Global Rebalancing: Money, Power, And Islamic Banking

by David C. Grabbe
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In world history, no nation has been as staggeringly wealthy as the United States. In 2007, its gross domestic product (GDP) was about $13.8 trillion—over one-quarter of all the goods and services produced in the world that year. America's GDP is larger than the combined GDPs of the next four countries (Japan, Germany, China, and the United Kingdom). Despite being post-Industrial, last year U.S. industrial production exceeded $2 trillion, which equals Japan's, China's, and Germany's industrial production *combined*. Truly, America is a financial behemoth.

For decades, the dollar has been the reserve currency of choice due to its stability and competitiveness. In the last few years, however, a trend called "global rebalancing" has become increasingly evident. In short, global rebalancing is a shift away from growth dominated by the U.S. toward a configuration in which more countries contribute. U.S.-based assets are regarded as too risky, and investing in the infrastructure of developing countries with strong growth is a more attractive option. Some portfolio managers even say that "the economic center of the world is changing"—slowly moving away from the U.S.

One recipient of such financial attention is the United Arab Emirates. The seven tiny countries of the UAE are awash in more money relative to their size—slightly smaller than the U.S. state of Maine—than perhaps any region in history. The Sovereign Wealth Funds (SWFs) of two of them—Dubai and Abu Dhabi—manage an estimated $500 billion and $1 trillion, respectively. Dubai is a banking hub that attracts immense wealth from Saudi Arabia, Kuwait, Egypt, Syria, Iran, Russia, and Jordan, largely because of record-high oil prices. In addition, Dubai is considered a safe haven because there is no risk of accounts being frozen or money being seized by the U.S. in its anti-terrorism efforts. Sheikh Mohammed bin Rashid al Maktoum's vision for Dubai is to be the financial center of not only the Middle East, but also of India and Pakistan.

Because the dollar has been the reserve currency for so long, as well as the currency of oil trade, a "dollar bloc" has been created. Even though the dollar is currently weak, and U.S. financial institutions are facing a liquidity crisis, the massive reserves of dollars in the foreign SWFs act as a stabilizing force. Dollars are flowing back into the U.S. economy from China and the Arabian Peninsula, keeping things propped up.

This appears fine on paper, yet a high price is being paid: greater foreign ownership of commercial real estate, large portions of U.S.-based financial institutions, and other businesses. For example, Dubai, through its company, Dubai Ports World, tried to buy the management of six American ports in early 2006, only to have Congress scuttle the deal. Yet, in November 2007, when Abu Dhabi purchased a significant chunk of ailing Citigroup—the nation's largest financial institution—not a single governmental eyebrow was raised. With its 4.9% stake, Abu Dhabi now ranks as Citigroup's largest shareholder. U.S. institutions are remaining liquid, but control is ebbing away.

Another factor beginning to come into play is Islamic banking (also known as *Sharia banking*), a system of banking or financial activity in alignment with Islamic law (*Sharia*). As such, it

» requires that 2.5% of revenue be donated to Islamic charity (though Islam and the West clearly differ on the definition of "charity");

» prohibits borrowing and lending with interest (though paying for the "time value of money" is accepted, as long as it is seen as a "gift" rather than a guarantee); and

» requires "socially responsible investing" (meaning that a bank cannot invest in something that is against Islamic principles).

Banks that offer Islamic banking products and services are required to establish a Sharia advisory council to ensure that the operations of the bank comply with Islamic principles—according to the interpretation of the council.

Exactly how large the Sharia banking sector is at present is unknown (not all Muslim financial institutions follow Sharia banking), but estimates range from a very conservative $500 billion up to $1.5 trillion. Western financial institutions, including Morgan Stanley, Goldman Sachs, Ernst & Young, and McKinsey and Co., are eager to tap into this "emerging market."

But financial institutions are not the only ones interested in Sharia banking. On June 13, 2006, then-Finance Minister (now Prime Minister) of Britain, Gordon Brown, spoke at the Islamic Finance and Trade Conference:

> . . . the foundation for making Britain the gateway to Islamic trade, is to make Britain the global center for Islamic finance. . . . Today British banks are pioneering Islamic banking—London now has more banks supplying services under Islamic principles than any other Western financial center. . . . All these changes are vital to increasing trade with Muslim countries and making London the location of choice for Islamic investment, but they are also vital to ensuring the Muslim community in Britain can trade, build successful businesses and create jobs.

Brown later pledged that the British government will issue its own "Sharia compliant bonds" (*sukuk*)—government debt compliant with Islamic principles—in 2008.

The U.S., facing a liquidity crisis, is being kept afloat in part by dollars flowing back from oil-rich Middle Eastern nations and banking centers. Western Europe is confronted by a rapidly-growing Muslim immigrant population—along with a related "clash of civilizations"—and its governments are responding by changing banking practices to accommodate Muslims without regard to the true price. Western money and power are gradually slipping away and collecting in the Middle East.