

# **Breaking the Formalist Deadlock? Islamic Investment and Corporate Social Responsibility**

Kilian Bälz<sup>1</sup>

## **TWO MACRO-LEVEL TRENDS**

The purpose of this paper is to examine two macro-level financial practices, Islamic investment and socially responsible investment. Islamic investment is defined as investing in accordance with the principles of Islamic law (*shari'a*). It is one aspect of Islamic finance. Socially responsible investment means investing in accordance with ethical principles. Socially responsible funds promote sustainable development and environmental protection. Socially responsible investment is one aspect of corporate social responsibility, the idea that a corporation has a social responsibility extending beyond the responsibility towards its shareholders. Corporate social responsibility and socially responsible investment both have attracted a lot of attention recently. Upon the initiative of former Secretary General Kofi Annan, the United Nations in 2000 launched the United Nations Global Compact, with the intention of spreading the idea of corporate social responsibility in the corporate world.<sup>2</sup> The European Union followed suit, issuing a Green Paper on corporate social responsibility in 2001.<sup>3</sup>

---

<sup>1</sup> The author is Attorney at Law, Frankfurt/Main and Cairo. Research for this paper was carried out in spring 2008 while the author was a research fellow at the Islamic Legal Studies Program of Harvard Law School. He is indebted to Harvard Law School for the institutional support it provided. In addition, he wants to extend his thanks to the directors Baber Johansen, Peri Bearman, and Nazim Ali.

<sup>2</sup> On the activities affiliated with the UN Global Compact and its underlying principles and goals see:

Socially responsible investment and Islamic investment have one important feature in common: under both regimes, the investment decision is partly based on non-economic criteria. Both socially responsible investment and Islamic investment testify to a global “correctionist striving” in which ethics are introduced to economic decisions. In light of these criteria, it does not come as a surprise that socially responsible investment often is discussed in the context of Islamic finance, and, vice versa, Islamic finance has been viewed as a form of socially responsible investment. Moreover, it has been suggested that a rapprochement between Islamic investment and socially responsible investment might provide a cure for one of the most pressing issues in Islamic finance, namely that the industry at times is more concerned with formal adherence to Islamic legal rules instead of promoting alternative, specific Islamic business values. This is what I refer to as the “formalist deadlock”: in present day Islamic finance, form can often prevail over function. Instead of implementing specific Islamic business values, the industry follows a formalist interpretation of Islamic law, which allows it to disguise conventional financial products in a *shari‘a*-compliant form.

In this paper I want to explore if and how the concept of socially responsible investment can help to overcome this situation. I will isolate areas in common between socially responsible investment and Islamic investment and attempt to figure out what one area can learn from the other. Contrary to what has occasionally been claimed,<sup>4</sup> I will argue that Islamic investment and socially responsible investment are two different concepts with only a limited overlap. This implies that socially responsible investment cannot be expected to cure the alleged flaws of Islamic finance. However, Islamic investment and socially responsible investment tend to raise similar sets of issues and questions. Enhancing cooperation between these two fields can therefore nevertheless be beneficial—and I will come up with some

---

<http://www.unglobalcompact.org/AboutTheGC/index.html> (accessed May 8, 2008).

<sup>3</sup> European Commission—Employment & Social Affairs, *Green Paper Promoting a European Framework for Corporate Social Responsibility*, July 2001, [http://ec.europa.eu/employment\\_social/soc-dial/csr/greenpaper\\_en.pdf](http://ec.europa.eu/employment_social/soc-dial/csr/greenpaper_en.pdf) (visited on May 8, 2008).

<sup>4</sup> For a typical argumentation see Blake Gould, “Social Responsibility and Islamic Finance,” available at <http://investhalal.blogspot.com/2008/04/social-responsibility-and-islamic.html> (accessed March 9, 2009).

concrete suggestions on what Islamic investment can learn from socially responsible investment.

## THE “FORMALIST DEADLOCK” AND THE CALL FOR A REVIVAL OF SUBSTANTIVE VALUES IN ISLAMIC FINANCE

The tremendous success of the Islamic finance industry in recent years has been accompanied by increasing unrest and dissatisfaction with how Islamic financing transactions actually are implemented. Critical voices tend to emphasize that Islamic finance largely is limited to mimicking *shari'a*-compliant versions of conventional financial products, and that the industry has failed to establish a financial system actually based on different, genuine Islamic values.<sup>5</sup> This becomes clearer when looking at recent debates on *sukuk* and *tawarruq*, in both of which the Harvard Islamic Finance Project was involved:<sup>6</sup> in both cases the concern was raised that the practice of Islamic finance has departed from genuine Islamic economic principles—in particular the concept of risk sharing—and has designed structures imitating conventional structures in terms of function and allocation of risk; only the legal means to achieve this structure are different, in order to formally satisfy *shari'a* requirements.

I will present two hypotheticals to illustrate the discomfort with a simply formal application of Islamic legal rules: Would Islamic finance have prevented the credit crisis? And would Islamic finance enhance carbon trading? Both questions, which are presently being debated in Islamic scholarly circles, illustrate the issues related to a formal application of Islamic legal rules.

### (i) **Case Study 1: Would Islamic finance have prevented the credit crisis? Potentially. But for the right reasons?**

The credit crisis is a complex phenomenon and this is not the right place to go into the details. For the purpose of this paper it

---

<sup>5</sup> For a forceful critique of alleged formalism in Islamic finance see Mahmoud A. El-Gamal, *Islamic Finance: Law, Economics and Practice*, Cambridge: Cambridge University Press, 2006.

<sup>6</sup> See materials from the 2007 workshop on *Tawarruq* at <http://ifptest.law.harvard.edu/ifphtml/ifpseminars/WorkshoponTawarruq.pdf>; the website for the 2008 workshop on *Sukuk* is now being prepared.

is sufficient to point out the major factors that contributed to this devastating development. Fundamentally, the crisis is due to the fact that (1) banks granted loans to house buyers with a low creditworthiness secured only by a mortgage (“subprime lending”) and (2) that the loans were securitized, repackaged as mortgage based securities (“MBS”) or collateralized debt obligations (“CDOs”), and sold to investors all over the world (due to repackaging, the risk structure became very opaque). When home buyers, due to rising interest rates, could no longer repay the loans, banks found out that the value of the mortgaged property did not provide sufficient security. The system collapsed and, due to the globalization of the secondary market, sent shockwaves around the globe.

*Shari‘a* principles arguably would have posed considerable constraints on the securitization and trading of the loans, as the exchange of one debt for another generally is held impermissible under *shari‘a* law.<sup>7</sup> This makes securitization structures difficult to implement, unless they are asset-based. An application of Islamic financial rules, therefore, would have prevented the credit crisis, an argument that is regularly put forth in Islamic financial circles.<sup>8</sup> However, it remains questionable whether Islamic finance would have actually addressed the problem underlying the credit crisis, namely that (1) the asset used as security was not sufficient to secure the debt and (2) that no thorough analysis of creditworthiness of the debtor had been made (“subprime lending”). Although Islamic finance might have prevented the crisis from a purely practical standpoint through its limitations on securitization, it still would not alleviate more fundamental issues of subprime lending.

---

<sup>7</sup> For an exposition of the rules of *fiqh*, see Frank E. Vogel and Samuel L. Hayes, *Islamic Law and Finance: Risk, Religion and Return*, Boston: Kluwer Law International, 1998, pp. 114–125.

<sup>8</sup> See, e.g., “Islamic Finance can Solve Global Crisis, Says Scholar,” *Arab News*, April 24, 2008, available at <http://www.arabnews.com/?page=6&section=0&article=109247&d=24&m=4&y=2008> (accessed May 6, 2008).

(ii) **Case Study 2: Would Islamic finance endorse emission trading?**

Emission trading, as envisaged in the Kyoto Protocol, is among the key instruments for combating climate change. In simple terms, emission trading (the system also is known as the Clean Development Mechanism or “CDM”) is based on a limitation of carbon emissions by setting a ceiling for permissible emissions and allocating emission rights to individual polluters. These rights are tradeable, so that a polluter not fully using its allowance can sell the pollution rights to another polluter. Environmentalists disagree on whether emission trading will save the planet (it is argued that the ceilings are too high and that the trade in emission rights may encourage an increase of emissions rather than a cut-back, depending on where prices settle).<sup>9</sup> In any event, there seems to be a consensus that this is a step in the right direction and there seem to be no really practical alternatives. What would Islamic finance say? This is not merely a hypothetical question, as emission trading is high on the agenda of most international financial institutions (and some Islamic financial institutions have started to devise relevant structures, too).<sup>10</sup> Under Islamic law, the trade in emission rights poses a whole set of problems, including (1) whether an allowance constitutes property (*mal*), if not framed by a contract, (2) if an allowance relating to a time period in the future can be sold (this might be deemed unlawful speculation—*gharar*), and (3) whether the right to pollute the environment constitutes *mal mutaqawwam*, i.e., can be legally traded.<sup>11</sup>

Although coming to a definite conclusion on the permissibility of emission trading is beyond the scope of this enterprise, there

---

<sup>9</sup> For a critical assessment of the CDM, see, e.g., Melanie Jarman, *Climate Change*, London: Pluto Press, 2007, pp. 45–66.

<sup>10</sup> “Doha Bank to Trade Carbon Emissions the Islamic Way,” *Arab Environment Watch*, October 14, 2007, <http://www.arabenvironment.net/archive/2007/10/350490.html> (accessed May 7, 2008).

<sup>11</sup> On the *fiqh* rules relating to property, see Vogel and Hayes, *Islamic Law and Finance*, pp.94–95.

is a general sense in the Islamic scholastic community that emission trading would pose several significant problems. First, there is the issue of whether these rights could be legally traded, and next, whether the trading of future rights is permissible. Again, the conclusion is: Islamic finance would most likely ban emission trading, but not because of a disagreement with the CDM as provided for in the Kyoto Protocol, but because a formal interpretation of Islamic legal principles makes it difficult to accommodate emission trading schemes. Again it is arguable that Islamic finance would ban emission trading for the wrong reasons.

Both examples, the credit crisis and emission trading, show that an application of Islamic legal rules may lead to results that are primarily driven by legal technicalities and not underlying values. Does the concept of socially responsible investment provide a cure? Would a rapprochement between socially responsible investment and Islamic finance help to overcome the formalist deadlock?

### **ISLAMIC INVESTMENT AND SOCIALLY RESPONSIBLE INVESTMENT COMPARED**

In order to investigate what socially responsible investment can contribute to Islamic investment, I will first analyze what both currents have in common and what separates them. On that basis, I will then proceed to discuss what Islamic investment can contribute to socially responsible investment and vice versa.

Socially responsible investment and Islamic investment have the following features in common:

- (i) *Investing in accordance with values*: The investment decision is partly based on non-economic criteria. The paradigm “risk and return,” which underlies any investment decision, is enriched with an ethical component. Islamic investment and socially responsible investment both can be termed “ethical investment” in the sense that they claim to abide by certain ethical/religious principles.
- (ii) *Advisory bodies foster legitimacy*: Typically, the investment company would entrust a board of external advisors (in the case

of an Islamic fund, the *shari'a* board) with bringing in the ethical/religious values. Normally, there would be a division of labor between the fund manager on the one hand (in charge of the financials) and the ethical/religious advisors (in charge of ethical/religious compliance) on the other.

- (iii) *Juridification of Ethical Principles*: Both Islamic investment and socially responsible investment result in a juridification of ethical (extra legal) principles, in the sense that ethical principles are being integrated into a contractual arrangement with the effect of becoming legally binding among the parties. A typical example for such a juridification of ethical rules would be the screening procedure of socially responsible and Islamic funds. Ethical rules become legally binding for the parties concerned.
- (iv) *Negative Screening*: Traditionally, the screening procedures have been negative (i.e., excluding certain non-permissible investments). Certain investments are excluded. Although both Islamic investment and socially responsible investment share a certain vision (the “Islamic economic order” and “sustainable development” respectively), they normally would have a negative selection on the implementation level. Recently a shift toward a positive investment policy can be observed, where funds either use their shareholdings in order to influence corporate behavior or selectively invest in companies active in certain areas (including the “best of class” approach, where investments target companies that which are most advanced in terms of social responsibility in their industry).
- (v) *Liberality*: Liberality, in the sense of donations to charities or the common good, is employed as a means to purify the assets. Both socially responsible and Islamic funds typically provide that a certain percentage of the income (reflecting “impure” activities) has to be given to charity.
- (vi) *Shared Values*: There is a certain overlap of values with regard to the investment policy. Both socially responsible and Islamic funds tend to abstain from investments in morally questionable industries such as alcohol, gambling, prostitution, and pornography. Although coming from an entirely different

background, Islamic investment and socially responsible investment have certain values in common.

There is certainly room for cross-pollination between socially responsible investment and Islamic investment. The commonalities suggest combining socially responsible investment and Islamic investment as “ethical investment,” in particular as far as regulatory, legal, and tax issues are concerned. Whereas the first Islamic investment funds set up in the West may have benefited from the experience in socially responsible investment, now the situation has changed and I believe that socially responsible investment benefits from the growth in and the technological development of Islamic investment. Both Islamic funds and socially responsible funds, for instance, must cope with a fair amount of pluralism regarding the ethical principles guiding the investment policy. Here, Islamic funds in the meantime have developed a set of mechanisms to deal with divergent interpretations of the *shari‘a* (and the effect that what qualifies as a *shari‘a*-compliant investment from the perspective of one scholar does not need to be compliant from the perspective of another—also termed *shari‘a* risk).<sup>12</sup>

There are, however, certain issues that distinguish socially responsible investment from Islamic investment:

- (i) *Rules and Values*: Socially responsible investment puts emphasis on values, whereas mainstream Islamic investment tends to be rule-oriented (in the sense that it requires adherence to a formal

---

<sup>12</sup> The juridification of ethical principles that are open to a pluralist interpretation actually entails intricate legal issues on the documentation level. If a certain investment is sold with the claim to comply with certain religious/ethical principles, the question arises whether it can amount to misselling (with the liability on the side of the fund or sponsor) if the investor can demonstrate that the ethical pledge is not correct. In legal practice, therefore, offer documents regularly contain a “risk factor” pursuant to which the fund/sponsor points out that religious/ethical standards are open to interpretation and normally are not unanimously shared, that the fund/sponsor follows the advice of a certain body regarding religious/ethical permissibility, and that it encourages the investor to form an opinion of its own. As a result, the juridification again is partially reversed. I have discussed this aspect in more detail in my paper “Shari‘a Risk: How Islamic Finance has Transformed Islamic Contract Law,” which is forthcoming as an occasional paper of the Islamic Legal Studies Program.

interpretation of *shari'a*). What this entails can be seen by looking at recent innovations in the respective fields.

Traditionally, socially responsible funds have employed a “negative selection” (or screening method) where certain companies and industries are excluded from the investment universe. This method increasingly is seen as inappropriate, mainly because it does not account for attempts by certain “unclean” industries (e.g., the oil industry) to make steps toward improving environmental friendliness. To remedy this situation, the “best in class” approach has been introduced, which abandons a formal application of negative screening principles in favor of an evaluation of companies in light of the industry environment they operate in.<sup>13</sup> The result is that a company can qualify as a permissible investment even if it is active in a non-acceptable industry—provided that it is engaged in steps toward the right direction. This approach is based on a value judgment as opposed to a formal application of rules and recognizes the will to improve in a non-perfect world. It simultaneously demonstrates what I mean by socially responsible investment being value based as opposed to rule based: the overarching goal (to promote environmental friendliness) overrides the strict application of rules (negative screening criteria). A company active in an unclean area of business qualifies as a permissible investment provided it makes efforts in the right direction.

The situation is quite different in Islamic finance, as becomes obvious when looking at the attempts to structure *shari'a*-compliant fixed income products, such as the structure proposed by Dar al Istithmar in the “White Paper” published last year.<sup>14</sup> The structure proposed in the White Paper is based on creative legal reasoning and is beautifully crafted. It intends to tackle one

---

<sup>13</sup> Australian Government, Department of the Environment, Water, Heritage and the Arts, “Socially Responsible Investing: Your Questions Answered,” available at <http://www.environment.gov.au/settlements/industry/finance/publications/resp-on-investment.html> (accessed May 7, 2008).

<sup>14</sup> See [http://www.deutschebank.de/presse/en/content/press\\_releases\\_2007\\_3347.htm](http://www.deutschebank.de/presse/en/content/press_releases_2007_3347.htm) (accessed May 5, 2008).

of the most pressing issues in product development and does so by bringing together different legal and economic perspectives. However, it avoids addressing directly the issue whether there may be a fixed return on an investment and how this is consistent with the general principle of Islamic finance that any return must be based on sharing of business risk.<sup>15</sup> This also differentiates the approach of Dar al Istithmar from the way other Islamic scholars have treated the issue (including Muhammad Abduh and the former Egyptian Mufti Tantawi, who both opined that under certain conditions the investors' profit share under a *mudaraba* contract may be fixed, as this would not inflict any harm on either party).<sup>16</sup>

To conclude: socially responsible investment tends to put more emphasis on values, whereas mainstream Islamic finance prefers to adhere to legal principles. This may be an important difference between socially responsible investment and mainstream Islamic finance. However, it is not a suitable remedy for breaking the formalist deadlock. It only pinpoints the problem, without offering a solution.

- (ii) *Where are the Stakeholders?* Corporate social responsibility, as the overarching concept embracing socially responsible investment, is stakeholder oriented as opposed to rule oriented. Corporate social responsibility grew out of the idea that under U.S. company law, management decisions of a corporation will primarily be oriented toward the shareholders' interests (what is termed the shareholder approach). This at least is the general principle. A company is owned by its shareholders, who have entrusted capital to the management. Management, therefore, owes a fiduciary duty toward the shareholders, and is barred from taking into consideration the interests of other stakeholders, such as the employees, business partners, the environment, and the community at large. The idea of corporate social responsibility

---

<sup>15</sup> See, e.g., Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance*, Singapore: John Wiley, 2007, pp. 43–44.

<sup>16</sup> For a summary and critical discussion of the opinion see, e.g., Mallat Chibli, "Tantawi on Banking Operations in Egypt," in *Islamic Legal Interpretation: Muftis and Their Fatwas*, ed. Muhammad Khalid Masud, Cambridge, MA: Harvard University Middle Eastern Studies, 1996, pp. 286–297.

evolved as a concept counterbalancing the shareholder orientation of U.S. company law, which in turn is a byproduct of its capital market orientation and widespread shareholding. A corporation has a social role to play, which extends beyond providing its shareholders with the highest possible return. Formulating corporate social responsibility policies thus allows the company's management to also take into consideration interests other than interests of the shareholders.

The actual difference, therefore, seems to be that corporate social responsibility policies are stakeholder oriented, whereas Islamic finance is rule oriented. This leads me to the conclusion that it is the stakeholder orientation that distinguishes socially responsible investment from Islamic investment.

### **BREAKING THE FORMALIST DEADLOCK: A STAKEHOLDER-ORIENTED APPROACH TO ISLAMIC INVESTMENT?**

How to bring a stakeholder oriented approach to Islamic finance? How to define the concerns and interests of people and to integrate them into the body of rules of Islamic finance? If possible at all, this requires three steps. First, the stakeholders of Islamic finance need to be determined. Second, the place and role of these stakeholders must be defined. Finally, a process must be designed permitting an integration of stakeholder interests into the discourse on Islamic finance rules.

Discussing the place of stakeholders in Islamic finance simultaneously means talking about the aim of Islamic finance. Islamic finance is about an implementation of Islamic values in business: It is both religious (in terms of its origin) and worldly (in terms of its implementation). For Muslims, on the individual level, Islamic finance can be seen as the performance of a religious duty. On the collective level Islamic finance is aimed at implementing an Islamic financial system, a system that is deemed to promote justice and thus to be superior to the conventional financial system.<sup>17</sup> Islamic finance, consequently, is more than an act of worship. It is both a religious obligation for Muslims and a worldly practice. In addition, Islamic

---

<sup>17</sup> These discussions are summarized in Florian Amereller, *Hintergründe des "Islamic Banking,"* Berlin: Duncker & Humblott, 1995, pp. 84–96.

finance today is no longer confined to Muslims or Muslim markets, but has managed to attract customers irrespective of their faith and geographic location. This makes it legitimate to also inquire into the worldly application of Islamic finance — in order to improve its worldly application. And when focusing on the worldly implementation of Islamic finance, the search for stakeholders comes into play. Among the stakeholders are:

- (i) *Shareholders*: As in any other company, the financial institution's shareholders will also be among the company's stakeholders (possibly the shareholders are among the most important stakeholders). The shareholders will primarily have an interest in the corporation being profitable (although this interest may well extend to a long term profitability of the company and is not limited to the short term). This implies that for an Islamic financial institution it will be of central importance to operate profitably and disburse returns to its shareholders and other investors.
- (ii) *Employees*: Another central stakeholder group will be the financial institution's employees. Again, in this regard an Islamic financial institution is not different from any other corporation.
- (iii) *Customers and Business Partners*: Further stakeholders will include the institution's customers and other business partners. Here, for the first time, specificities of Islamic finance will come into play. The customers will expect an Islamic bank to operate in a *shari'a*-compliant way, as Islamic finance is based on the *shari'a* promise (the institution's pledge that it will abide by Islamic legal principles in its dealings). This is why the customers have chosen an Islamic financial institution. Arguably, the customers may also expect a higher degree of fairness in dealings of an Islamic financial institution, at least on the retail level. It has been suggested, for example, that Islamic financial institutions must scrutinize the creditworthiness of their clients with particular care (in order to prevent, e.g., subprime lending).
- (iv) *Environmental Concerns*: Environmental consequences also need to be taken care of under a stakeholders' approach. In project finance, for example, it would be expected that an Islamic bank

adheres to the relevant codes of conduct regarding environmental protection such as the Equator Principles.<sup>18</sup>

- (v) *The Industry at Large*: Finally, the industry at large also belongs among the stakeholders. In the context of Islamic finance, this will include the development of the regulatory, legal, and tax framework of the industry as well as its overall reputation, including the further development of *shari'a* rules. Talking about the overall framework of the industry, I believe that in particular the latter aspect may be central: Viewing Islamic finance from a stakeholder perspective, I believe that there is a specific duty resting on Islamic financial institutions to develop *shari'a* principles skillfully and carefully.

But how to take matters forward? What is required is to integrate stakeholder interests in the *shari'a* process? Stakeholder interests, in the area of Islamic finance (as elsewhere in the business world), are not easily defined. One of the issues is that the conventional *shari'a* process, focusing on the ad hoc certification of a specific transaction, makes it difficult to integrate the larger picture and to take on board the interests of the stakeholders at large. A *shari'a* opinion rendered in view of an individual case will inevitably focus on the peculiarities of the matter. In this case it will be difficult to integrate interests of stakeholders who are not a party to the contract.

In this context, drawing a parallel to Islamic constitutionalism may help. Islamic constitutionalism and the process of Islamic legislation face a similar challenge when trying to distill certain values out of the *shari'a* and molding it into state-enacted legislation. Principles of governance also can be applied to corporate governance and investment. A value-based system depends on an institutionalization of the *shari'a* process. In other words: A value-based approach may be promoted by a change in the *shari'a* process that moves away from the certification of the individual product and puts more emphasis on institutionalization, what may enhance sustainability in the field of *shari'a* innovations.

---

<sup>18</sup> <http://www.equator-principles.com/principles.shtml> (accessed May 7, 2008).

## How does this work?

First, it is important to point out that the debate on form versus substance is not limited to Islamic finance, but a recurrent theme in the debate on the application of *shari'a* law. The emphasis on Islamic values is in no way unique to Islamic finance. The debate in the area of Islamic financial law is only an offspring of the general debate on *maqasid al-shari'a* and the role *shari'a* values will play.<sup>19</sup> Looking at this debate more generally, in particular from the perspective of Islamic constitutionalism, one will note the following trend: in interpreting the sources of Islamic law and defining *shari'a* values, the role of Islamic scholars is paramount. Islamic scholars will interpret the sources of Islamic law and come up with a suggestion on what values can be derived from it. In view of the interpretative pluralism in Islamic jurisprudence, however, there must be another authority that determines the binding interpretation. The task of the latter authority is to tame the natural pluralism of *shari'a* law and make it operable on the level of implementation. In Islamic constitutionalism, this authority normally is assigned to the parliament (or another representative body). Parliament is entrusted with finding the authoritative interpretation of *shari'a* values, based upon the guidance of the scholars, and defining it for the nation-state. Parliament also ensures that the *shari'a* discourse is put on a broader discursive basis, so that what is required as the binding force of the interpretation will not only apply to one specific situation but is going to be enacted as a law.<sup>20</sup>

---

<sup>19</sup> On this debate, see e.g. Hashim Kamali, “*Maqasid al Shari'a*: The Objectives of Islamic Law,” <http://awis-islamforschung.eu/archiv-1/archiv/maqasid-al-sharia-i/view> (accessed March 9, 2009).

<sup>20</sup> This can be seen most clearly in the jurisdictions that refer to “the principles of the *shari'a*” as “a” or “the” source of legislation. Here, there seems to be an emerging consensus that this requires parliament to implement *shari'a* principles by selecting one possible interpretation within the overall framework of the *shari'a*. To the extent there is a plurality of opinions, parliament may find an interpretation that fits the time and clime, so to speak, exercising legislative *ijtihad*. See, most notably, the approach of the Egyptian Supreme Constitutional Court (discussed in great detail in Clark B. Lombardi, *State Law as Islamic Law in Modern Egypt*, Leiden: Brill, 2006). On the negotiation of the content of the *shari'a*, see also Abdullahi Ahmed An-Na'im, *Islam and the Secular State: Negotiating the Future of the Shari'a*, Cambridge, MA: Harvard University Press, 2008.

How can this mechanism possibly be transferred to Islamic finance? Global financial markets are no democracies, they do not have parliaments and hardly ever hold elections. Defining stakeholder interests is a complicated, at times ill-defined process—this holds true for the realm of corporate social responsibility and Islamic finance. Let me nevertheless point at two actors who will be crucial. As in the realm of constitutionalism, the *shari'a* scholars have an important role to play. The production of *shari'a* knowledge is the key competence of *shari'a* scholars and this cannot be changed. However, it might be the responsibility of the *shari'a* scholars to find *shari'a* innovations that do not just permit achieving a certain financial result (e.g., to mimic a certain conventional product). Further, I believe that industry associations (such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)) and possibly also the regulator will have to play a more significant role in the *shari'a* process. In the absence of parliamentary representation, industry associations and regulatory bodies will have to take on the responsibility to integrate stakeholder interests and reconcile them with an interpretation of the *shari'a*. Integration of stakeholder interests, it seems, will be facilitated by a *shari'a* discourse that is no longer focused on the individual transaction, but engages in standard setting, approaching the issues from a broader framework. A *shari'a* certification process that is disconnected from an individual transaction (and not curtailed by the requirements of a specific case) will make it easier to put interpretation of *shari'a* rules into a broader perspective. An institutionalization of the *shari'a* process, therefore, seems key to integrating stakeholder interests and overcoming the formalist deadlock.

## CONCLUSION

Contrary to what is occasionally put forth, there is a notable difference between mainstream Islamic finance and socially responsible investment. It therefore is an oversimplification to promote Islamic finance as simply “one more form of socially responsible investment,” the reason being that socially responsible investment is value based, whereas conventional Islamic finance tends to be rule based. Nevertheless, there is a strong tendency in the Islamic finance industry calling for a revival of Islamic business values in Islamic finance and giving values priority over legal rules. The concept of socially responsible investment, I believe, can help to elucidate the quest for

Islamic business values. It shows that business values must be determined from a stakeholder perspective. Adopting a stakeholder perspective in Islamic finance, I argue, will help a reorientation of the industry, making it value based as opposed to rule based. In order to define stakeholders and values, a reorganization of the *shari'a* process may help, which will put more emphasis on the institutional aspects. *Shari'a* scholars will continue to play the predominant role in the *shari'a* process. It nevertheless is required that the *shari'a* process move away from certifying individual transactions to setting up industry standards.