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Conceptualizing Dynamic Challenges to Global Financial Diffusion: Islamic Finance and the Grafting of Sukuk

Abstract

Following the Global Financial Crisis of 2008-9, there has been renewed interest in the diffusion and pluralization of financial ideas and practices, and in understanding how new ideas and practices can emerge to challenge the prevalence and diffusion of dominant ones. However, existing concepts and language in the broader literature on diffusion limit our ability to analyze and assess the contestation of ideas, especially as it is sustained and transformed *over time*. In this paper, we develop the concept of grafting as a post-equilibrium approach to analyze the ongoing contestation of global finance at the level of market practice. We apply our conceptual framework to analyze the complex dynamics of a class of financial assets that in recent years has made significant inroads in global financial markets: *sukuk*, often referred to as Islamic bonds. We highlight dynamic differences in the grafting of ideas and practices from Islam and conventional finance and suggest that the grafting of sukuk is an ongoing contestation of the diffusion of global finance that contributes to the emergence of an increasingly pluralistic global economy.

Key words: global finance; diffusion; Islam; sukuk; Southeast Asia; GCC

INTRODUCTION

Following the Global Financial Crisis (GFC) of 2008-9, there has been renewed interest in the diffusion and pluralization of financial ideas and practices, and in particular, in understanding how ***new*** ideas and practices can emerge to challenge the prevalence and

diffusion of dominant ones. However, existing concepts and language in the broader literature on diffusion limit our ability to analyze and assess the contestation of ideas, ***especially over time*** (for a discussion, see Solingen 2012). Work in the field of International Political Economy (IPE) has tended to focus on the spread of a dominant set of ideas but rarely on how contending ideas might co-mingle in or more overtly contest – and in some cases even reverse - the flow of diffusion over time. As a result, the main conceptualizations of pathways of diffusion in the literature – coercion, emulation, mock-compliance and localization as well as their variants – point to the resolution of or success in the transplantation of generally the dominant set of ideas. Even mock compliance and localization suggest the – at least partial - adoption of external ideas, albeit not their full internalization. In doing so, the existing literature on diffusion has tended to downplay enduring dynamics of contestation. In this paper, we develop the concept of grafting as a post-equilibrium approach to understanding the ongoing contestation of global finance at the level of market practice.

The concept of grafting has previously been applied in diffusion studies, specifically in accounts of norm localization. We follow the literature's definition of grafting as the 'melding' of two sets of ideas, norms, policies or practices. However, we think that this definition of grafting has a number of dynamic implications that have not been fully exhausted. There are three further key reasons to the significance of grafting. First, there are the dynamics of the graft product itself. Grafting creates composites in which alternative ideas co-mingle. Through an iterative grafting process, it is possible to vary the relative content of the graft. Stability of the graft, amongst other things, depends on the compatibility of alternative ideas (or norms or policies or practices), the ways in which they interact as well as the pathological aspects of the graft. Second, conceptualizing grafting as an iterative process allows taking into account both the alteration and the dynamic development of source models. Grafts can be renewed by either substituting one or both of the component parts. This includes grafting new composites using one or more pre-existing grafts. Third, grafting does not occur within a vacuum. The success and long-term survival of a graft – as well as its development over time – are closely linked to contextual, agential and in some cases even commercial factors, which we discuss below.

We apply our conceptual framework to analyze the development over time of a class of financial assets that in recent years has made significant inroads into global financial markets:

sukuk, often also referred to as Islamic bonds.[1] *Sukuk* are instruments used to arrange financing for corporate and sovereign actors; this alone makes them inherently political. In general discussions, they are often termed Islamic bonds although it would be more correct to refer to them as Islamic investment certificates. A *sukuk* has to conform to a number of precepts that are found in the *sharia* (popularly known as Islamic law) to be deemed compliant with Islam. The two main characteristics are that (1) there be no element of interest (*riba* or usury), and (2) the financial instrument must be linked to a tangible asset (which economists refer to as 'real' asset).

It is now widely accepted that today's conventional finance specifically, and the capitalist economy more generally, has undergone a significant process of financialization, which is generally understood to mean the progressive elevation of the financial sphere above the 'real sector' of the economy. Whereas in previous decades the financial sector was tightly linked to the real sector as the former primarily served the needs of the latter, today it not only generates profits on its own but 'profits [also] accrue primarily through financial channels rather than through trade and commodity production' (Krippner 2005: 174; see also Epstein 2005; van der Zwan 2014). Islamic teachings on the other hand emphasize the need for economic reward to be associated with tangible contributions to the economy, which is promoted by the requirement that financial transactions be linked to real assets. Advocates of Islamic finance further emphasize that its ultimate function is to serve the *maqasid al-sharia*, the foundational goals of Islamic jurisprudence, namely the protection of faith, life, progeny, intellect and property. To the extent that Islamic finance is subordinated to these goals, it serves to challenge the *apotheosis* of finance in the conventional sector and the global economy more broadly.

A *sukuk* can be structured in a number of ways, some of which will be discussed briefly in this paper. The precise structures of *sukuk* found in the market are complex discussions on their own.[2] Here, it suffices to say that *sukuk* structures involve additional transactions (or steps), often considered to be convoluted, in order to serve functionally equivalent purposes to conventional bonds. Where there is usually a direct relationship between the investor and

[1] 'S*ukuk*' is the plural of '*sak*' or '*sakk*' – Arabic for check or deed. In this paper, we follow contemporary convention and use '*sukuk*' as both singular and plural noun.

[2] Latham & Watkins, an international legal advisory firm, produced an accessible guide on structuring *sukuk* in June 2015, which can be downloaded at this link: https://www.lw.com/thoughtLeadership/Latham-guide-to-structuring-sukuk-2015.

the obligor (the bond issuer) in a conventional bond, at least one intermediary actor (usually a special purpose vehicle, SPV) is always introduced between the investor and the obligor in a *sukuk* in order to facilitate compliance with *sharia* precepts. It is important to note that in Islamic finance both substance and form matter (Maurer 2010). This can have implications, for instance, when it comes to the order in which legal documents are signed.

The growth of Islamic finance in recent years has been presented as challenge to the dominant neoliberal approach to organizing contemporary finance, while simultaneously facilitated by actors, techniques and practices derived from 'conventional' finance (Zeti 2009; Askari et al. 2010). As such, Islamic finance can be understood, to a degree, as an extension of the contemporary global diffusion of the processes of financial liberalization (Rethel 2011; Fang 2014). This process of diffusion is contested and, as we demonstrate in this paper, the phenomenon of Islamic finance is better understood as a 'grafted' outcome that embodies ideas and practices from both 'conventional' finance and Islam. Our findings reveal dynamic differences in how ideas from Islam and 'conventional' finance are grafted in Islamic finance, which can be explained by variations in the normative and material preferences of key actors and institutional constraints posed by developments in the 'conventional' and Islamic sectors. Our conclusion in this regard speaks to an extensive literature that points to a variegated understanding of capitalisms and in particular the pluralization of finance, and emphasizes further how these complex dynamics unfold over time (Hall and Soskice 2001; Brenner et al. 2010; Bassens 2012).

By analyzing how financial instruments embody contested ideas and how dynamics of contestation unfold over time, we demonstrate that the process of diffusion, in particular partial diffusion, can also take place at the level of market practice, an understudied area in international politics. There is an emerging recognition that the design of financial instruments is no mere technical matter but is rather an exercise in which a number of political and normative assumptions become imbued in market practice. In reference to the GFC, it is now widely observed that the design of collateralized debt obligations was not neutral but rather embodied normative understandings of the distribution of risks and economic rewards, which were reflective of a larger socio-economic system that placed great value on financial innovation and the creation of financial wealth. It has been argued that social institutions and policy approaches reflect normative and political preferences, however this paper, and the observations that emerged from the GFC, make the point that it is equally important to study market practices and techniques, such as the design of financial

instruments, for their political and normative foundations – and ultimately their contestability and reversibility.

DIFFUSION AND THE POLITICS OF FINANCIAL CHANGE

The study of diffusion carries with it the notion that a set of ideas, policies or practices is dispersed, disseminated, or propagated. Diffusion studies cover a wide range of issue areas: from regulatory standards to forms of governance, from social movements to public policy. The focus in IPE has tended to be on the ***process*** of diffusion, in particular on explaining the ***pathways*** of diffusion, and how they affect ***outcomes*** in diffusion (see also Solingen and Börzel 2014). For example, Simmons *et al.* (2008a) identify coercion, competition, learning and emulation as important pathways for the diffusion of markets and democracy. In terms of outcomes, their contributors explore *inter alia* the diffusion of tax policy and investment treaties, as well as democratic institutions and gender rights. What many of these studies share is that they see diffusion – be it full or partial – as the endpoint; once an idea, policy or practice is diffused, equilibrium is restored, order is achieved.[3] Yet, what if these ideas, norms, policies and practices have an afterlife? How can we account for ***ongoing dynamics of change and contestation***? After briefly reviewing core arguments in the diffusion literature, we develop a conceptualization of grafting as a post-equilibrium approach to diffusion.

Making Sense of Financial Diffusion

Existing studies of diffusion and financial change can be categorized according to two criteria that focus on process and outcome. First, we can think of diffusion as the result of a process in which host societies exercise varying degrees of agency. In a situation where the object of diffusion is imposed by external forces, then host societies exercise weak degrees of agency. We can think of conditionality written into 1980s IMF loan agreements as one example (e.g. Mathews 2001; Babb 2013). Conversely, host societies might exercise strong degrees of agency by actively and voluntarily participating in the process of diffusion, for instance in order to seek solutions to domestic problems. An example of this is the establishment of sovereign wealth funds by a number of countries in the 2000s as a means to manage their growing financial reserves more effectively (Chwieroth 2014). Second, we can think of the

[3] Our usage of the term 'equilibrium' in this paper follows the notion of 'steady state equilibrium' in macroeconomic growth theory.

outcome of diffusion as sitting along a continuum of harmonization (alternatively convergence or isomorphism) to non-harmonization (or partial harmonization), where harmonization is the full and substantive embrace of foreign ideas, policies or practices. The degree of harmonization reflects the degree of acceptance or internalization by host societies of foreign ideas.

Whether existing studies make reference to full or partial harmonization can be influenced by methodological choice. For example, large-N studies often take policy ideas as uncontested and seek to test their adoption in different jurisdictions without considering in depth that these ideas might be adapted or changed in the process (e.g. Simmons et al. 2008b; Chwieroth 2014). They do not ask, for instance, how ideas are embedded or adopted, or if they are adapted in kind or purpose (see also Meseguer and Gilardi 2009). By contrast, ethnographically informed approaches provide fine-grained analyses of how ideas, policies or practices travel and the ways in which they are negotiated at the local level (e.g. Lagerwaard 2015). Only rarely, however, do these accounts reflect on how – and under what circumstances - these localizations in turn influence developments at the core, or how they themselves are subject to change.

The interaction between the agency exercised by the host society and their receptivity to foreign ideas results in different diffusive processes. Thus, in categorizing diffusion according to these two criteria – the degree of agency (along a continuum of weak to strong) on the part of the host society, and the degree of receptivity to foreign ideas (along a continuum of full to partial harmonization) – we identify four main varieties of diffusion that dominate the literature. These varieties of diffusion, ideal types in the Weberian sense, are presented in Table 1.

[Insert table 1 about here]

One common, and long-standing, approach to conceptualizing the diffusion of financial policies and ideas invokes the notion of emulation or mimesis. This type of ***socialized diffusion*** takes place, for example, when actors attempt to solve problems or policy challenges in an environment that is rooted in uncertainty and bounded rationality. Here, foreign ideas are perceived to be 'an appropriate or efficient solution (…) irrespective of the existence of actual evidence to support this conclusion' (Chwieroth 2014). The notions of emulation and mimesis suggest that the object of diffusion (such as financial practices or policy approaches) has been successfully adopted, implanted or accepted in host societies. As

such there is harmonization, convergence, isomorphism or compliance in outcome. Emulation and mimesis are employed to refer to situations where host societies have exercised considerable agency in the process of diffusion. For instance, in his study of the spread of sovereign wealth funds, Chwieroth (2014) argues that reserve- and resource-rich countries decided to create such funds because they had become a fashionable solution to policy challenges among countries with similar characteristics. Emulation is distinct from 'learning', which involves an enhanced understanding and requires evidence of the relationship between ideas and outcomes. Klingler-Vidra and Schleifer (2014, 271) suggest that the greater reflexivity inherent in learning leads to greater selectivity in terms of the adoption and adaption of 'source model(s)', which can facilitate 'less convergence'.

Coercive diffusion takes place when host societies exercise a weak or low degree of agency in either contesting or accepting external ideas or practices. The external pressure, both formal and informal, could emanate from foreign governments, international organizations, key market actors, or international rules or norms upon which host societies depend for power, resources, legitimization or status. For example, it has been demonstrated that developing countries' adoption of ideas and policies associated with the policy paradigm of the 'Washington Consensus' in the 1980s and 1990s was a result of the combination of the exercise of political power by key donor countries and international financial institutions like the World Bank and the IMF, the dominance of a particular shared understanding of appropriate policy measures by the global community of economic scholars, and the expectations of market actors (Chwieroth 2007; Babb 2013). As with socialized diffusion, coercive diffusion sees the successful adoption or implantation of foreign ideas, policies or practices in host societies, thus resulting in harmonization or convergence in outcome.

Cosmetic diffusion occurs when host societies do not internalize foreign ideas, but lack the capacity to outright reject them. A good example here is that of 'mock' compliance by a number of East Asian countries with international standards of financial governance (Walter 2008). According to Walter, the contestation of international standards or 'mock' compliance happens when the costs of 'true' compliance are relatively high, the costs of outright non-compliance are also relatively high, and the detection of 'mock' compliance is relatively low. However, East Asian countries were unable to fully resist these standards due to coercive pressures, both material and normative, emanating from market forces and international actors. As a result of weak agency to fully resist the diffusion of international financial standards, but strong motivations to contest these standards, Walter observed 'mock' compliance, where there is superficial acceptance but not full internalization of the object of

diffusion. Cosmetic diffusion is different from coercive diffusion as there is no substantive compliance or full convergence in outcome. Walter (2007: 177-180) himself questions whether mock compliance is sustainable or whether it will lead to more 'substantive compliance' over time. In the case of adopting international financial standards he remains skeptical, but we would like to caution against equating this with no change taking place at all – mock compliance is far removed from *stasis*. Drawing on the work of postcolonial theorist Homi Bhabha, Hobson and Seabrooke (2007: 17, 14) employ the term 'hybridized mimicry' to refer to instances when 'agents appear to adopt dominant discourses, but filter them through their own cultural lenses so as to produce something new and hybridized'. In so doing, subordinate agents can 'attain agency', even within structurally confined contexts. The relative importance of agency increases further as we move more squarely to the fourth variety of diffusion.

In ***localized diffusion***, host societies exercise considerable agency in melding foreign ideas, policies or practices with local beliefs and cultural precepts. The result is a diffusive process that does not result in full harmonization. Rather, foreign ideas, policies or practices are made 'to fit' local contexts (Acharya 2004: 251). Local agents borrow foreign ideas, stripping off features that are clearly not compatible with the local context. In turn, these ideas might help to amplify, or accentuate, prior held beliefs and practices (Acharya 2004: 245-6; see also Eimer et al. 2016). Yet, it is precisely the question of how foreign and local ideas co-mingle – and the resultant stability (or not) of the graft - which warrants further scrutiny. Thus, for example, in his work on how economic ideas 'go local', Ban (2016: 21; see also Ban 2013) distinguishes between editing as a way of translating neoliberal ideas that does not 'displace the goals of this school of thought' and grafting, which 'challenges the distinctive goals of neoliberalism' and thus contests the source paradigm itself. Localization approaches therefore highlight qualitative differences in the extent to which the object of diffusion is affected and the stability that is accorded to outcomes. However, this provokes a new question: how should we then conceptualize the concrete forces of diffusion and contestation at work and their relative impact over time? To this end, we propose moving beyond this 2x2 matrix by developing a deeper, three-dimensional conceptualization of grafting, which highlights its dynamic features.

The Three Dimensions of Grafting

In the context of financial diffusion, grafting might occur when the dominant set of ideas and/or practices is unable to sweep away its competitors, and when emergent ideas are

similarly unable to fully contest dominant ones. The outcome is a composite result that nevertheless cannot be reduced to its component parts. Taking an example from horticulture, if lemon and orange were each distinctive sets of ideas, then grafting the two might produce a new plant, a *bizzaria*, composed of 'mixtures' of lemon and orange characteristics.[4] This definition of grafting has a number of implications whose import has not been fully appreciated in the IPE literature – they pertain to the graft product itself, its component parts and the circumstances under which grafting occurs.

First, there are the substance and dynamics of the graft product itself. Grafting creates composite products in which alternative ideas (or norms or policies or practices) co-mingle. The relative content of a graft can be varied through an iterative grafting process. Amongst other things, the stability of the graft depends on the compatibility of alternative ideas (their taxonomic affinity), the ways in which they interact throughout the life of the graft product as well as the pathological aspects of the graft (that is, in both spreading and overcoming 'diseases'). Since grafting is the result of the melding of ideas through a process of contestation, we might expect compromises or distortions in the acceptance, implementation or execution of these ideas. A feature of grafting is therefore potential tension in the outcome when distinctive sets of ideas coalesce. If these sets of ideas sit imperfectly against each other, we would expect them to shift or adjust until a more sustainable accommodation is achieved. The success of the graft would depend on a number of factors, including the compatibility of each component part and the closeness of fit, among other factors.[5] Incompatible component parts that are grafted together might produce a result that survives for a period of time before it dies. This dimension of grafting closely approximates accounts of localized diffusion as discussed in the previous section and we will discuss in the next sub-section how it applies to the grafting of the first sukuk. The point to note here is that grafting as an analytical tool points to dynamic significance that lies beyond the one-time production of hybrid outcomes.

[4] See Mudge et al. (2009: 479-480) for a brief history of the *bizzaria*. In developing our understanding of grafting, we draw on recent discussions in the plant science literature, in particular Mudge et al. (2009) and Goldschmidt (2014).

[5] Goldschmidt 2014 also refers to instances where graft-take was impacted by plant age. Ban (2016, 244) makes a similar point in arguing that 'the timing of incorporation into the transnational diffusion of neoliberalism' matters.

Thus second, understanding grafting as an iterative process allows taking into account both the alteration and the dynamic development of source models. Even in the case of stable grafts there is no endpoint, no automatic cut-off date by which a lasting, harmonious resolution is achieved. Not only do ideas continue to co-mingle (as in the first dimension), but existing grafts can also be subject to improvement and renewal and become the product of fresh attempts at graft invigoration. Grafts can be renewed by substituting either one or both of the component parts. This includes using one or more new or pre-existing grafts in grafting new composites. This is important as neither foreign nor local ideas, policies or practices are ever static – they have both their histories and futures. For example, the current international financial system is unrecognizable from how the financial system looked at the time modern Islamic finance emerged several decades ago, or for that matter how the system was initially designed following the 1944 Bretton Woods conference. It would be naïve to ignore how this has filtered back into the ongoing development of Islamic financial products (and of the conventional sector). At the same time, greater recognition of and familiarity with key precepts of Islam have allowed Islamic finance practitioners to experiment with new financial structures. These complex dynamics within source models can lead to new grafting attempts as we will highlight in our discussion of *ijara* and *wakala* sukuk below.

Third, grafting does not occur within a vacuum, but neither does it change due to external stimuli only. The success and long-term survival of graft products as well as their development over time are closely linked to – often intersecting - contextual, agential and even commercial factors which can be abstracted only to a limited extent. These factors play a role with regard to both the question of what produces successful graft-take as well as what motivates grafting to occur in the first instance. In our horticultural analogy, climate, soil and pathological factors certainly play important roles in facilitating graft-take; at the same time, however, climate and soil adaptation as well as the desire to manage and control plant pests are important drivers of the engineering of grafts themselves. As grafting as a practice becomes more widespread, the technical repertoire of its agents grows. Similarly, increasing familiarity with grafting techniques and outputs can lead to their wider acceptance. In so doing, endogenous components also play an important role. We will discuss these dynamics in the final sub-section of the next part of the paper.

Our notion of grafting departs in a significant way from the four main approaches to diffusion discussed in the previous section. For us, grafting characterizes a diffusive process that is more dynamic than the two-step sequential process of stimulus/outcome that has

captured so much attention in the existing literature. This conceptualization allows us to analyze not only how contending ideas co-mingle or more overtly contest, if not – at least to some extent - even reverse the flow of global financial diffusion, but also how these complex dynamics unfold over time.

In the remainder of this paper, we apply our approach to the case of Islamic finance, specifically to the dynamic development of one category of instrument in this market: *sukuk*. To facilitate a nuanced and fine-grained analysis, we disaggregate the instrument into four constituent elements: conceptual design, legal documentation, investor marketing and economic outcome (see Table 2). Our analysis in the following sections highlights different degrees of melding of 'conventional' and Islamic financial ideas that occur in different constituent elements across space and time. Observed variation in the grafting of Islamic with 'conventional' ideas of finance in these market practices speaks to wider concerns about financial stability, politico-economic organization and socio-economic justice.

[Insert table 2 around here]

GRAFTING AND THE DEVELOPMENT OF *SUKUK*

Islamic finance, in its current guise, is a distinctively modern phenomenon. The first modern Islamic financial institutions were established in former British colonies – Egypt, Pakistan and Malaysia - in the 1960s and mainly targeted rural populations. Following the oil price hike of the 1970s, the first full-fledged private Islamic banks were set up. However, only from the late-1990s onwards did Islamic finance gain increasing traction with international financial markets, riding on the diffusion of financial liberalization (Warde 2010). Islamic finance thus has an ambiguous relationship with contemporary finance as both part of and resistance to the diffusion of financial liberalization. As Bill Maurer (2005: 9) observed, '(t)he end of Bretton Woods and the oil price rises that flooded the world with petrodollars, for example, co-occurred with a new quest for purity on the part of wealthy Middle Eastern Muslims seeking a means to clear consciences, give alms, and spiritually renew themselves.' While to many of its advocates, Islamic finance is a reaction to dominant ideas and practices of finance, and to the excesses of neoliberal financialization more specifically, we suggest that the phenomenon of Islamic finance is better understood as a 'grafted' outcome that embodies ideas and practices from both 'conventional' finance and Islam, rather than as an

alternative – or parallel – economy. This is especially so if we look at how the complex dynamics of Islamic finance have unfolded over time.

This observation is also illustrated by the rapid expansion of Islamic finance. While the market might once have been restricted to the Muslim community and Muslim countries, its elevation to the main stage of global finance was well and truly heralded when it was embraced by mainstream financial actors such as investment bank Goldman Sachs and the British and Hong Kong governments who all started issuing *sukuk* in 2014. Our analysis of the development of *sukuk* in this paper confirms this tension and Islamic finance's ambiguous relationship with 'conventional' finance, but our findings go further to reveal temporal and spatial variations in how ideas from Islam and 'conventional' financial markets are grafted in Islamic finance. These variations can be explained by differences in the normative and material preferences of key actors and institutional constraints posed by developments in the conventional sector. The instruments and practices of Islamic finance are grafted outcomes in that they do not adhere strictly or purely to Islamic ideas, but also embody ideas and practices from 'conventional' finance.

The governance of Islamic finance is distinctive in that it involves the participation of experts in Islamic law, so-called *sharia* scholars, to ensure compliance with *sharia* principles. They endorse products and these endorsements are referred to in the industry as *fatwa* (Daud 2016). In Islamic law, a *fatwa* has the status of a non-binding legal opinion – in this case on whether a specific financial product or practice is *sharia*-compliant or not. In Islamic finance, *fatwa* are typically issued by a collective of scholars, operating at the product and/or firm level. However, a number of countries, including Indonesia and Malaysia, also operate *sharia* boards at the national level and the trend is towards more centralized forms of *sharia* governance (Lindsey and Steiner 2012; Maznah and Saravanamuttu 2015).

Sharia scholars employ interpretation and analogous reasoning techniques in assessing financial products (e.g. Pollard and Samers 2007). Certification via *sharia* boards is an important means to bestow Islamic legitimacy on Islamic financial products, but this should not be equated with the product being universally accepted. Indeed, *sharia* interpretations may vary and it has become common practice to include an exhortation to 'potential investors [to] obtain their own independent Sharia advice as to the compliance of the Transaction Documents and the issue and trading of the Certificates with Sharia principles' in the

prospectus for a new *sukuk* offering (HM Treasury 2014).[6] As Pitluck (2016, p. 367) succinctly puts it, 'there is no single theory of how to interpret [Islamic financial principles], and thus no singular definition as to what constitutes Islamic finance and what does not'. This ambiguity is very much a constitutive feature of Islamic finance and sets it apart from the naturalizing discourses underpinning much of contemporary market practice (Rethel 2018fc).

[Insert table 3 around here]

The value of total outstanding *sukuk* in the global market was estimated to amount to US$321 billion at the end of 2015, with the Malaysian market having a 57 percent share (IIFM 2016). As Table 3 indicates, *sukuk* have increasingly been taken up by mainstream actors and markets – Muslims and Non-Muslims alike – and this includes the issuers, the actors who engineer/structure the instruments and the investors.

Grafting the First Sukuk

The first *sukuk* of the modern era is usually traced back to an issuance by Shell MDS in Malaysia in 1990 to part fund a middle distillate synthesis (MDS) plant that converted natural gas to produce petroleum products.[7] Aside from being a landmark development in Islamic finance, the MDS plant made scientific and technological history as the first commercial gas-to-liquids plant that was developed in response to the energy crises of earlier decades.

A number of banks had put in bids to provide financing for the Shell MDS project. While the bulk of funding was arranged 'conventionally', key actors within Shell, notably its then Chief Finance Officer, were interested in soliciting some of its financing in an Islamic manner (Alim 2013). It has been suggested that a prevailing ethos of innovation and creativity in Shell influenced this decision.[8] As Islamic banking was at the time a new and

[6] See table 3 for further information about the firm-level *sharia* boards and advisory firms that were involved in approving a number of recent *sukuk*.

[7] The Islamic notes raised MYR125 million out of a larger funding package that was in excess of MYR1.1 billion, see Reuters (1990).

[8] This view was expressed by two interviewees during fieldwork conducted in Kuala Lumpur in September 2014.

emerging phenomenon in Malaysia,[9] there were certainly conceptual synergies between exploring novel forms of financing to fund the construction of a technologically groundbreaking infrastructure. Moreover, as a big multinational corporation, Shell had the material resources and experience to invest exploring and developing new financial instruments, which involved lengthy negotiations on the financial and legal aspects.[10]

Bank Islam Malaysia Berhad - at the time the country's first and only Islamic bank - was approached by Shell to offer a form of private debt security (as corporate bonds were then called in Malaysia) that complied with Islamic principles. The main engineer of the Shell MDS *sukuk* at Bank Islam, having had prior experience in the conventional private debt market, modeled the *sukuk* on promissory or loan notes. The main obstacle was that interest payments were an integral component of these promissory notes, which were overcome by combining a sale-and-purchase contract with the creation of a trust to hold the assets that were being funded by the issuance on behalf of lenders. This was the genesis of the now (post-GFC) infamous special purpose vehicles that are ubiquitous in contemporary *sukuk*. The trust, or the SPV, acted as an intermediary between the funds provided by investors and the tangible assets for which Shell MDS required funding. Incorporating the trust into the structure of the financial instrument was necessary to enable Shell MDS to defer payments for the purchase of the assets as they might have done with a conventional bond. However, more importantly it created a clear link between the funding and the tangible assets, thus providing evidence of its compliance with *sharia*. This approach to structuring an Islamic form of financing, combining a sale-and-purchase agreement with deferred payment, is known as the Islamic contract of *bai' bithaman ajil* (BBA).

The participating investors were three Malaysian Islamic financial institutions, namely Bank Islam itself, Tabung Haji (the pilgrimage fund) and Syarikat Takaful Malaysia Sendirian Berhad (the first and at that time only Malaysian Islamic insurance company); Cagamas (the recently created National Mortgage Corporation of Malaysia); two state-owned non-financial corporations; two Malaysian development finance institutions; a Malaysian commercial bank and Bank of Tokyo Ltd (Reuters 1990). Thus, the Shell *sukuk* found a ready market dominated by Islamic and/or government-linked investors.

[9] The first Islamic bank in Malaysia was established in 1983, with the second following only in 1999. For an overview of the development of the Islamic banking and finance sector, see Lindsey and Steiner (2012).

[10] Interview with Islamic investment bankers and former Shell employee in September 2014 and May 2016.

This first corporate Islamic debt security quite clearly embodied ideas and practices that were diffused from conventional finance. In recounting how the Islamic form of corporate financing was designed or structured, the engineer of the instrument at Bank Islam freely uses the word 'replicate' and described how it was modeled on conventional instruments (see also Alim 2013: 134). The design of the instrument was based on 'conventional' papers right down to the incorporation of a 'coupon' that could be traded in the secondary market. These coupons are generally considered the interest element in 'conventional' papers. The instrument was priced using a formula taken from what was popularly known as the 'Red Book' issued by Bank Negara Malaysia, the Central Bank, which contained formulae used to calculate the pricing of all papers traded in the capital and money markets. The difference was that in calculating the price of the Islamic instrument, the variable for 'interest' was replaced with the desired 'profit'. The 'profit' itself was benchmarked against equivalent private debt securities in the 'conventional' market in order to render the instrument competitive for both the issuer (Shell MDS) and investors.

Formally, the Shell MDS paper also had to comply with the then prevailing regulatory framework detailed in *Guidelines for the Issuance of Private Debt Securities*, a document issued by the Central Bank in 1989 with the aim to develop the at the time nascent 'conventional' bond market. Compliance with the guidelines meant that the instrument could be classified by the Central Bank, the then regulator of the capital market, in the same class as 'conventional' private debt securities to allow secondary trading to take place. As the Malaysian corporate bond market was a relatively new and underdeveloped market at this point in time, the legal effect of this new instrument was also strongly influenced by Shell's in-house legal team who had both the expertise and capacity to draft legal documentation from their experience with 'conventional' and international finance. While this facilitated graft-take, it also meant that the *sukuk* was more a localized 'conventional' bond than a radically new instrument. In short, ideas and practices from 'conventional' finance permeated the design, the legal documents and the economic outcome of the Islamic financial instrument.

The preponderance of 'conventional' financial ideas in this purportedly Islamic financial product had a number of explanations. First, there was outright emulation that came from financial practitioners borrowing ideas based on their experience with and knowledge of 'conventional' finance. Second, market players in the financial sector held specific understandings and expectations of financial instruments to which proponents of Islamic financial instruments had to cater. The engineers of the Shell MDS *sukuk* at Bank Islam felt

obliged to design the Islamic instrument so as to be almost indistinguishable from 'conventional' papers in order that the former would be easily understood and recognized by investors in the market. Similarly, at the institutional level there was only one framework in Malaysia to regulate bond-like instruments for corporate financing, with which the Shell MDS *sukuk* had to comply thus requiring it to possess certain characteristics including a fixed rate coupon, being tradable and behaving **like** debt.

Despite the successful and extensive absorption of 'conventional' ideas and practices into this first Islamic *sukuk*, one of its engineers contended that the design was innovative in how it securitized a number of assets to the SPV in order to provide a material foundation to the financial instrument, thus complying with *sharia*. Through the trust, Bank Islam, as lead arranger, and the nine other banks and firms bought these assets for the MDS plant that were then sold back to Shell MDS at a profit. Securitization was, however, not a new concept but was a practice that had a long history in the conventional sector dating as far back as at least the eighteenth century (Frehen et al. 2014). What was new in the Shell MDS instrument, in our view, is the grafting of Islamic arguments onto a modified form of a securitized loan to ensure its ethical acceptance. In the 'conventional' sector, securitization is normally undertaken to minimize the risk of default (the idea of collateral), or more generally to isolate financial risk.

However, in Islamic finance, securitization is conducted primarily to comply with ethical precepts rather than risk management, although concern over the latter is also part of *sharia*. This was the case with the Shell MDS *sukuk* as the ultimate guarantor of the financing for lenders was not so much the assets but rather the reputation and financial stability of Shell, the multinational corporation. Securitization in the *sukuk* was brought about by the grafting of Islamic ideas onto those of the conventional sector, and the SPV was a device to transform forbidden interest-based debt into permissible religiously compliant financing. This grafting to comply with religious precepts was an arguably relatively small component of what was otherwise a financial instrument infused with ideas and practices from conventional finance. It is here that most of the norm localization stories would end, and where the contestation of the design and structure of corporate bonds begins. Although culturally incompatible elements were stripped out when corporate bond finance arrived in Malaysia – the localization argument – by infusing 'conventional' bonds with Islamic ideas, it gave rise to the birth of a new kind of financial instrument and the global market for Islamic financial instruments. The commitment to developing financial instruments in compliance with – if not organized around – Islamic financial principles would gain greater traction over time.

Improving and Renewing the Graft

Sukuk issuance took off in the 2000s, initially in Malaysia and then elsewhere in the Islamic world. Most of the financial instruments in the earlier part of this period adopted the BBA and another similar approach, *murabaha* (cost-plus financing), in its structure. Together, they became the preferred approaches to financing projects that have long gestation periods due to the fixed return nature of these securities (Saifuddin 2001). These instruments were however heavily criticized for their similarity to debt financing, reflecting the preponderance of ideas from 'conventional' finance in the process of grafting the instruments with Islamic ideas (Wan Hashim and Hassan 2011).

Partially in response to these criticisms, in particular the refusal of Middle Eastern scholars to accept the BBA structure, and partially driven by the desire to innovate on the part of proponents of the industry, an alternative financial structure was popularized in the market in 2001 when a Malaysian public listed company issued a tradable *sukuk* using an *ijara* contract.[11] This structure, developed by Bank Islam, was also adopted by the Malaysian government when it issued the first ever global sovereign *sukuk* in 2002, with HSBC as the lead arranger.[12] Denominated in US$, the 2002 *sukuk* was directly marketed to international investors with roadshows being conducted in Hong Kong, Abu Dhabi, Dubai, Bahrain and Jeddah (Montagu-Pollock 2002). The investor base included both Islamic and conventional investors with an order book that held 51 accounts from 17 countries – with the issue being allocated to investors from the Middle East (50%), followed by Asia (30%), Europe (16%) and the US (4%) (Horne 2002).

The *ijara* structure was at the time deemed a breakthrough as the instrument represented ownership in assets, as opposed to mere securitization, and was therefore more clearly not a form of debt. This meant that *ijara* contracts complied more strongly with *sharia* and therefore embraced greater elements of Islamic ideas in their design. In our horticultural analogy, if oranges were Islamic ideas of finance, one can think of *ijara* as the product of a strengthening of the orange content in a *bizzaria* graft.

However, legal provisions in the underlying contracts frequently undermined the 'true' transfer of ownership of these assets. In the case of the Malaysian sovereign *sukuk*, investors

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[11] *Ijara* is similar to a lease in conventional finance.

[12] The *ijara* structure had previously been used in project finance, most famously to finance the Equate project in Kuwait (Esty 2000), as well as in sovereign issuance by the Bahrain Monetary Authority in 2001.

were merely vested with 'beneficial ownership' of the asset and not 'true' ownership due to restrictions that arose from prior obligations made on pre-existing international bonds that the government had issued (Haneef 2009: 108-9). In other words, there were institutional constraints on the ability to infuse the instrument with Islamic ideas, which in this case should have resulted in a transfer of the legal ownership of the asset. This, in combination with pressures from potential investors, resulted in the adoption of a practice from 'conventional' finance (the idea of 'beneficial ownership') that compromised the instruments' compliance with *sharia*. Despite this deviation from Islamic precepts, the originally slow pace of its adoption in the market had more to do with the difficulty of identifying suitable assets that could be used to underpin the issue of these instruments in order to provide the link with tangible assets as required by *sharia*.[13] Sovereign issuers had great difficulty in identifying suitable public assets where ownership could be transferred away, as required by the *ijara* structure, without raising public alarm. Corporate issuers also faced a shortage of suitable assets that had not previously been encumbered.

In attempts to reconcile religious precepts with prevailing market dynamics, market actors turned instead to alternative contracts like *musharaka* (investment partnership) and *mudharaba* (investment management partnership).[14] These contracts contained elements of equity or partnership, and were deemed to be more compliant with *sharia*. In principle, the innovation of these new structures was the integration of an element of risk sharing into mass corporate financing, as these instruments should offer no fixed return, nor guarantee or security. They were designed in opposition to fixed-income conventional bonds and were intended to be more profit sharing in nature. These design features could however not legally exist under the prevailing regulatory framework that governed private debt securities in Malaysia that emphasized limited liability. Since the government supported the development of the Islamic finance market, it began to issue new guidelines that were specifically tailored to these types of Islamic securities in 2004.[15] The regulatory framework could be likened, in our horticultural analogy, to the soil composition not being amenable to the graft and thus requiring replacement.

[13] *Ijara* structures have since become the standard contract for government *sukuk*.

[14] For a detailed discussion of and graphic representations of these structures, see http://www.islamicbanker.com/education/sukuk-al-musharaka for *musharaka* and http://www.islamicbanker.com/education/sukuk-al-mudaraba for *mudharaba*.

[15] These guidelines were updated in 2011, 2012 and 2014.

However, the exposure of investors to these economic risks was frequently undermined through purchase undertakings or other financial obligations (such as indirectly guaranteeing capital or delivering fixed returns) that were built into the legal contracts (Haneef 2009). These techniques were called 'credit enhancements' and were adopted to solicit investors and secure better ratings, in other words, in response to market demands and institutional dynamics. So the financial and legal effect of the instrument that came from Islamic ideas about finance were neutered, despite the obvious difference in the design of the financial instrument compared with those in the 'conventional' sector, although the materiality of that too has been questioned (Haneef 2009).

Recognizing these issues, the *sharia* board of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), a Bahrain-based global standard setting body in Islamic finance, issued a *fatwa* in February 2008 that restricted the use of certain 'credit enhancements' in *musharaka* and *mudharaba sukuk* issued in the Gulf Cooperation Council (GCC).[16] There was a precipitous drop in issuances of *sukuk* globally after the *fatwa* was issued – compounded by market uncertainty at the height of the GFC. This pointed to a difficulty in producing and marketing instruments that embodied more substantively ideas that were derived from and were therefore more compliant with *sharia*. In our horticulture analogy, not only was it difficult to produce a *bizzaria* that contained a higher orange content, but it was also difficult to find a market for such a graft. When the market rebounded from 2010 onwards, practitioners went back to the earlier *ijara* structures as well as a new contract called *wakala*.

A *wakala* is an arrangement whereby one party entrusts another to act on its behalf, and is therefore akin to an agency arrangement. In a *wakala sukuk*, the originator appoints an agent to invest or manage assets provided by the originator as part of a complex set of economic transactions in order to provide a form of financing.[17] By contrast, in 'conventional' finance, an agency agreement is merely an arrangement to manage assets, not to provide financing. The *wakala sukuk* is in principle a completely novel approach to

[16] See Bi (2008) for an analysis of the import of this statement from a practitioner's perspective. In mid-2009, the GCC held the dominant share of the international (that is, foreign currency denominated) *sukuk* market with 83 per cent, whilst Malaysia held the biggest share of domestic *sukuk* markets with 66 per cent and a share of 53 per cent of the global *sukuk* market (both domestic and international) (IIFM 2009: 12).

[17] For a discussion of how *wakala sukuk* is structured, see http://www.islamicbanker.com/education/sukuk-al-*wakala*.

designing a financial instrument taking a number of economic transactions that are common in conventional finance but are given new normative meaning as a result of how they are structured in order to provide a form of financing that complies with *sharia*. It is a clear attempt at improving the robustness of the graft. However, *sharia* compliance is undermined in practice as practitioners in the market frequently link *wakala* instruments with the purchase of commodity *murabaha*. The latter, as noted earlier, is a form of Islamic contract that closely mirrors conventional debt. So, despite earlier criticisms and lessons, debt-based contracts, with their preponderance of 'conventional' rather than Islamic ideas, have not completely disappeared but have been grafted back onto what are otherwise relatively 'purer' forms of Islamic financial structures.

It is worth noting that grafting takes into account dynamic developments with regard to both foreign and local ideas and practices; indeed, the line between the two can appear increasingly blurred given that *sukuk* has become a staple in global financial markets. Social impact bonds – or SIBs – are a recent innovation in conventional financial markets that seek to meld commercial and social objectives. More specifically, SIBs are issued to finance for example welfare projects – such as addressing the issue of rough sleeping and homelessness. Financial returns are directly linked to meeting pre-agreed targets with regard to the delivery of welfare projects (Andreu 2016). In an interesting attempt at graft renewal, 2015 saw the issuance of the first Social Impact *sukuk* to fund educational projects (Reuters 2015). In this instance, a new graft product developed in the conventional financial space was grafted back into Islamic finance, again highlighting the need for more nuanced accounts of the complex dynamics of financial change and how it takes place over time.

One result of contestation is that outcomes are not 'neat'. Sets of ideas may survive, but not necessarily in their original forms. Until today, the prevalence of debt-based contracts in Islamic finance, characterized by the shifting of risks and sometimes tenuous links to the real economy, undermines the argument that Islamic finance charts an alternative pathway to organizing finance that is radically different from its 'conventional' counterpart. Nevertheless, there is an observable shift in the balance of Islamic and conventional ideas in the dynamic development of *sukuk* grafts over time. Increasingly more Islamic elements have been embedded into the design of *sukuk*, but the material preferences of investors and institutional dynamics of the market constrain the ability for *sukuk* to deviate on legal documentation and economic outcome. The contestation between Islamic and 'conventional' ideas coupled with the relative but not complete freedom to chart an alternative path results in the grafted outcome of Islamic finance.

Grafting and the Pluralization of Economic Practice

In this paper, we have argued that the emergence and rapid expansion of *sukuk* are best understood as the outcome of the grafting of Islamic and conventional financial ideas and practices. Contextual, agential and even commercial factors contributed to developing the market. In Muslim societies, one might expect ready market demand for financial products that allow Muslims to comply with their religious obligations.[18] The development of Islamic financial markets might also be the result of norm entrepreneurship or broader social pressures that support particular causes. This push for local or alternate ideas would be expected to filter into policy decisions such as in Malaysia where the growth and development of Islamic finance are widely recognized to be supported by government as a result of a policy decision to develop an alternate market (Lai 2015).

We traced how, through an iterative process of grafting, the Islamic 'content' of *sukuk* was successively strengthened. The success of this depended on a relatively coherent body of Islamic financial ideas in the first instance. With Bank Islam (and its *sharia* board), there was a stock of clearly formulated Islamic financial ideas on which actors could draw. Institutional changes such as the 1996 creation of a national *sharia* advisory council located at the Securities Commission in Malaysia contributed to the further consolidation of Islamic financial ideas – as did the emergence and growing influence of international Islamic financial standard setters such as AAOIFI (Rethel 2011; Lindsey and Steiner 2012).[19] With the growing importance of *sukuk* in financial markets, resources were deployed to build market-supporting infrastructures, including efforts to expand the knowledge base by setting up research and training institutions as well as accreditation bodies (Maznah and Saravanamuttu 2015).

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[18] The evidence of empirical studies is however inconclusive. Studies conducted by Erol and El-Bdour (1989), Haron *et al.* (1994), Gerrard and Cunningham (1997), Metawa and Almossawi (1998) and Naser *et al.* (1999) queried the influence of Islamic teachings on the choice of whether to patronize an Islamic bank with varying results. Customers in Bahrain gave more importance to religion when selecting their bank, while customers in Jordan, Malaysia and Singapore considered religion and profit as equally important in the decision making process. Another study by Pepinsky (2013) on Indonesia found no evidence that Islamic piety had any systematic effect on consumers' choice of Islamic versus conventional financial products.

[19] Indonesia created DSN-MUI, the national *sharia* board for Islamic finance in 1999, Bahrain is currently in the process of drafting legislation to this effect; however, national models of *sharia* governance continue to exhibit variety.

The market entry of big international financial firms was a critical moment in the mainstreaming of Islamic capital markets – and has indeed contributed to the acceptance of Islamic finance in core markets such as the UK and the USA. Norm entrepreneurs within these firms – such as Iqbal Khan at HSBC, Rushdi Siddiqui at Dow Jones Indexes and many others – saw a market opportunity and pushed their organizations to take Islamic finance seriously (Alim 2013). However, in terms of structuring *sukuk* specifically, the market dominance of a small array of investment banks, law firms and their like can contribute to pathological aspects of the graft. As an example, we discussed the use of credit enhancements to assure favorable ratings earlier in the paper. Unsurprisingly, the dependence on conventional bankers switching to the Islamic finance space increasingly proved to be a limitation, given that it made it more difficult to move beyond conventional market practice as a reference point. Nevertheless, with the growing significance of the market, a new cohort of Islamic financial market practitioners that grew up within the market has emerged, which has had a stabilizing effect.[20]

The emergence and development of *sukuk* depended on the existence of investable pools of capital; such as the initial investments by Tabung Haji and Bank Islam in the very first corporate *sukuk* discussed earlier.[21] Demand for *sukuk* is intermediated by financial structure, namely the existence of banks and institutional investors such as pension funds and their like as well as their appetite for Islamic financial assets. Perhaps worth mentioning here is that as a result of the greater availability of and familiarity with *sukuk*, pension funds have been able to expand their offer range to retail investors. For example, both the Malaysian Employees' Provident Fund and the UK Universities Superannuation Scheme introduced Islamic savings options in 2016. On the borrower side, we can also detect growing interest with the spate of debut issuances in 2014 discussed earlier being a case in point. However, we should also bear in mind that these issuances occurred in a specific context, namely high

[20] Similar dynamics are at play with regard to lawyers and legal documentation.

[21] Regulatory stipulations mean that the financial instruments on which we focus in this paper – sukuk – can only be marketed to 'sophisticated' investors. We thus hesitate to make inferences about the relationship between piety, or indeed religious conservatism, and demand for sukuk from our evidence base. See, however, the studies mentioned earlier. In a handful of countries including Malaysia and Indonesia, a limited number of savings *sukuk* have been offered to retail investors. These met with great demand, but were also heavily marketed by state actors.

global liquidity as a result of quantitative easing and anticipation of the end of the Fed taper in October 2014.

Whereas pre-GFC accounts of the development of Islamic finance emphasize pressures for convergence and its 'increasingly Western character' (Pollard and Samers 2007: 326; see also Rethel 2011), our analysis highlights a sustained commitment to challenging financial market practices that are deemed to be un-Islamic as well as greater efforts to enhance the *sharia* quality of *sukuk*. This is not to ignore significant pressures for convergence as succinctly summarized by Pitluck (2016). Nevertheless, the development of *sukuk* also represents an active attempt to produce a *sharia*-compliant *alternative* financial instrument that is competitive in the global financial market place. As in other stories of diffusion, the degree of agency and both the strength and compatibility of alternative ideas were important determinants of graft-take and longevity.

However, unlike many of these other accounts, in a grafting approach these are – at least to some extent – endogenously generated factors. Thus, we have shown that in the case of Islamic finance, agency increased as the market developed and the familiarity of issuers, engineers and investors with the concept of *sukuk* and underlying contracts grew. This was in turn helped by an increasingly rich – and codified - body of Islamic financial knowledge as well as progressively institutionalized practices of *sharia* governance. Against this background, Islamic finance practitioners managed to convert opportunities provided by the economic environment – in particular shifting pools of liquidity driven by the search for yield in the early 2000s and again in the aftermath of the GFC - into a growing market share.

CONCLUSION

The growth of Islamic finance is part and parcel of an increasingly pluralistic global economy. The analysis of *sukuk* in this paper demonstrates that Islamic finance is clearly not just mere emulation of 'conventional' finance. However, neither is it able to completely step away from the latter's shadow despite clear attempts to more fully embed Islamic ideas into the design and execution of new financial instruments. Islamic finance should therefore be understood as a product of the grafting of Islamic ideas, as embodied in *sharia*, and 'conventional' financial ideas that have been diffused through market actors and institutional factors. Grafting constitutes a post-equilibrium approach that allows us to analyze both diffusion and the contestations it provokes. The approach clearly recognizes the dynamic nature of and ongoing shifts within the constituent elements of the grafted product. Grafts can

be improved and renewed, and as we have seen conventional and Islamic ideas can be re-grafted in multiple ways. This is different from concepts such as layering or bricolage that give little analytical purchase to the ongoing development - and even alteration - of the source model(s) which we have shown to be pertinent with regard to both the improvement and renewal of grafts.

Grafting portrays a dynamic form of contestation that goes beyond (local) adaptation, yet at the same time does not constitute the wholesale replacement of the source paradigm. This conceptualization enables a nuanced analysis not only of how contending ideas co-mingle in, contest and in some cases even reverse the flow of global financial diffusion, but also – and importantly - how these dynamics change over time and how they are subject to both push and pull factors. At times, the differences between Islamic and conventional finance that we have described may seem incremental, if not rather small. However, they are not inconsequential, as we have demonstrated in this paper, and they should not be dismissed, for 'gradual changes can be of great significance in their own right; and gradually unfolding changes may be hugely consequential as causes of other outcomes' (Mahoney and Thelen 2010: 3; see also Hobson and Seabrooke 2007). This is particularly important, as the fallout from the GFC has very clearly put ethical considerations on the financial reform agenda. Analyzing Islamic finance as a product of grafting usefully highlights a number of tensions and contestations that have political, economic, policy and analytical implications.

First, there is the contestation of ideas between Islamic and conventional finance. The notion of grafting suggests the inability of the former to fully displace the latter. Conversely, the case of Islamic finance clearly shows that countries at the periphery of global finance have the agency to create a space for taking alternative ideas to the market and doing so successfully. It would be wrong to delegate their role to that of being merely norm-takers.

Second, grafting highlights the push and pull of material, institutional and normative forces that support both conventional and Islamic finance, all of which condition the complex dynamics of Islamic financial instruments. Commercial factors are widely perceived to determine the market demand for and viability of *sukuk* instruments while *sharia* compliance determines the validity and recognition of *sukuk* products as true Islamic financial instruments, and therefore a 'real' alternative to conventional finance (RAM Ratings 2013).

Third, grafting highlights an internal tension that exists within the contemporary manifestation of Islamic finance as a result of compromises that have been made in the contestation of ideas between Islamic and conventional finance. This internal tension raises questions about the continuing accommodation between Islamic and conventional ideas in

Islamic financial instruments, and the long-term viability of the Islamic finance market. These multiple tensions, both internal and external to Islamic finance, potentially create limits on the development over time of Islamic financial instruments, and therefore on the industry's ability to chart an independent path that would challenge and offer a viable 'true' alternative to conventional finance, which has been so criticized since the crisis of 2008-9.

Finally, for International Political Economy, the notion of grafting expands our analytical toolkit in particular to cases where harmonization, convergence or isomorphism in their pure forms are not observed in outcomes. Furthermore, as distinct from much of the localization work, the lens of grafting encourages us to analyze how new ideas are (potentially) projected back onto the international level as part of a growing global market, thus drawing attention to what could be thought of as processes of 'reverse' diffusion.

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Table 1. Varieties of Diffusion

		Degrees of Agency	
		Weak	**Strong**
	Harmonization	Coercive diffusion	Socialized diffusion
	Non-harmonization	Cosmetic diffusion	Localization

Table 2. Key Constituent Elements of Financial Instruments

Analytical Dimension	Political Import And Effect
Conceptual Design	Embodies intent and purpose
Legal Documentation	Provides legal effect and obligations
Investor Marketing	Cultivates demand and distributes product
Economic Outcome	Measures distribution of value and risks

Table 3. Selected Sukuk Debuts in 2014

	Issuer/ Exchange Listing	Structure	Lead Arranger	Sharia Certification	Issue Size/ Order Book	Investor Distribution/ Investor Type
	United Kingdom/ London Stock Exchange	*Ijara*	HSBC and Barwa Bank, CIMB, NBAD, SCB	Bait Al-Mashura Finance Consultations Company, Shariah Committee of CIMB Islamic Bank Bhd, The Executive Shariah Committee of HSBC Saudi Arabia Ltd and Standard Chartered Bank Shariah Supervisory Committee	£200 million £2.3 billion	39% UK, 37% Middle East, 24% Asia Investor type breakdown not provided
	Hong Kong Hong Kong, Bursa Malaysia, NASDAQ Dubai	*Ijara*	HSBC, SCB, CIMB, NBAD	Executive Shariah Committee of HSBC Saudi Arabia Limited, Standard Chartered Bank Sharia Supervisory Committee, CIMB Islamic Bank Berhad and Shaikh Nedham Mohamed Saleh Abdulrahman Yaqobi	US$1 billion US$4.7 billion	36% Middle East, 47% Asia, 6% Europe, 11% US 11% fund managers, 56% banks and private banks, 30% SWFs, central banks and supranationals, 3% insurance companies
	South Africa Luxembourg Stock Exchange	*Ijara*	BNP Paribas, KFH Investment, Standard Bank Group	Members of the BNP Paribas Shari'a Supervisory Committee and the Shari'a Advisory Boards of KFH Investment Co. K.S.C.C.	US$500 million US$2.24 billion	23% UAE, 18% UK, 12% Qatar, 10% Saudi Arabia, 8% US Offshore, 7% Malaysia, 5% Bahrain, 3% South Africa, 14% other 49% banks, 24% fund managers, 14% central banks, 10% hedge funds, 3% others
	Sharjah Irish Stock Exchange, NASDAQ Dubai	*Ijara*	HSBC and KFH, NBAD, Sharjah Islamic Bank, SCB	Executive Shariah Committee of HSBC Saudi Arabia Limited, the Fatwa and Shari'a Supervisory Board of Sharjah Islamic Bank, the KFH Investment Sharia Board and the Shariah Supervisory Committee of Standard Chartered Bank	US$750 million US$7.85 billion	50% Middle East, 20% UK, 14% Asia and 11% Europe (ex-UK), 5% others 39% banks, 39% fund managers, 18% central banks/official institutions, 2% insurance companies, 2% others
	Luxembourg (EMU) LuxSE	*Ijara*	HSBC, BNP Paribas	Sharia Supervisory Committee of BNP Paribas and the Executive Shariah Committee of HSBC Saudi Arabia Limited	€200 million €500 million	61% Middle East and North Africa, 20% Europe, 19% Asia 50% central banks and official institutions, 40% banks, 10% asset managers
Corporate	Goldman Sachs LuxSE	*Wakala*	Goldman Sachs and Abu Dhabi Islamic Bank PJSC, Emirates NBD Capital, NBAD, NCB Capital, QInvest	Shari'a Advisory Group consisting of Dr Abdul Sattar Abu Ghuddah; Sheikh Nizam Yaqoby; and Dr Mohammed Elgari	US$500 million US$1.5 billion	87% Middle East, 11% Europe, 2% Asia 77% banks, 22% asset managers, 1% private banks [*sic*!]