. I did not witness much difference in the everyday practices of Islamic bankers compared to conventional bankers as far as explicit Islamization is concerned, which tells us that normative institutionalization was limited in this context. Their daily practices and activities are to bring in more clients so that their job can be secured. Again, this aspect is not different than the conventional bankers' goals, thus revealing a lack of additional normative pressures from the religious realm.

There are almost no cultural-cognitive institutionalization processes evident in my observations. The respondents were critical of certain aspects of the institution and could certainly vision alternative scenarios which would be more meaningful to them.

Given the observations above, we can see that IBF took the conforming route to institutionalization. My contribution was to bring out the importance of heeding the level of analysis. I observed a stronger effect of isomorphism at the structural and operational level, but much more agency at the individual level. Most banks within the Islamic finance institution follow similar procedures, norms, structures and functions. We can say that the banks are de-secularized, but are not infused with the religious spirit, thus depicting isomorphic effects. However, IBF's form focused institutional logic was not internalized by the practitioners. They utilized various "repertoires" to assess and opine about the issues faced by their industry. At the same time, the Islamic bankers did not have the means or the will to affect the institutional logic in-spite of their reservations.

CHAPTER 5:

CONCLUSION

5.1 Consolidating the Findings and Study's Contributions

In the post 9/11 era of the global war on terror, Islamic resurgence is generally associated with militancy and an anti-Western disposition, and Islamic finance has also taken this connotation in some quarters. At the same time, the Islamic finance industry is posing confidently to be a viable player after the 2008 financial crisis. My goal was to unpack these complexities of Islamic de-secularization in the contemporary modern world.

In the introductory chapter, I specified as to what the Islamic finance industry looks like so that the first impressions of a religious banking institution being either a sham or backward are addressed. IBF was shown to be a contemporary industry and a booming sector not only in the Muslim world but also having major presence in Europe. Next, I explained that until recently, Muslims were able to choose whether to follow or avoid the *haram* (the prohibited), except for the *riba* prohibition. Due to the juridical consensus of Islamic scholars that *riba* was financial interest, pious Muslims were not able to avoid this prohibition because of an absence of alternatives. Contemporary Islamic finance is fulfilling this need for earning *riba*-free livelihood. The conundrum was the widespread critique and opposition to/of IBF not from the West, but primarily from within the Muslim community. If IBF was to provide Muslims with a way to avoid the prohibited *riba*, then why would Muslims object to this solution? The objections to IBF were also puzzling given the dominant understanding of Muslim societies in general and Pakistan in particular because IBF was confirming the thesis that Muslims reject modernity and are de-secularizing their social institutions. But then why was there so much debate amongst various Muslim groups on the legitimacy and efficacy of IBF? Questions like these demanded a theoretical foundation to proceed.

The second chapter provided the theoretical underpinning that would answer the two main research questions: how did IBF emerge given the pervasiveness of the secular economic institution and secondly, what are the consequences of IBF institutionalization at the structural level as well as the individual level. For the first question, economic sociology would either predict that IBF has been consciously created through political interventions, state regulations, elite domination, or specific moral projects. The other prediction by economic sociology would be to pose IBF creation as a naturally evolving capitalistic system. I challenged these two opposing positions to suggest that markets develop through the interaction of various factors, some of which may be attributed to a force of history alongside factors that are more laden with agency. The third chapter empirically demonstrates this by drawing attention to cultural discourses and political processes as the two dominant factors present throughout the history of Islamic economics.

A historical contextualization was important for my study because it highlights the underlying cultural models missed by most similar analysis. I showed that the roots of the historical process are within two approaches for interpreting Islamic injunctions formed at the start of the twentieth century. The first approach was adopted by the traditional Muslim scholars in which they presented their juristic opinions based on the rulings by eminent Islamic theologians of the past. Another prominent feature of these scholars was the lack of engagement with the (Western) ideas of the day. The second approach was the non-traditional interpretation, adopted by certain Islamic groups who issued Islamic juridical rulings taking into account the perceived challenges of their times. One such group was that of Maulana Maududi. Maududi's quest was to Islamize modernity within a colonial context (with issues of identity, colonial imposition in the ordinary life-world etc.) and the strictest Islamic canonical prohibition of *riba*. This triggered the theoretical work in Islamic economics. The theory gained some scientific rigor due to the work of Western trained Islamic economists who were operating within the socialism/capitalism debate and continued the justice and logic centered narrative of Maududi. At this point, the traditionalist scholars did not have any particular position on an Islamic economic system. It is only when Islamic economics became impossible to ignore during the 70s, then a few traditionalist scholars engaged with it seriously. The traditionalists maintained the same approach, i.e. an engagement with Islamic economics rather than with the larger economics discourse in general. Thus the point of contention for the traditionalists became focused on whether the letter of the Islamic law was being followed by the Islamic economists or not, whereas for Islamic economists the goal was to develop a viable alternative to the disparity producing economic system while remaining true to Islamic values.

The political processes contributing to the establishment of the first Islamic bank in the history of Islam were the petro-dollars windfall combined with a new-found confidence of the global South during the Cold War. In Pakistan, the escalating

Islamization rhetoric of the 70s and Pakistan's Islamist military regime of General Zia-ul-Haq during the 80s, led the Pakistani state to change its secular economic system to a de-secularized Islamic economic system. Both the traditionalists as well as Maududi's group concurred in their support of an Islamic economic system. However, both these groups rejected Zia's economic Islamization as it was applied in practice and later challenged the state through the judiciary with the aim of implementing an 'authentic' Islamic economic system. Zia's Islamization rhetoric closed the doors to open a private Islamic bank because this option would not rid the economy of financial interest. Changing the system towards a more equality based ideal was not politically expedient. The best course of action was to maintain the rhetoric on ridding *riba* without substantial changes. Market globalization processes in the form of neo-liberal economic policies during Nawaz Sharif's premiership combined with Islamization rhetoric, thus delaying the judicial proceedings concerning the *riba* case. Political animosity between the Sharif government and judiciary propelled the Chief Justice of Pakistan to time the hearing of the *riba* case at a politically sensitive moment for Nawaz Sharif. Unlike Zia and Nawaz Sharif, General Musharraf was not bound by any economic Islamization claims and the secular minded, anti-Islamization Musharraf ended up establishing the first private Islamic bank in Pakistan. Thus institutionalizing de-secularization at a meso-level, in other words de-secularizing a market.

One of the significant contributions of my research was to delineate the formation of norms of exchange (Spillman 1999) and the particular factors that led to the institutionalization of one particular norm rather than another. The two discourses of Islamic interpretation, one paying more attention to form and the other more focused on the spirit of Islamic injunctions led to the formation of two corresponding theoretical norms of exchange: the social-justice norm of Islamic economics through the non-traditional discourse, and a letter-of-the-law norm through the traditional approach. Despite the political interests, these two norms have remained fairly distinct. The alignment of the form focused norm with the conventional system whereby the Islamic solutions mimicked the mainstream ones, led this norm to become institutionalized as the Islamic finance industry.

In summary, a combination of political interests and cultural processes played their respective roles in the formation of the first Islamic bank in Pakistan. We can also clearly discern that the capitalistic system is consciously constructed through state regulations and other political processes but there are also elements of un-intended consequences, for example the alignment of the form focused Islamic instruments with capitalist finance. The historical context is also a telling reminder that labels such as "de-secularization" and "Islamist" are not monolithic and may have complex and fluid meanings. I will elaborate this point in the proceeding paragraphs.

Before moving on to the discussion on concepts related to modernity theory, I would like to attend to an insight within the institutional literature. Meyer and Rowan's (1977) seminal article in this literature posited that formal institutional structures are "myth and ceremony" that are loosely coupled with work activities. They go on to suggest that it is the formal structures that will be similar across the organizations rather than the core activities. My case also observes a loose coupling by depicting a religious image that is presented to be in contradistinction with conventional banking, while the core processes and instruments are virtually the same. The conundrum is in the direction of institutionalization. Instead of the structural features being similar as proposed by the institutional theory, it is the core activities that are the same in my case. A tentative explanation for this reversal is the nature of the industry I am studying. Meyer and Rowan (1977) looked at the mainstream industry while my case is of a niche industry whose interest is in creating a difference. Another point to be kept in mind is that I studied commercial banks only. I would predict differences if other Islamic financial industry is studied, for example the upcoming Islamic micro-finance organizations.

The present study challenged the Orientalist assumptions of the "Muslim World" as the anti-Modern or anti-Western Other (Atia 2008). The critical discourse between the social justice focused Islamic economists and the form focused Islamic financial jurists gives us an insight into how Muslim groups attempt to make Islam relevant in contemporary times.

De-secularization was a prominent theme of this study. Homera Iqtidar (2011) distinguishes between secularism as a project and secularization as a social process. In the same vein, I would like to make a distinction between de-secularism and de-secularization, where the former can be associated with a project while the later is the social process. In this regard, the extensive hybridity of Islamic finance with conventional finance is symptomatic of the limitation of de-secularism as a project. Islamic economists and financiers have had limited success in operationalizing a 'pure/distinctive' Islamic economic system. Even the hybrid form (not to talk of the 'pure' form) was also unable to successfully institutionalize at the state level, but found a space in the market. What this implies is that as a social process (increasing Muslim religiosity), de-secularization in the economic realm was able to take root at the market level rather than the state level.

This brings us to the question of defining modernity as discussed in chapter two. I do not see IBF to be a case which can be seen as wholly anti-modern, pre-modern or of multiple modernities. Islamic finance is a combination of all three. As an illustration, the opposition by certain Islamic leaders with the concept of ‘sovereignty resting with the people’ could be interpreted to be irrational and enchanted; an anti-modern/pre-modern concern and be highlighted as an example of Muslim backwardness. However, there have been competing explanations from other scholars who do not deem sovereignty issue to be antithetical to Islam. Moreover, we also witness critical engagement between the form (fundamentalist literalism) vs. substance (bounded rationalization) debate not only in contemporary times but all throughout the Islamic history. We also observe certain pre-modern concepts being re-introduced but applied in a conventional manner. The individual banker’s approach as well as the organizational approach is pragmatic and realistic while remaining attached to certain religious commandments. The question to ask is whether we assign a label on the theory of Islamic economics or on how it is applied. I submit that a different label will have to be applied depending on our research lens. These observations strengthen the multiple-modernities theory because the trend to present a normative reading of modernization is broken through the recognition of cultural and cognitive aspects. I have shown that a religious institution is not necessarily pre-modern or anti-modern. Presenting the concomitant complexities and contradictions inherent in IBF also re-enforces the idea that the phenomena is of a different kind of modernity.

My objection to multiple modernity perspective is that an emphasis on the pervasiveness of certain modern concepts like the state as well as the capitalistic system is lacking. The types of internal conflicts that created modern Europe are portrayed to be of similar nature as those being faced by the recently colonized societies. The implication of recognizing an imposing capitalistic structure is that now we can understand that survival and avoiding alienation play an important role in Muslim (along with other social groups) quest to find (Islamically) legitimate ways to participate in the unprecedented globalized world.

The deep historical analysis of IBF emergence in Pakistan has also problematized various labels assigned to the state, like that of state Islamism (Tugal 2009). Tracing Pakistan's economic trajectory, starting with a secular economic system, a brief attempt at Islamization of the economy in 1980s, the state's opposition to the Islamist groups in 1990s and the eventual patronization of private religious financial institutions (Islamic banks) during the next decade reveals two important aspects. The first is the fluid nature of Islamism amongst various social arenas. Tugal shows how state Islamism became increasingly hegemonic on the issue of Islamic finance in Turkey. In Pakistan's case, the state has taken on many different pragmatic stances regarding Islamism in economic affairs depending on the market and political conditions. The take home point is that a general 'Islamist' label should not be applied by looking at only one social arena. Secondly, within a particular field, which happens to be economics in my case, the historical approach combined with multi-level approach is necessary to gain a holistic picture. If I had only studied Islamization of the economy during the 1980s, I would have missed the subsequent clash of the state with the Islamist groups. Similarly, focusing only on the meso-level market institution during the last decade would have resulted in assigning a staunch religious hegemony thesis, missing the re-secularization at the macro/state level.

Having highlighted the various contributions and insights of IBF institutionalization at the macro-level, I would like to turn to consolidating the findings of studying institutionalization "on the ground". I employed institutional analysis to explore the second research interest which deals with the consequences of IBF institutionalization. My intent was to analyze whether and how the form-focused norms of exchange institutionalized during the creation of the Islamic finance industry impacted the operations and processes of Islamic banks? Additionally, I also asked if the IBF practitioners deeply believe the literalist institutional logic to be as the ideal practice or is their commitment instrumental and superficial?

I found that the form focused norms of exchange formed during the creation of the industry were institutionalized in the operations and procedures of the Islamic banks I studied. The employed mechanism was primarily regulatory (*shari'a* supervisory board, additional audits, circulars, memos, real consequences in case of a breach), with some normative aspects as well. For example, most of the Islamic bankers I interviewed did not consider leaving their profession in-spite of their reservations with the Islamic banking system. The normative aspects were not thorough as the Islamic banks did not present themselves as overtly religious. There were almost no cultural-cognitive institutional aspects observed.

The institutional logic (form focused rather than substance focused) that emerged during the formation of the industry in Pakistan is prevalent at the organizational and operational level. This finding gives more credence to conformity theory rather than the alternative view of institutional heterogeneity. However, field observations and in-depth interviews with the bank employees revealed that conformity is not thorough. Islamic bankers may be practicing the form focused logic, but they are cognizant and critical of certain IBF operations that mimic conventional instruments. My field work showed that middle level bankers had various justifications of why things are the way they are and what it means for the future. However, these practitioners did not enact their understanding in practice too much.

The in-depth interviews related in the previous chapter depicted IBF as a cultural institution. It was found that the practitioners in various banks are similar to each other but it can not be construed that they follow a specific institutional script. They show agency in the sense that even-though the daily life activities are mundane (about survival, routine work, making profit), nevertheless, they are cognizant of the spiritual side. I propose that the reason for this awareness is their professional choice of working in an industry in which they are faced with challenging questions about their work. The moral questioning of their professional work is not a salient concern for them as I did not observe the employees to be consumed by these critiques. Rather, their day to day activities are not much different than the conventional bankers. Practitioners' cognitive understanding was revealed during the in-depth interviews. They engaged with substantial issues and topics like asset based, risk sharing and ethical aspects, deemed to be the major features of Islamic banks. At the same time, most have come to terms with the standard critiques of Islamic legitimacy in one way or another. Common explanations are that the IB is not operating in an Islamically optimal mode because it is at an infant stage compared to the centuries old conventional finance industry, and that IBF needs protection because of this infancy. In-spite of their self-awareness, Islamic bankers are not willing to shoulder the responsibility of their customer's religious obligations. The same institution that has placed the bankers in a situation in which they are questioned about the religious legitimacy of their work also provides them the necessary avenue of a *shari'a* advisor to limit the theological burden. Lack of cultural-cognitive institutionalization has given the space for the IB practitioners to contemplate and recognize the prevalent issues.

5.2 Research Limitations and Future Directions

An extensive research study such as a dissertation always has arenas that need more attention. I made an effort to prioritize the data collection according to the purpose it would serve in my analysis. One aspect further down on my list was to analyze the consumers of IBF to answer questions pertaining to institutionalization. What led them to choose an Islamic bank? What are the societal and cultural mechanisms that hinder or perpetuate an Islamic bank's image? Which cultural repertoires are employed during the interaction between a banker and customer? To what extent do the multiple institutional logics inform their choice?

One aspect that would have facilitated my investigation was financial and economic expertise. I was not able to deeply assess the trade-offs that were made by the policy makers in the *shari'a* board. Practicality, profit maximization, pragmatism and minimum confrontation, religious dictates and other such considerations would have lend my analysis a better picture of the decision making process.

Lastly, I would have liked to explore deeper as to why were the practitioners reluctant to voice their reservations of their work practices? Is it because of the industry type, or some wider cultural aspects? Do mainstream institutions like banking provide or limit certain avenues for enacting grievances. I would like to pursue this line in future analysis.

Another direction that I would like to explore in future is to conduct comparative analysis. Multiple comparisons could be made, including; comparison of IBF in another country, comparison of the Islamic finance industry within the same institution (Islamic micro-finance etc), or IBF comparison with another industry based on moral underpinnings like the organic food industry.

APPENDIX A:

INTERVIEW PROTOCOL

- Professional Life history – for contextualizing
  Q. Could you please briefly relate your professional experience?
  Q. How and why did you join Islamic Banking?
  Q. How long have you been in this bank?
  Q. What is your role as an '-----' (position)/ job description.
  Q. Who do you report to?
  Q. What are some of the specific tasks you face in your daily routine? (can look at the scheduler as well)

- Shari'a board – details on the "parties to exchange" dimension - how the management visualize/perceive the religious element.
  Q. What is the process of choosing the *shari'a* board? What are the criteria? Are critical scholars considered?
  Q. What is the extent of your interaction with the members of the *shari'a* board? How many times do you meet? How many e-mails in a day/week?
  Q. What is the extent of their involvement in the actual day to day banking operations? What kind of access do they have to the departments?
  Q. How necessary are the Shari'a scholars to Islamic finance apart from the state's regulatory prescription? Because AAOFI standards are there, Product development is generic (also software solutions are catered for generic products)

- Banking operations – how much are the IB operations institutionalized, what repertoires are used to deal with an unexpected situation; isomorphism
  Q. How much of leverage do you have to modify/change/tweak a particular banking operation/s?
  Q. What is the mechanism of introducing a new product or a new service? Where do you get the idea? Is it need based or is it trend based or both?
  Q. Any extra-ordinary incident or a problem that you faced recently, details.

- Ideology – norms of exchange.
  Q. If you were to be offered a lucrative job at a mainstream bank, what would you do?
  Q. Do you know people who have left Islamic banking for ideological reasons?
  Q. Any difference in performance, passion between religious and non-religious staff?

- Constraints to – institutionalize, innovate, experiment, or convenient excuses
  Q. Are there any specific structural factors that may prevent your bank from developing new products based on Islamic concepts?
  Q. What is the role of the government in terms of facilitating or hindering IB?
  Q. What should be the role of the government?

- Comparison with the mainstream banking system – institution building.
  Q. Having worked in the mainstream system, how different is the workings, culture, norms (technical as well as non-technical) of your specific bank compared to other Islamic banks as well as the mainstream banks?
  Q. What is your opinion about the capitalistic system? Are you working with-in it, or not? Is it a hindrance/enabling?
  Q. Any observations on the recent US financial crisis?

- Meaning of IB – norms of exchange, object of exchange.
  Thinking about the IB products that you are familiar with:
  Q. How they work, etc.

- Marketing/image related – decoupling/isomorphism
  Q. How do you want your bank to be perceived by your customers, employees?
  Q. How does your bank track public perceptions about itself? How do you deal with for example rumors, or opinion of a religious scholar regarding your bank?
  Q. What are the strategies employed by your bank to gain a niche in this booming sector?
  Q. How are the Islamic banks competing with the mainstream banks in Pakistan?
  Q. Is there a list available for all the events that your bank has sponsored?
  Q. What kind of events do you hold for customers, or for your own employees?
  Q. question on charity

- Secularization questions
  Q. How much do you interact with the mainstream banking (non-islamic banking) sector/community? What is the nature of the interaction? (meeting at conferences? Other events?)
  Q. interaction with non-muslims – comfort level bringing Islam in the conversation dealing with economic matters.

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