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## Diplomacy and The Birth of Islamic Finance As An Alternative Financing Source for The Global South

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### Abstract

Islamic finance (IF) is the latest form of international financial system that emerged to offer an alternative source of financing development particularly among some countries in the global South. The aim of this article is to explore the role of diplomacy in the emergence of IF as an alternative financing source particularly for the global South. This article argues that IF was born out of diplomatic process, like its counterpart the Bretton Woods system. It further argues that, to understand the emergence and the forces behind the emergence of Islamic financial system, there is need to look at the context of the notion of South-South Cooperation that was conceived in 1950s and gained momentum in 1960s. The notion of South-South Cooperation showed to the Muslim world the possibility of creating a new financial system that began with the formation of the Organization of Islamic Conference (OIC) in 1969, the establishment of Islamic Development Bank (IDB) in 1973 and consolidated with the Mecca Conference in 1976. This article concludes that although international financial systems are always the product of diplomacy, however, the nexus between the two has been overlooked by researchers. It, therefore, recommends that future studies examine this relationship in an in-depth manner.

**Keywords:** Diplomacy, Global South, International Financial Systems; Islamic Finance, South-South Cooperation

### Introduction

IF is the latest international financial system that emerged to provide an alternative financial system vis-à-vis the conventional Bretton Woods systems (Askari & Krichene, 2014b, 2014a). In recent years, it has been a source of financing development for many countries, particularly those in the Global South (Rahman, 2021). In addition, the macro aspect of IF continues to be increasingly a significant international financial system that analysts are now becoming convinced that it is more stable than the capitalist financial system particularly during time of financial crisis (Baber, 2018; Biancone & Salem, 2019). However, while it is less debatable the role of IF in the contemporary global world, so far there are no scholarly works on the role of

diplomacy in conceiving IF and its implementation afterwards making it currently a growing competing international financial system.

Numerous studies have studied the emergence of IF and its role in the contemporary world economy (Alrifai, 2015; Ariff, 1982; Choudhury, 2001; Ibrahim & Alam, 2018; Iqbal, 2017; Nagaoka, 2012; Schoon, 2008; Waemustafa, 2013; Warde, 2004, 2010). These studies have mainly examined the emergence of IF within the context of the global economy. What appears missing from this array of studies, however, are studies on the role of diplomacy in conceiving the idea, in the first place, and making it a reality in terms of implementation.

This article, therefore, vows to fill in this gap within the extant literature by discussing the role diplomacy played in the emergence of IF as an alternative financial system, the context in which it emerged, its relationship with the global South, and other factors that also played some roles in its emergence. The article is organized in five main sections. Section one focuses on international financial systems such as the restoration of the pre-war international gold standard and Bretton Woods systems, and the New International Financial Architecture (NIFA) highlighting the role of diplomacy in bringing them about. This section also consists of three subsections that include diplomacy and the international financial systems, global South versus the international financial systems, and financing development in the global South. Section two discusses diplomacy and the emergence of IF. Section three identifies other factors that played a role in the emergence of IF. Section four discusses IF in the context of global economy. Section five draws some conclusions and offers recommendations for future research.

### **IF in the Context of International Finance**

It is altruistic that no system emerges out of a vacuum. In understanding the emergence of IF and factors that played a role in its emergence, it is essential to revisit the emergence of the conventional international financial systems, particularly the restoration of the pre-war international gold standard and Bretton Woods system. The purpose for doing so is to offer some contextual background as to how international financial systems emerged and the role of diplomacy in their emergence.

#### ***Diplomacy and the International Financial Systems***

The aim of this section is not to discuss the purpose and success of Bretton Woods financial system. Rather, the purpose is to highlight the role diplomacy played in establishing international financial systems from the end of World War I to the current international financial system that was established in the aftermath of the World War II which has been governing the global financial affairs since then.

Diplomacy started to become formally involved in the process of international financial system in the 1920s after the end of the World War I when a major international conference in Brussels was convened in 1920. The goal of the conference was similar to the famous Bretton Woods which was to devise a vision for the rebuilding of the international monetary system following the economic destruction caused by the war (Gallarotti & Gallarotti, 1995; Helleiner, 2013). It was during this conference that the representatives of thirty-nine countries agreed on the restoration of the pre-war international gold standard along with other various national policies in support of the goal that include balanced budgets, the creation of independent central banks, and the abolition of exchange controls (Gallarotti & Gallarotti, 1995; Helleiner, 2013).

In spite of the resolutions being non-binding, there was a considerable political weight attached to the conference as it was among the first held by the League of Nations and had the supports of powerful officials and bankers mainly from the US and UK (Costigliola, 1984). The Brussels conference was followed by another conference in Genoa in 1922 in which the same objectives were reiterated with many countries subsequently introducing gold-based currency stabilization programmes assisted by the Bank of England, the Federal Reserve Bank of New York (FRBNY), and private bankers in both London and New York (Costigliola, 1984; Helleiner, 2013; Leffler, 1978).

The idea of developing a new international financial system was born after the great depression of the 1930s. However, because of the World War II that engulfed the world after the great depression, no solution was devised until the war was over in 1944 (Mundell, 1972). The goal for conceiving the idea was to make the world depression-proof and, to some extent, this has been relatively achieved in the post-war era (Blanco & Carrasco, 1999). The Bretton Woods negotiations were dominated by representatives of the British and US treasuries notable among them were John Maynard Keynes and Harry Dexter White (Helleiner, 1994; Schenk, 1995).

One of the major concerns with regard to the restoration of the pre-war international gold standard and Bretton Woods agreements was the fact that they were both conceived, designed and implemented by the developed countries, otherwise, the global North. The global South had no agency in the development of both systems. The United States, Canada, Australia, Japan and the Western European countries were the countries that first conceived and signed the Bretton Woods Agreement in 1944. The process of the agreement began before the end of the war with 730 delegates from all the 44 allied nations gathered at a place called the Mount Washington Hotel in Bretton Woods, New Hampshire, the United States of America (Kindleberger, 1974). It is therefore the diplomatic relationship among these 44 allied countries that first gave birth to the Bretton woods international financial system.

Without the use of diplomatic relationships among the countries involved, it would have been hard to conceive the restoration of the international gold standard of the post-World War I and the subsequent Bretton Woods embedded liberalism ideas let alone their implementation. Such is the essence of diplomacy that when employed nations can be able to collectively achieve their political, economic and security objectives without resorting to conflict or war.

### ***Global South Versus the International Financial System***

As briefly mentioned under the previous section, the international financial system was a child of diplomatic process among the 44 allied nations emerging from the World War II. The system therefore was originally conceived and designed to serve the interests of the participating nations. However, a major political structural change followed the end of the World War II when the roofs of colonialism came down crashing effectively ending the institution of colonialism that until then was a major component of the international structure. The new development gave birth to nations that were not only new but also weak relative to the older nations. It soon appeared to the newly emerging nations that the international financial system was not designed for them as it failed to address their developmental issues and concerns.

Many analysts and scholars argued that international financial systems from the Bretton Woods to the New International Financial Architecture (NIFA) that was conceived in the last decade of the 20<sup>th</sup> century were never planned to address the interests of the global

South (Soederberg, 2004). The NIFA was the products of the G7 summits, most notably the 1995 Halifax Summit and the 1999 Cologne Summit which attempted to create a new multilateral governance structure aimed at strengthening the existing international financial system under the Bretton Woods institutions. The summits were held to the exclusion of the global South except a few of them that were later invited under the G20 umbrella (Soederberg, 2004).

Among the key concerns of the global South majority of whom were the newly independent nations in the 1950s and 1960s was development and economic growth. The Bretton Woods institutions have been on the firm belief that the two are linked which was the reason why the Bretton Woods institutions advocated for free trade which, from their perspective, would inevitably lead to development (Chant & McIlwaine, 2009). This idea was, from the outset, contested by the newly emerging countries that had different set of challenges and were at a different phase of their statehood relative to the more established nations (Gray & Gills, 2016).

Beginning from the historic Bandung Conference of 1955, for the first time, the newly less developed nations met to challenge the political and economic domination of the global North. In the conference, the newly decolonized nations emphasized cooperation on various aspects that include economic, cultural, human rights and promotion of world peace (Gray & Gills, 2016). These countries and a host of others under the United Nations Conference on Trade and Development (UNCTAD) called for the establishment of a New International Economic Order (NIEO). The goal of NIEO was to tackle structural unequal exchange through a more just and equitable relationship on the goods exported and the goods imported by the newly developing countries. In other words, the newly decolonized nations were asking for more just and equitable economic relationship with the nations of the global North.

The likes of the South-South Cooperation (SSC) and the NIEO were the indication that countries of the global South were not satisfied with the then existing world economic order, part of which was the international financial systems. It was in this context that IF notion was born as discussed later in detail.

### ***Financing Development in the Global South***

The dominant development models of the 1940s and 1950s equated development solely with economic growth. At the time, the problem with emerging developing countries was having abundance of labor supply but a lack of investment that would constrained economic growth and development (Sagasti, 2005). This condition warranted mainstream development theories to assign virtually an exclusive importance to finance and investment. However, at some point the dominant prescription about development used to focus on savings and how countries with less development have people who are too poor to invest or they simply spend like the people in the developed parts of the world. some tried to explain development in terms of international exploitation particularly when explaining the poor development in the developing parts of the world (de Carvalho, 2009).

As earlier indicated, the end of the World War II brought about some deeply ingrained changes in the world geopolitics. Former colonies of the European powers pressed for political autonomy. Soon the colonial powers realized that they could no longer delay the hurricane of political independence sweeping across the world. The emergence of the newly independent states then automatically created two camps of nations in terms of development: the former colonial and advanced nations and the newly independent nations.



Right from the outset, the newly independent nations were faced with pressing developmental challenges as pointed out by numerous experts (Ratha et al., 2008).

After attaining independence, the source of many of the newly independent global South nations had to look abroad to finance their development. The financing mainly came in the form of aids and loans from the developed world, the global North (Ratha et al., 2008). The so-called Bretton Woods institutions were at the heart of the foreign aids and loans that the global South has been so much reliant on for its development. According to Mphande (2020), Bretton Woods institutions were the source of the funds used for financing development in the developing world albeit they are criticized for their exploitation through loans conditionalities ensuring that the developing countries are debts trapped.

Among the major aspects of development is infrastructure development. In recent years, countries such as China have emerged as a major source of financing infrastructure development in the developing world. In relation to that, Jiang (2019) investigated China and Japan's expansion of overseas infrastructure investments. Both countries have funded transport infrastructures in numerous emerging economies. The two, according to the study, have emerged as competitive partners challenging the traditional norms of development financing by Washington Consensus and the Development Assistance Committee (DAC). Financing infrastructure development in Africa, according to Bongwa and van Dijk (2021), faces numerous challenges and requires various innovative financial mechanisms. Unfortunately, Africa's existing legal, institutional and governance constrain the attraction of development financing sources particularly the private capital.

The domestic sources of financing development were mostly inadequate. Griffin (1965) made this assertion in the case of Pakistan that both private savings and government's surplus on current expenditure were then totally inadequate to finance Pakistan development plans in those years. Foreign aids continued to play a major role in financing development of Pakistan in post-independence period. In a much earlier study on Latin America, Griffin (1970) investigated the sources of financing development in Latin America. The study claimed that despite Latin American countries' governments used of income inequality and inflation as a form of substitute for taxation as well as resource mobilization through the public sector, the countries relied increasingly on foreign aid and private foreign investment for the financing of their development. Ferraz et al (2013) also argued that it was essential for Brazil to raise its rate of investment in order to maintain its then growth after the 2008 financial crisis.

The challenges brought about by the external debts accrued in financing development in the developing world has been an issue studied by some scholars. Although the goal of this study is not to investigate the challenges associated with one form of financing development or the other, it is worth highlighting Loxley (2019) study that revealed the challenges associated with the international financial system as sources of financing development in the developing world which include the problems caused by the external debts to receiving countries and the fragility of international trade monetary systems. Such problems and challenges are likely to be among the factors leading to the emergence of IF as an alternative source of financing development in the global South.

However, the traditional sources of financing development, as argued by Dash (2018), through the multilateral development banks and other forms of financing such as aids and so on are still the main sources of infrastructural financing. There has been expansion of the scope for greater participation of private investors with innovative instruments such as bonds, equity, and other forms of capital market instruments that include both debt and equity features. These innovative instruments can be said to be inclusive of IF.

Contrary to foreign aids, loans, and investment, Birdsall and Rojas-Suarez (2004) argued that regionalism is another strategy and opportunity through which the developing world can speed up the development of their domestic institutions and be able to generate faster and steadier growth as well as develop their ability to deal with the challenges and risks involved in the deeper integration into the global economy. They also revealed and assessed three pillars of development finance namely, foreign financial flows, funding development through private saving and taxation, and generating resources using higher exports ratios as well as trade diversification.

Some internal sources have also been identified as sources of financing development. Lau (2022) suggested four areas Malaysia should focus on in order to finance its development and become a developed nation. Among the areas suggested are effective use of public expenditure, nurturing human capital, maintaining transparency and accountability, upgrading technology and enhancing value-added initiatives. Similar areas were also suggested by Berua (2020) in a study that investigated the way to finance sustainable development particularly in the developing countries. The study argued that to finance sustainable development goals, there are needs for greater inter-state cooperation, increased cooperation between public and private sectors, making growth equitable and inclusive, availing reliable data, increase stakeholder interest and role-play, adequate planning and preparation, and better communication framework.

A new trend in financing development that emerged is what is known as public private partnerships (PPP). Many countries in the global South employ this method in an attempt to bridge the development gap. Owolabi et al (2018) explored the used of PPP for financing development in the developing world and challenges associated with it. The study is also similar to Sergi et al (2019) in which PPP was studied as a means of financing sustainable development. It was argued by the study that PPP is a perspective mechanism for financing sustainable development for its harmonization of private and public interests, unification of entrepreneurial and government investments, and the development of highly effective as well as full-scale implementation initiatives.

Among the aspects of development that developing countries strive to finance are economic growth. Alhassanz (2019) investigated the effects of access to finance and related activities on innovative growth and development in Sub-Saharan Africa. The study found positive correlations between economic growth and a host of other variables that include domestic credits to private sector, domestic credit to credits provided apart from the private sector, central government credits, bank credit to private sector, and inflation. All these factors seem to fall within the sphere of domestic sources of financing development. This section shows that there are various methods employed in financing development particularly by the global South. Most of these sources of development financing in the context of the global South countries were the results of the unreliability on aids and loans streaming down from the global North. IF should be perceived in this light as it continues to be increasingly a significant financing source for the countries that have opened up for it.

### **Diplomacy and the Emergence of IF**

IF is relatively a new development in both academic and practical terms. Its emergence is often attributed to an agenda promoted in 1970s by economists, Islamic jurists, practitioners and policymakers who met in various forums to discuss Islamic economics. These series of forums culminated into the famous International Conference on Islamic Economics, famously known as Makka (Mecca) Conference, held between 21 and 26 February 1976 (Ibrahim &

Alam, 2018). The outcome of the conference led to the development of Islamic banking and finance institutions and the ever-growing scholarly interest of Islamic banking and finance as well. The most significant IF institutions that resulted from the conference include the International Centre for Research in Islamic Economics and the Islamic Development Bank (IDB).

The conference which was headed by the then President of King Abdulaziz University, Jeddah, Dr. Muhammad Omar Zubair was planned to be the first of many to come every two years. However, it was not until 1983 that the next conference was held in Islamabad, Pakistan (M. Iqbal, 2017). There was, though, a seminar on Monetary and Fiscal Economics of Islam that was also held in Islamabad, Pakistan in 1978 (Iqbal, 2017; Iqbal & Mirakhor, 2013). It was during the Second conference that a resolution was passed that ended up establishing the association named "International Association for Islamic Economics (IAIE)" that subsequently assumed the responsibility of convening latter conferences sometimes in conjunction with the Islamic Development Bank (IDB) (Iqbal, 2017). Since then, there were over ten conferences held for the promotion of the IF agenda, as revealed in Table 1.

Conference/Venue	Dates Held	Local Host	Theme
First Conference, Makkah, Saudi Arabia	21-26 February, 1976	King Abdulaziz University, Jeddah.	General
Second Conference, Islamabad, Pakistan	19-23 March, 1983	International Islamic University, Islamabad.	Development, Finance, and Distribution in Islamic Perspective
Third Conference, Kuala Lumpur, Malaysia	28-30 January, 1992	International Islamic University, Kuala Lumpur.	Financing Development from Islamic Perspective
Fourth Conference, Loughborough, UK	13-15 August, 2000	Loughborough University.	Islamic Finance: Challenges and Opportunities in the 21 <sup>st</sup> Century
Fifth Conference, Manama, Bahrain.	7-9 October, 2003	Bahrain University and the Central Bank of Bahrain.	Sustainable Development and Islamic Finance in Muslim Countries
Sixth Conference, Jakarta, Indonesia	21-24 November, 2005	Indonesian Ministry of Finance and the Central Bank of Indonesia.	Islamic Economics and Banking in the 21 <sup>st</sup> Century
Seventh Conference, Jeddah, Saudi Arabia	1- 3 April, 2008	King Abdulaziz University, Jeddah.	Thirty Years of Research in Islamic economics: Solutions and applications for Contemporary Economic Issues
Eighth Conference, Doha, Qatar	19-21 December, 2011	Hamad bin Khalifa University, Qatar Foundation, Doha	Sustainable Growth and Inclusive Economic Development from an Islamic Perspective
Ninth Conference, Istanbul, Turkey	9-10 September, 2013	Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESERIC), Istanbul.	Growth, Equity, and Stability: An Islamic Perspective
Tenth Conference, Doha, Qatar	23-24 March, 2015	Hamad bin Khalifa University, Qatar Foundation, Doha	Institutional Aspects of Economic, Monetary and Financial Reforms
Eleventh Conference, Kuala Lumpur, Malaysia	11-13 October, 2016	International Islamic University, Kuala Lumpur.	Rethinking Islamic Economics and Finance: Paving the Way Forward for Inclusive and Sustainable

Source: Iqbal (2017).

Prior to Mecca Conference in the 1970s, the first financial company established based on Sharia was the Mit Ghamr saving project in the Egyptian town of Mit Ghamr in 1962 (Nagaoka 2012; Schoon 2008). The foremost objective of Mit Ghamr is to enable local population access to financial services in accordance with Islamic Shari'ah principles and possibly increase their wealth. Later in 1971, Mit Ghamr project was incorporated into Nasser Social Bank which formally became the first Islamically oriented bank (Nagaoka, 2012; Schoon, 2008). After the Mecca Conference, as part of the fruits of the conference, the IDB was established as the first multilateral development bank to assist in mobilization of funds for investments in development projects within member states (Nagaoka 2012; Schoon 2008). By 1980s, IF started to grow exponentially.



The way IF emerged in the 1970s made some scholars to call those behind it a social movement (Henry, 2019). The Islamic Development Bank that was founded in 1973 currently has a consortium of fifty-seven (57) member countries. Table 2 shows the list of IDB current member countries.

APPENDIX: Country Membership in the Entities of IDB Group						
	Country	IDB	ICIEC	ICD	ITFC	Membership of the Entities (out of 4)
1	Afghanistan	√	×	×	×	1
2	Albania	√	√	√	×	3
3	Algeria	√	√	√	√	4
4	Azerbaijan	√	×	√	×	2
5	Bahrain	√	√	√	√	4
6	Bangladesh	√	√	√	√	4
7	Benin	√	√	√	√	4
8	Brunei Darussalam	√	√	√	√	4
9	Burkina Faso	√	√	√	√	4
10	Cameroon	√	√	√	√	4
11	Chad	√	√	√	×	3
12	Comoros	√	×	√	×	2
13	Côte d'Ivoire	√	√	√	√	4
14	Djibouti	√	√	√	√	4
15	Egypt	√	√	√	√	4
16	Gabon	√	√	√	√	4
17	Gambia	√	√	√	√	4
18	Guinea	√	√	√	×	3
19	Guinea-Bissau	√	×	√	×	2
20	Indonesia	√	√	√	√	4
21	Iran	√	√	√	√	4
22	Iraq	√	×	√	×	2
23	Jordan	√	√	√	√	4
24	Kazakhstan	√	√	√	×	3
25	Kuwait	√	√	√	√	4
26	Kyrgyz Republic	√	×	√	×	2
27	Lebanon	√	√	√	√	4
28	Libya	√	√	√	√	4
29	Malaysia	√	√	√	√	4
30	Maldives	√	×	√	×	2
31	Mali	√	√	√	×	3
32	Mauritania	√	√	√	√	4
33	Morocco	√	√	√	√	4
34	Mozambique	√	×	√	√	3
35	Niger	√	√	√	√	4
36	Nigeria	√	√	√	√	4
37	Oman	√	√	×	×	2
38	Pakistan	√	√	√	√	4
39	Palestine	√	×	√	√	3
40	Qatar	√	√	√	√	4
41	Saudi Arabia	√	√	√	√	4
42	Senegal	√	√	√	√	4
43	Sierra Leone	√	×	√	×	2
44	Somalia	√	×	×	√	2
45	Sudan	√	√	√	√	4
46	Suriname	√	×	√	×	2
47	Syria	√	√	√	√	4
48	Tajikistan	√	×	√	×	2
49	Togo	√	×	×	×	1
50	Tunisia	√	√	√	√	4
51	Turkey	√	√	√	√	3
52	Turkmenistan	√	×	√	×	2
53	Uganda	√	√	√	√	4
54	U.A.E.	√	√	√	√	4
55	Uzbekistan	√	×	√	×	2
56	Yemen	√	√	√	√	4
	Total	56	40	52	37	-

Source: <https://www.isdb.org/sites/default/files/media/documents/2018-12.pdf>

Apart from the Islamic Development Bank, the first privately owned modern Islamic bank was opened in Dubai in 1975. After 1975, a number of Muslim countries that include Pakistan, Iran and Sudan 'Islamized' their banking systems from top to bottom (Henry, 2019). However, what is more interesting was the emergence of privately owned Islamic financial institutions in Sudan after the Islamization of its banks.

Ever since the emergence of Islamic banking and finance, the finance aspect has particularly dominated the practical application of the new institution. Many questions have been raised as to whether IF brings about any notable social difference (Abedifar et al., 2016; Gheeraert & Weill, 2015). Whether IF is good for growth is also another aspect the available literature focuses on (Ibrahim & Alam, 2018; Imam & Kpodar, 2016). Many of the available literature posited that IF along with its banking format is more stable than its conventional counterpart particularly during financial crisis. It has been described as being more resilient and able to stabilize credit during aggregate downturns (Alqahtani et al., 2017; Hasan & Dridi, 2010; Ibrahim & Alam, 2018; Kabir et al., 2015; Srairi, 2013).

The emergence of IF was aimed at developing an alternative order that has its foundation in Islamic principles and not dependent on a socialist state. The new order was rather designed to be based on individual entrepreneurship with emphasis on Islamic ethic while also maintaining efficiency and material progress (Moisseron et al., 2015). The 1970s decade was a turning point in the history of IF with the reconciliation of Sharia with the material private interests that were perceived by the conventional finance and economic as the driving force of human behavior (Moisseron et al., 2015).

Many countries dominated by Muslims or otherwise currently approve of both Islamic and conventional financial system. In fact, apart from IDBs member countries listed in Table 2, there are twenty-two (22) non-borrowing countries that provide capital and have voting representation in the Bank's Board of Governors and Board of Executive Directors as indicated in Table 3. This further testifies the role diplomacy plays in the continuous growth of IF and its institutions. These 22 countries are mainly countries of the global North.

	<b>IDB Non-Borrowing Members</b>
1	The United States
2	Canada
3	Japan
4	Israel
5	The Republic of Korea
6	The People's Republic of China
7	Austria
8	Belgium
9	Croatia
10	Denmark
11	Finland
12	France
13	Germany
14	Italy
15	The Netherlands
16	Norway
17	Portugal
18	Slovenia
19	Spain
20	Sweden
21	Switzerland
22	The United Kingdom

Source: Generated from <https://www.iadb.org/en/about-us/non-borrowing-member-countries>

Perhaps one way to understand how far Islamic banking and finance has reached is by looking at the number of Islamic banking and finance institutions across many countries in the world. According to the Global Islamic Finance Report (2010), there were over six hundred Islamic banking and finance institutions spread across over fifty different countries throughout the world in 2010 and as of 2020 the number was estimated to be over 1500 across 80 countries according to Bank Negara Malaysia (Bank Negara Malaysia, 2020; Moisseron et al., 2015). This is indicative of its exponential growth over the course of a decade. It is also estimated that in the near future nearly half of the savings of the Islamic world may end up being managed by Islamic financial institutions (Warde, 2010).

One of the debates that have occupied scholars interested in IF is whether it is relatively a new discipline. As discussed above, the 1970s was the decade when IF popularly emerged as an academic discipline and as a new practical financial system. Some scholars contested this view asking that if IF is relatively a new discipline, then how have Muslims managed their financial affairs over centuries since the time of Prophet Muhammad pbuh (Cizakca 2013). The answer to this is the fact that IF is as old as Islamic faith itself. IF was part of an entire economic system. Islamic economics was the ethical, commercial, and preindustrial capitalist system that predated Western capitalism by a millennium. In fact, the West borrowed the Islamic economic system in the medieval time prior to Industrial Revolution (Cizakca 1996, 2006).

Currently, with many countries being members of the IDB both as borrowing and non-borrowing members, IF is becoming a global financial system alongside its conventional counterpart. Furthermore, IF has been integrated into the global economy with the Dow Jones Islamic Market Index that tracks hundreds of companies within and outside the Muslim world that their products and services do not violate Islamic law (Warde, 2010). Several world's known and well-established financial institutions such as Citibank, HSBC and so on have established Islamic banking faction and Islamic products are now being offered by many conventional banks in the Muslims world, some Asian countries, Europe and the United States of America (Henry, 2019; Warde, 2010).

This section discusses the emergence of Islamic banking and finance system and the instrumental role diplomacy plays in the process. The section also reveals the development and evolution of IF both as an academic discipline and as a practical financial system that offer solutions to some practical problems. With its integration into the global economy, IF is likely to continue to grow and, using diplomatic forums and platforms, more countries are likely to join in the IF bandwagon.

### **Other Factors Responsible for the Emergence of IF**

There have been a number of factors that many scholars believed were responsible for the emergence of IF. This section discusses major of those factors responsible for the emergence of IF particularly as a form of financing national development. Some of the factors that could be attributed to the emergence of IF within the extant literature include emergence of Muslim nations, a large percentage of Muslims in the world population, globalization of finance, and economic strength of some Muslim countries.

According to Warde (2010), two political economic factors led to the emergence and development of IF. The first of the two main factors were pan-Islamism that began earnestly in the 1960s during the 'Arab Cold War' precipitated by Gamal Abdel Nasser's brand of nationalism, secularism and socialism. Nasser's ideology fitted him against the Saudi King Faisal who began sponsoring a pan-Islamic movement known as the Muslim World League using the pilgrimage to Mecca as a means to forge ties with Islamic leaders within and without the Arab world. King Faisal also offered substantial amounts of aid particularly to non-Arab Islamic countries in both Africa and Asia while visiting Muslim world capitals including Tehran during Shah's time in 1965.

Furthermore, there were a number of key events then that made the climate ready for Islamic revivalism. One of such events was the crushing Arab defeat that humbled Nasser and forced him to make a specific reference to religion which called many of the principles of Egypt's foreign policy in question. Many went attributed Arab's defeat to their straying from the true Islamic path. Another important event was an incident that took place in 1969 when a deranged Aussie man set Al-Aqsa Mosque on fire. This latter event became the reason for King Faisal's call for an Islamic summit in Rabat, Morocco during which an agreement was reached to establish a permanent Islamic organization. The following year, the Organization of the Islamic Conference (OIC) was dully formed, the same year Nasser died (Liu & Fan, 2018).

With Saudi new found oil wealth, pan-Islamism became a powerful movement by the mid-1970s (Sindi, 2019). A number of Muslim countries such as Turkey and Pakistan used Islamic solidarity then as a central theme in their foreign policies partly because the Muslim oil-producing countries of the Middle East were becoming quite an important market particularly for manpower and also a significant source of economic aid. Pakistan newly established close relationship with the Arab oil-rich countries particularly Saudi Arabia made

Pakistan the center of the earlier bulk of research in Islamic banking and finance while Saudi Arabia and other Gulf wealthy countries provided the cash. Pakistan, therefore, provided much of the manpower and the zeal for the network of supranational Islamic institutions that were formed.

The second factor, mentioned by Warde (2010), was the petrodollar windfall that followed the oil boom of the 1970s. Oil producing states started to amass immense wealth and with the accumulated wealth came power vis-à-vis oil consumers. As worldwide demand for oil continued to rise, oil producing countries felt that oil prices were stagnant while there increasing inflation. The countries renegotiated terms of oil prices with oil companies enabling to obtain better terms, “greater control over oil policy, higher prices, greater share of receipts, and even gradual nationalization, which increasingly transformed the role of foreign oil companies” from the position of power to a mere service providers hired “at the discretion of governments, to explore for, extract, refine and sell the oil” (Warde, 2010, p. 93).

The condition stated above led Saudi King Faisal, with the support of Anwar Sadat of Egypt, to use oil as weapon particularly in the Arab-Israeli conflict (Daoudi & Dajani, 2019; Galbraith & Price, 2021). The Arab Islamic countries under the leadership of Saudi Arabia embarked on oil embargo in October 1973 against countries that were in support of Israel (the United States included) (Daoudi & Dajani, 2019; Galbraith & Price, 2021). The oil embargo sparked the talk of what is known as a New International Economic Order (NIEO), and a new relationship between global North and global South particularly Islamic solidarity (Belay, 2019). It was in that context that Islamic banking and finance developed from a vague notion to a functional reality.

### **IF and the Global Economy**

In the previous sections, the emergence and the factors that led to the emergence of IF were discussed. After its emergence in 1970s, IF continued to grow exponentially against many odds. The aim of this section is to discuss the trend and factors that help to explain its growth throughout the last two decades of the 20th Century and more recently in the 21st Century.

The 1980s decade was a decade that witnessed a great deal of changes internationally. There was a change of leadership in Russia with the ascension of Mikhail Gorbachev in 1985 which all but transformed the relationship between the USSR and the West. The Berlin Wall also fell and the USSR disintegrated by the beginning of the last decade of the 20th Century. All these brought about new changes, a New World Order, a shift in approaches to development with the World Bank changing its approach from financing individual projects to transforming economic structures (Warde, 2010). The IMF, on the other hand, has become what Warde (2010, p. 96) termed a “global bankruptcy judge” giving loans and funds only when a country agrees to adopt structural adjustment policies (SAP).

All these changes brought about a new global economic paradigm aided by the collapse of Communism in Eastern Europe. Capitalism and the market economy became the unchallenged economic paradigm which also underwent transformations particularly in the relationship between the state and the market. Old economic ideas such as the view of government leaders as unable and unwilling of promoting public goods and; state control encourages inefficiency, stagnate entrepreneurship and delay reform (Bergsten, 1989; Ikenberry, 2005). The wave of the liberal New World Order reached the Muslim world relatively late but somewhat ended up complimenting some aspects of the newly emerging IF.



There was a convergence in their opposition towards statism. Firstly, the Islamic financial system emphasizes on private property, free enterprise and the importance of contracts vis-à-vis the state-led economic policy as well as the arbitrary decisions embedded in a strong state bureaucracy (Warde, 2010). Secondly, the privatization of welfare (through zakat, waqf and other Islamic redistribution schemes) goes in parallel with the Washington Consensus' downsizing of the state. Therefore, according to this IF principle, by helping the poor the wealthy become better human beings and through the voluntary provision of charity there is basically no need for public welfare organizations which are considered costly to run (Warde, 2004, 2010).

IF has become increasingly more prominent over the last two decades. One of the reasons behind the recent prominence were the financial crises the world economy experienced in both the first and the second decades of the 21st Century. The first global financial crisis of the 21st Century started in 2008 in the United States of America caused by the liquidity crisis resulting in loss of confidence in the mortgage credit market (Elasrag, 2010). Many hoped at the beginning of the crisis that it would be restricted to financial markets and would not escalate to affect the real economic sector and the rest of the world. This, however, proved to be a mere wishful thinking as the crisis dramatically escalated by September 2008 when the world economy experienced strong downward fluctuations in the stock market, a substantial reduction of the economic growth, volatile exchange rates, decreased demand and consumption, dramatic falls of industrial production and decreased flows of international trade and FDI (Dogarawa, 2012; Elasrag, 2010; Rarick & Han, 2010). The crisis and its consequences led to a serious evaluation of the foundations of the capitalist financial system and the search for answers and solutions. Consequently, IF came to the fore as a solution to the vulnerabilities and limitations of the capitalist financial system (Chapra, 2011; Dogarawa, 2012; Rarick & Han, 2010).

## Conclusion

The aim of this article is to discuss the role of diplomacy in the emergence of IF as an alternative source of financing development, particularly for the global South. A few conclusions can be drawn from this article. First, diplomacy is the means and the platform that gives birth to international systems, more specifically in this case, the international financial systems. This conclusion is based on the fact that you need more than a nation to conceive and establish an international system. International system, including financial systems, cannot be established through coercive means. It is simply impractical for an entire system, particularly financial systems, to be established on coercion or power alone without the parties involved being willing participants.

Second, Islamic finance emerged prior to the Mecca Conference as discussed earlier. However, it was only after the conference that the idea spread across many nations that were willing to give it a go. This implies that without using diplomacy as a conveyor and platform IF idea was more than likely to remain insignificant and fragmented rather than an established system though not yet capable of riveling its conventional counterpart but capable of providing an alternative financial system.

Third, with the likes of the IDB continuing to use more diplomacy in attracting both states and non-states participants, IF continues to be increasingly more global in its coverage and services as evidenced in IDBs borrowing and non-borrowing member countries. Fourth, Islamic countries' ability to come together and establish IF in the late 1960s and early 1970s introduced the new financial system. However, without making the idea practical, attractive

and value-added, the notion of IF might have died long before now. Its evolution, therefore, depends on the system's ability to bring more values to the table for the world economies. IF has been making way into the likes of the US, UK, Singapore, Hongkong and so on because of the system's ability to offer something new that the conventional international financial system cannot. More economies, therefore, will be willing to open for IF providing that it continues to add values to world economies. Finally, the relationship between IF and diplomacy is an area that has been overlooked by researchers. More future studies are therefore needed in order to fill in this particular gap.

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