Transnational Dispute Management
www.transnational-dispute-management.com

ISSN : 1875-4120
Issue : Vol. 19, Issue 6
Published : November 2022

China and Islamic Finance: Past, Present, and Future
by M.S. Erie

This paper is part of the TDM Special Issue *"Islamic Finance and Dispute Resolution"* edited by Prof. Dr A F M Maniruzzaman.

Professor Dr A F M Maniruzzaman
University of Portsmouth, United Kingdom

China and Islamic Finance: Past, Present, and Future

Matthew S. Erie[1]

Abstract

China's commercial and geostrategic interests increasingly deepen its trade and investment in Muslim countries throughout the world. In terms of compliance with local law, many Muslim countries feature mixed or hybrid legal systems, including common law, civil law, and sharia. Chinese enterprises have little experience with sharia compliance and Islamic finance. Domestically, whereas China has emerged as an innovator in such areas as fintech and digital commerce, Islamic finance is one field of transactional and financial regulation that is largely absent. While there is no inherent obstacle to Chinese commercial and financial institutions acquiring expertise in sharia-compliant Islamic banking, they nonetheless will experience a learning curve as the Chinese government promotes ties with Muslim countries. This brief article reviews the short history of Islamic banking in China, assesses the current supply of sharia-compliant financial instruments for cross-border business between Chinese parties and counterparts based in Muslim states, appraises the demand of Chinese enterprises for Islamic banking products and services, and, lastly, suggests possible trajectories for the integration of Islamic finance into the political economy of China and Muslim states.

Introduction

In the late summer of 2021, there were two news stories that erupted on the Internet: the first was a declaration by the Taliban that the newly-founded Islamic Emirate of Afghanistan would implement sharia (Islamic law) and the second comprised statements from the Government of the People's Republic of China (PRC or China) that they would occupy the vacuum left by the Americans in providing development assistance for economic recovery to the country.[2] The latter includes reports that Chinese enterprises are eager to invest in Afghanistan.[3] These news stories seem to have missed each other, however, as Chinese enterprises, to the extent that they do have an appetite for entering the Afghan market, may have little knowledge of operating in sharia-based legal systems, especially in what will likely be a more conservative version as implemented by the Taliban. The question of Chinese enterprises that purportedly seek to conduct business in Afghanistan poignantly raises a broader set of issues concerning how such enterprises adapt to cross-border business in Muslim states that feature sharia, a legal order that is for the most part is foreign to them.

This brief article provides some preliminary thoughts as to how and to what extent Chinese enterprises engage with sharia-compliance, particularly in the field of Islamic finance. *Sharia*

---

[1] Associate Professor and Member of the Law Faculty, University of Oxford. This work is part of the "China, Law and Development" (CLD) project, funded by the European Research Council under the European Union's Horizon 2020 research and innovation program (Grant No. 803763). For more information about the CLD project, see here: https://cld.web.ox.ac.uk/#/.

[2] Anon., 'What is Sharia law? What does it mean for women in Afghanistan?' (BBC, 19 Aug. 2021) <https://www.bbc.co.uk/news/world-27307249> accessed 6 Oct. 2021 (including a news conference in which the Taliban spokesman stated that Afghan women would have rights "within the framework of Islamic law"); Anon., 'Zhongguo zengjia dui Taliban yuanzhu, zhengshi kaishi zai Afuhan buju, youwang canyu zhan hou chongjian [China has increased its aid to the Taliban which it has officially begun to roll out [within the country of] Afghanistan, and is expected to participate in post-war reconstruction] (Dingqing shijie [Dingqing Vision], 3 Sept., 2021) <https://baijiahao.baidu.com/s?id=1709866453622900839&wfr=spider&for=pc> accessed 6 Oct. 2021.

[3] Id.

is understood to mean, most technically, the divine path or God's will and includes the revealed text of the Qur'an and the sunna (the practice established by the Prophet Muhammed) as well as that of the earliest generations of pious Muslims which includes the hadith tradition, the sayings and deeds of the Prophet Muhammad.[4] It may also include the secondary sources of analogies and consensus, and is complemented by the *fiqh* (lit., "understanding") which refers to the human effort to know and apply sharia.[5] *Islamic finance* refers to sharia-compliant financial instruments organized around the prohibition against *riba* (interest).[6]

The central claim of this article is that despite the growing amount of trade and investment between China and Muslim states in the Middle East, Caucuses, Central Asia, South Asia, and Southeast Asia, and further, despite some degree of government-to-government coordination that has provided a nascent supply of Islamic financial products and services to Chinese users, Chinese enterprises, for the most part, have not demonstrated a demand for Islamic banking. To explain this disconnect, the article examines another underlying disconnect between the status of sharia-based institutions in China and Chinese official and commercial entities' treatment of them outside of China, finding that because Chinese enterprises are both rational actors and cultural subjects, at this current stage, they have little incentives to engage with Islamic finance overseas. The remainder of this article is organized into five parts: the first anchors the analysis by providing a short history of the domestic Chinese environment for sharia-compliant business and Islamic finance; the second shifts the focus in both time and space to provide an overview of the contemporary political economy of China and Muslim states, noting their growing level of trade and investment; the third assesses some of the efforts to introduce Islamic finance into these commercial relationships, the fourth provides some initial reflections of lawyers working on these transactions in terms of the relevance of Islamic finance for Chinese enterprises, the fifth projects into the future possible scenarios for the role of Islamic finance in Chinese-driven economic globalization. It bears emphasis that this article is meant merely as an early exploration, and more empirical research is needed on this and related issues.

I. A Very Short History of Islamic Banking in China

Overseas investment requires due diligence to assess, manage, and mitigate potential risks, with that due diligence based on market analysis and local knowledge.[7] Knowledge of overseas markets in Muslim countries is a particular challenge for Chinese enterprises.[8] The political, cultural, and economic differences between China, on the one hand, and Muslim countries, on the other hand, are significant, and yet to the extent that religion underwrites some of those differences, China has its own tradition of Islam and sizeable Muslim population. Hypothetically, Chinese corporate and financial institutions could have their own indigenous resources with which to gain familiarity with those Islamic institutions abroad that, in part, shape markets and governance, namely, sharia. Yet despite the large number and social and

[4] Matthew S. Erie, *China and Islam: The Prophet, the Party, and Law* (CUP 2016), 18.
[5] Id at 19.
[6] Id. at 264.
[7] Dan Haendel, *Foreign Investment and the Management of Political Risk* (Routledge 2018), 4,5; Aniruddha Rajput, 'Due Diligence in International Investment Law: From the Law of Aliens to Responsible Investment' in Heike Krieger, et al., (eds), *Due Diligence in the International Legal Order* (OUP 2020), 279 (citing ICSID *Plama Consortium Limited v. Republic of Bulgaria*, ICSID Case No. ARB/03/24, Award of 27 Aug. 2008, para. 268, finding the foreign investor to be at fault for not conducting due diligence on host state tax legislation before investing).
[8] See Andrea Ghiselli, *Protecting China's Interests Overseas: Securitization and Foreign Policy* (OUP 2021), 119.

economic significance of China's Muslim population, China has not grown its own sharia institutions.[9] Prohibitions on or limitations of religious institutions, including Islamic ones, in recent years have worked against economic integration with Muslim countries, disadvantaging Chinese enterprises wishing to conduct business there.[10] The result is a paradoxical state of affairs: Chinese enterprises purportedly desire to engage with Muslim countries and yet the space is shrinking for homegrown sharia institutions. To understand how this situation affects Chinese enterprises, it is helpful to review the status of sharia-compliant Islamic banking in the PRC.

Sharia is conventionally understood to be a source of law in Muslim countries, yet Muslim-minority jurisdictions may also include elements of sharia, and China is no exception in this regard. China has a long history of Islam with over 23 million Muslims.[11] Most of China's Muslim minorities reside in the north-western region, and yet they live throughout the country, including in almost all of the major cities on the eastern seaboard, such as Beijing, Shanghai, and Shenzhen. China's Muslims are categorized into ten officially-recognized ethnic minority groups, including the Chinese Muslims or Hui, the largest group, and the Turkic Muslims, the Uyghurs, an almost equally large group who reside in the Xinjiang Uyghur Autonomous Region (XUAR).[12]

According to the PRC Constitution and the Regional Ethnic Autonomy Law of 1984, ethnic minorities, including Muslim minorities, have the "power of autonomy" (*zizhi*) within the Chinese state,[13] and yet over the course of PRC history, China's Muslim minorities have been subjected to various degrees of assimilation if not outright persecution.[14] Since 2017, there are credible reports that a large number of Uyghurs and other Turkic Muslims in the XUAR have been confined to "re-education camps" against their will.[15] The PRC government claims the camps are necessary to prevent the "three evils" of "terrorism, splittism, and extremism" (*kongbuzhuyi, fenliezhuyi, jiduanzhuyi*).[16] Critics, however, view the camps to violate human rights law.[17] Moreover, Islamophobia has spilled over affecting other (i.e., non-Uyghur)

[9] Matthew S. Erie, *China and Islam: The Prophet, the Party, and Law* (2016), 12-13.
[10] Matthew S. Erie, 'Shari'a as Taboo of Modern Law: Halal Food, Islamophobia, and China' (2019) 33 JLR 390, 404-406.
[11] Erie, *China and Islam* (n 9) 8.
[12] Id at 8-10.
[13] *Zhonghua renmin gongheguo xianfa* [PRC Constitution], adopted at the Fifth Session of the Fifth National People's Congress and promulgated for implementation by the announcement of the National People's Congress on Dec. 4, 1982, as amended March 14, 2004. art. 119; *Zhonghua renmin gongheguo minzu quyu zizhifa* [PRC Regional Ethnic Autonomy Law], issued by the Second Session of the Sixth National People's Congress on May 31, 1984, and effective October 1, 1984, as amended Feb. 28, 2001, art 2.
[14] Erie, *China and Islam* (n 9) 71-72.
[15] United Nations Human Rights Office of the High Commissioner, "China: UN experts deeply concerned by alleged detention, forced labour of Uyghurs," (UN, 29 Mar 2021) <https://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=26957&LangID=E> last accessed 6 Oct. 2021; UK Mission to the WTO, UN, and Other International Organizations (Geneva), 'UN Human Rights Council 47: Joint statement on the human rights situation in Xinjiang' (Gov.uk, 22 June 2021) <https://www.gov.uk/government/news/un-human-rights-council-47-joint-statement-on-the-human-rights-situation-in-xinjiang> last accessed 6 Oct. 2021.
[16] Anon, Xinjiang "sange shili" shi ge minzu de gongtong diren [Xinjiang "Three Forces" are every nationalities' common foe] (Guangmingwang [Bright Net], 24 Apr. 2013) <http://news.sohu.com/20130424/n373859173.shtml> last accessed 6 Oct. 2021.
[17] See Sean R. Roberts, *The War on the Uyghurs: China's Internal Campaign Against a Muslim Minority* (PUP, 2020), ix-xi.

Muslim minorities' everyday lives such that even mosque architecture, Islamic dress, and halal food are censored.[18]

The PRC government's all-consuming fear about Islamic terrorism is a necessary starting point to understand the stunted status of Islamic finance in China. Starting around the 2008 global financial crisis, governments in Greater China, including Taiwan, Hong Kong, and the PRC, began experimenting with sharia-compliant Islamic finance as an alternative to Wall Street capitalism.[19] For example, Taiwan established a Taiwan Sharia Index in 2008 for investment products that focus on sharia-compliant companies listed on the Taiwan Stock Exchange.[20] Around that time, Hong Kong financial authorities began discussing the possibility that Hong Kong could be a center for the Islamic bond (*sukuk*) market in Asia.[21] Concurrently, the Arab Chamber of Commerce & Industry established the International Islamic Mediation & Arbitration Centre[22] which theoretically could accept disputes arising out of Hong Kong's sukuk market.

In the PRC, anxieties about money laundering for Islamic terrorism have handicapped the growth of Islamic finance. In the Ningxia Hui Autonomous Region (NHAR), which one of the centers for Hui, the Bank of Ningxia (BON) in the NHAR's capital of Yinchuan launched a pilot project for Islamic finance in 2009.[23] Driven by local Hui businesses who sought sharia-compliant instruments through which to invest savings, the BON initiative was based on precedents in Malaysia.[24] Upon submission to the China Banking Regulatory Commission which oversees the banking industry in the PRC, the BON began offering sharia-compliant financial services at five of its branches in the NHAR.[25] Specifically, the BON offered no-interest savings accounts through which the BON provides "gifts" (*lipin*) to customers, investment accounts that accord with the rules of sharia, and *murabaha* (*jiajia maoyi*) under which the BON purchased goods on behalf of the customer and then resold the goods to the customer at the price plus profit.[26] Unfortunately, the project suffered from problems from the beginning, including inadequate capitalization, insufficient loans, restrictions on investment in trust companies, and prohibitions on using more sophisticated Islamic banking instruments such as the *mudaraba* and *musharaka*, all of which resulted in low customer yield.[27] According to a BON manager, the project was unable to progress because "The government is afraid Uyghurs will use the bank in Yinchuan."[28] Since that time, the initiative has mostly run out of steam.

Despite initial grassroots demand by Muslim minority communities in China, the PRC government has generally not supported Islamic finance within the PRC. If a draft halal food law was deemed too controversial and as a result was struck down in 2016,[29] then it remains

[18] Erie, 'Shari'a as Taboo' (n 10) 403.
[19] Erie, *China and Islam* (n 9) 288.
[20] Id.
[21] Wai-Yip Ho, *Islam and China's Hong Kong: Ethnic Identity, Muslim Networks and New Silk Road* (Routledge, 2013), 123.
[22] Arab Chamber of Commerce, 'International Islamic Mediation & Arbitration Centre' (IMAC, n.d.) <http://new.arabcci.org/IMAC_aboutus.htm> last accessed 7 Oct. 2021.
[23] Erie, *China and Islam* (n 9) 291.
[24] Id.
[25] Id at 292.
[26] Id at 293.
[27] Id at 294.
[28] Id at 295 (citing a 2012 interview).
[29] Erie, 'Shari'a as Taboo' (n 10) 413-16.

unlikely for there to be political support to establish a legislative basis or regulatory framework for Islamic finance in China. As a result of the limited relevance of Islamic finance within China, Chinese businesses have been unable to gain familiarity or to experiment with such financial instruments domestically. When these companies invest overseas, they have little knowledge of the benefits of Islamic banking, despite the prevalence of the Islamic banking in the countries in which they operate. This lack of knowledge and experience is potentially an impediment to the growing number of Chinese enterprises operating in Muslim countries.

II. The Political Economy of China and Muslim States

The Chinese government has multiple interests in Muslim states, including military, geo-strategic, and commercial. As early as the 1960s, the Chinese government was providing military aid to Pakistan, and, by the 1980s, aid was expanded to Iran, Iraq, and Saudi Arabia.[30] Military aid continues, and engagement has taken more visible incarnations, including, most notably in the form of the People's Liberation Army Navy's base in Djibouti, the first Chinese military presence outside of the PRC. The base provides China a purchase on the Bab el Mandab Strait, a major corridor for maritime shipping.[31]

These military and geo-strategic interests complement China's commercial ones. Commercial interests include both natural resource acquisition and market access. While China remains heavily reliant upon coal, of which it has domestic sources, China became a net oil importer in 1993, and its oil consumption has increased by 8 percent annually since 2002.[32] Saudi Arabia and Iraq, as well as Oman and the United Arab Emirates (UAE) are some of China's top suppliers of crude oil.[33] China is the leading trade partner of many Muslim states. According to the International Monetary Fund, China has surpassed the U.S. as the world's most dominant trading partner throughout most of the world and specifically in Asia, the Middle East, North Africa, and Southeast Asia.[34]

China's relations with Muslim countries from the Middle East and Caucuses to Central Asia, South Asia, and Southeast Asia have been turbo-charged under the steroidal "Belt and Road Initiative" (BRI) started in 2013. As conventionally understood, the BRI has showcased Chinese firms' ability to design, build, finance, operate, manage, and maintain major infrastructural and energy projects connecting Chinese economy to that of most of Asia and beyond. BRI projects have strengthened China's economic and geo-strategic links with the Gulf states, Caucuses, Central Asia, Pakistan, and Indonesia and Malaysia, in particular.[35]

Yet, the increasing footprint of Chinese enterprises in these countries has not been without its difficulties. Observers point to a number of challenges including fractious democracies and

[30] Ali Ghulam, *China-Pakistan Relations: A Historical Analysis* (OUP, 2017), 61; Geoffrey Kemp, *The East Moves West: India, China, and Asia's Growing Presence in the Middle East* (BIP 2012), 64-5.
[31] Matthew S. Erie, 'Chinese Law and Development,' 62 HILJ (2021), 51, 52.
[32] Kemp (n 30) 68.
[33] Jeff Baron, 'China's crude oil imports surpassed 10 million barrels per day in 2019' (U.S. Energy Information Administration, 23 Mar. 2020) <https://www.eia.gov/todayinenergy/detail.php?id=43216> last accessed 6 Oct. 2021.
[34] Iman Ghosh, 'How China overtook the U.S. as the world's major trading partner' (VisualCapitalist, 22 Jan. 2020) <https://www.visualcapitalist.com/china-u-s-worlds-trading-partner/> last accessed 6 Oct. 2021.
[35] Ben Simpfendorfer, *The New Silk Road: How a Rising Arab World is Turning Away from the West and Rediscovering China* (Palgrave, 2009); Bruno Maçães, *The Dawn of Eurasia: On the Trail of the New World Order* (Allen Lane, 2018); *Robert R. Bianchi, China and the Islamic World: How the New Silk Road is Transforming Global Politics* (OUP, 2019).

complex multi-party local politics, rights-aware civil society groups, vocal media, inter-ethnic tensions, and religious fundamentalism including Islamic terrorism, to name a few.[36] BRI projects present a host of political, economic, social, and legal risks.[37] There is a cottage industry of Chinese scholars, corporate officers, compliance officers, and in-house lawyers who analyse the various types of risks that Chinese enterprises face in Muslim states, particularly in the Middle East and North African region, and also in Pakistan.[38] In one study written by two Chinese economists, for example, of forty-three BRI countries, the "highest-risk" host states, based on measurements of total risk, political risk, economic risk, and social risk, were Pakistan, Yemen, and North African countries – all of which are Muslim-majority.[39] It is perhaps not surprising that one of the key sources of risk among many Chinese analysts is the presence of sharia in the legal systems of Muslim host states.[40] Given the unfamiliarity of Chinese enterprises with Islamic finance, one response by the banking industry in both Muslim states and in China has been to offer more Islamic financial products for Chinese enterprises. The following section provides an overview of the state of play of these products and their related services.

III. The Banking Industry's Supply of Islamic Finance

Greater economic integration between Chinese and Muslim states has undoubtedly created more opportunities for both Chinese banks operating in such states to offer Islamic financial products and, conversely, for Islamic banks to invest in China, and there has been much publicity for Islamic finance in the BRI.[41] In reality, however, at least at this stage, some of

---

[36] Bianchi (n 35) 7; Daniel S. Markey, *China's Western Horizon: Beijing and the New Politics of Eurasia* (OUP, 2020), 5-6.

[37] Erie, 'Chinese Law and Development' (n 31) 53, 78-84; Permanent Forum of China Construction Law, *The Belt and Road Initiative: Legal Risks and Opportunities Facing Chinese Engineering Contractors Operating Overseas* (Wolters Kluwer, 2019).

[38] Ye Jianmu [叶建木] & Pan Xiaoyao [潘肖瑶], *'Yidaiyilu' beijing xia Zhongguo qiye haiwai touzi fengxian chuandao ji kongzhi: Yi Zhongguo tiejian Shate qingruan xiangmu weili [The Transmission and Control of Chinese Enterprises' Overseas Investment Risks under the 'Belt and Road Initiative']*, 33 Caihui Yuegan [Accounting Monthly] (2017) 96; Yin Yiwen [阴医文], et al., *'Yidaiyilu' beijing xia woguo dui Zhongdong zhijie touzi: zhanlüe yiyi, zhengzhi fengxian yu duice [Chinese Direct Investment in the Middle East under the 'Belt and Road Initiative': Strategic Significance, Political Risk, and Countermeasures]*, 4 Guoji Maoyi [International Trade] (2017) 26; Xiao Xin [肖欣], et al., *'Zhongba jingji zoulang' dianli touzi xiangmu yunying fengxian pinggu ['China-Pakistan Economic Corridor' Power Investment Project Operation Risk Assessment]* 6 Guoji jingji hezuo [International Economic Cooperation] (2020) 138; He Shiyou [何时有] & Xiao Xin [肖欣], *'Zhongguo jingji zoulang' nengliang dianli xiangmu de touzi fengxian ['China-Pakistan Economic Corridor' Energy Resource Projects' Investment Risks]*, 2 Jingmao Shiwu [Business Practice] (2015) 82.

[39] Fang Hui [方慧] & Song Yujie [宋玉洁], *Dongdaoguo fengxian yu Zhongguo duiwai zhijie touzi: jiyu "Yidaiyilu" yanxian 43 guo de kaocha [Host Country Risk and China's Foreign Direct Investment: Based on a Survey of 43 Countries along the "Belt and Road Initiative"]*, 21 Shanghai Caijing Daxue Xuebao [Journal of Shanghai University of Finance and Economics] (2019), 33, 37-38.

[40] See e.g., Shao Shijun [邵士君] & He Tong [何童], *Zhongdong diqu: youqi touzi hezuo de falü fengxian [The Middle East: Legal Risks of Oil and Gas Investment Cooperation]*, 230 Zhongguo Shihua [China Petrochemical Industry] (2004), 60, 61.

[41] Arno Maierbrugger, 'Islamic finance gaining stronger foothold in China' (Gulf Times, 5 May 2020) <https://www.gulf-times.com/story/662422/Islamic-finance-gaining-stronger-foothold-in-China> last accessed 7 Oct. 2021; Muhammad Zulfikar Rakhmat, 'The Rise of Islamic Finance on China's Belt and Road' (The Diplomat, 15 Feb. 2019) <https://thediplomat.com/2019/02/the-rise-of-islamic-finance-on-chinas-belt-and-road/> last accessed 7 Oct. 2021; Nora Salim, 'China's Scope for Islamic Finance' (Eurek Hedge, May 2007) <https://www.eurekahedge.com/Research/News/844/Chinas-Scope-for-Islamic-Finance> last accessed 7 Oct.

these products and services remain more aspirational than practical. Whereas there is much discussion of the potential for Chinese banks to offer Islamic financial instruments in Muslim states and for the growth of an Islamic finance market in China, for the most part, the former remains embryonic and the latter continue to be limited for political reasons.

One of the earliest examples of a Chinese bank exploring Islamic finance offerings was that of the Industrial & Commercial Bank of China (ICBC) whose wholly-owned subsidiary ICBC Leasing purportedly established cooperation with the Islamic Development Bank (IDB), headquartered in Jeddah, Saudi Arabia, in 2015.[42] In statements issued in that year, ICBC Leasing and IDB stated they intended to cooperate in Islamic financial services for ICD's fifty-two member states, to provide services for *Ijara* (a type of operating leasing) and liquidity management, and to provide joint lending services for the private sector.[43] Also, in 2015, Southwest Securities in Chongqing signed a deal with Qatar National Bank and Qatar International Islamic Bank to offer Islamic financial products in China, and to access investors in Qatar and neighbouring Gulf states.[44] While these development signal some industry integration between the Chinese market and counterparts in the Middle East, South Asia, and elsewhere, they nonetheless remain, for the most part, nascent.

The China-Pakistan Economic Corridor (CPEC) would be one natural destination for Chinese-backed Islamic finance, and there may be some traction for the initiative. Meezan Bank, Pakistan's largest Islamic bank, signed a "strategic cooperation alliance" with the Pak China Investment Company Limited, a JV between Pakistani and Chinese governments through the Ministry of Finance of Pakistan and the China Development Bank, respectively, in 2016.[45] Whereas the official statements of the alliance do not explicitly provide for Islamic finance, they do suggest collaboration in facilitating businesses of both countries in undertaking strategic projects related to CPEC.[46] On 17 January 2017, the Institute of Business Administration's Centre for Excellence in Islamic Finance held the "Unlocking Islamic Finance Potential in CPEC and Beyond." In a strategy paper that came out of that conference, the organizers advocated for establishing a sharia-compliant infrastructure fund to attract Chinese investment.[47] The paper further notes

Decision makers in the Chinese Government should be made aware of the clause (Part 2, Chapter 2, Section 38 f) in Pakistan's constitution stating that 'the state shall eliminate Riba as

2021; Md Nazirul Islam Sarker et al., 'Islamic Banking and Finance: Potential Approaches for Economic Sustainability in China' (2020) 11 JIM 1725; Kao Tianyou, 'The Rise of Islamic Finance on China's Belt and Road' ResearchGate (2019) <file:///C:/Users/CDL-User1/Downloads/TheRiseofIslamicFinanceonChinasBeltandRoad.pdf> last accessed 7 Oct. 2021.

42 Anon, Zhongguo gongshang yinhang niyu yisilan fazhan yinhang hezuo kaizhan yisilan jinrong yewu zongbu weiyu [Industrial and Commercial Bank of China intends to cooperate with Islamic Development Bank to develop Islamic finance business] (Musilin zaixian [Muslim Net], May 13, 2015) <http://www.muslimwww.com/html/2015/jinrijujiao_0513/26920.html> last accessed 6 Oct. 2021.

43 Id.

44 Anon., Jiedu 'Kata'er yinhang niyu Xinan zhenquan zai hua chengli yisilan jinrong gongsi' de shizhi [Understanding the essence of 'Qatar Bank intends to establish an Islamic financial company in China with Southwest Securities'] (Guba.com [Stocks], 16 Apr. 2015) <http://guba.eastmoney.com/news,gssz,158589122.html?jumph5=1> last accessed 6 Oct. 2021.

45 Anon., 'Meezan Bank and Pak China Investment Company Limited enter into Strategic Cooperation Alliance to Capitalize CPEC Opportunities (Meezan Bank, 13 Oct. 2016) <https://www.meezanbank.com/meezan-bank-and-pak-china-investment-company-limited/> last accessed 6 Oct. 2021.

46 Id.

47 Institute for Business Administration, 'Unlocking Islamic Finance Potential in CPEC and Beyond: Conference Proceedings' (2017), (on file with author).

early as possible.' According to the Finance Minister Ishaq Dar, the Government of Pakistan plans to convert 20-40% of existing debt financing from conventional to Shari'ah compliant sources, in pursuing its aim to prioritize the use of Islamic financing modes to meet infrastructure and long-term financing needs.

This conversion does not seem to have happened, although it nearly occurred in 2000.[48] The cancellation of interest in Chinese loans would minimally require some kind of compensatory mechanism. It would be this type of conversion which would likely be deemed as a significant risk by Chinese lenders.

Another Muslim country which has sought to position itself as an Islamic finance center to an even greater extent is that of the UAE, and Dubai in particular. Since 2016, the respective governments have held the "China-UAE Conference on Islamic Banking and Finance" that has focused on the role of Islamic finance in the BRI.[49] The conferences have served as a platform for Emirati and Chinese parties to sign memorandum of understanding regarding promoting Islamic finance, translating into Chinese such sharia standards as those of the Accounting and Auditing Organization for Islamic Financial Institutions, and showcasing the work of such organizations as the China Islamic Finance Club.[50] Furthermore, the Dubai International Financial Centre (DIFC), a special economic zone in Dubai, has attracted the four largest banks in China which comprised 26% of the total assets booked in the DIFC in 2016.[51] While there is considerable discourse about the Chinese banks' providing Islamic finance under the Dubai framework, the DIFC model was designed, in part, to circumvent sharia which was deemed unfriendly to investors,[52] and so it would appear, at least at this stage, that the Chinese banks' presence in the DIFC is specifically to benefit from its own exceptional regulatory status, although the banks' provision of Islamic financial products remains a possibility.

Lastly, the Asian Infrastructure Investment Bank (AIIB) has also been exploring the provision of Islamic financing. The AIIB is often construed as a "Chinese bank" but is in fact a multilateral organization organized under international law,[53] in which China is the largest shareholder and is based in China with a Chinese president. In 2018, the AIIB signed a memorandum of understanding with the IDB to "promote co-financing and other forms of joint

---

[48] State Bank of Pakistan, 'Annual Report FY02' <https://www.sbp.org.pk/reports/annual/arFY02/chap10.pdf> 192, accessed 6 Oct. 2021 (describing the constitution of the Commission for Transformation of Financial System, but whose effect was ultimately minimal).

[49] Anon., 'Third China-UAE conference on Islamic Banking & Finance concludes successfully amid international acclaim' (Hamdan Bin Mohammed Smart University, 12 Nov. 2018) https://www.hbmsu.ac.ae/news/third-china-uae-conference-on-islamic-banking-finance-concludes-successfully-amid accessed 6 Oct. 2021.

[50] See id; Anon., 'The 1st China-UAE Conference on Islamic Banking & Finance to tap synergies between Islamic economies of both countries to drive in mutual growth' (Hamdan Bin Mohammed Smart University, 17 May 2016) <https://www.hbmsu.ac.ae/news/1st-china-uae-conference-on-islamic-banking-finance%E2%80%99-to-tap-synergies-between-islamic> accessed 6 Oct. 2021; Anon., 'AAOIFI Signs Agreement for a Chinese Translation of its Shari'ah Standards at 'China-UAE Conference on Islamic Banking and Finance', held in Shenzhen' (AAOIFI, n.d.) <https://aaoifi.com/announcement/aaoifi-signs-agreement-for-a-chinese-translation-of-its-shariah-standards-at-china-uae-conference-on-islamic-banking-and-finance-held-in-shenzhen/?lang=en> accessed 6 Oct. 2021.

[51] Dubai International Financial Centre, 'Growing UAE-China Trade Complements Dubai International Financial Centre Growth Strategy' (DIFC, 29 Feb. 2016) <https://www.difc.ae/newsroom/news/growing-uae-china-trade-complements-dubai-international-financial-centre-growth-strategy/> accessed 6 Oct. 2021

[52] Matthew S. Erie, 'The New Legal Hubs: The Emergent Landscape of International Commercial Dispute Resolution' (2020) 60 VJIL 226, 270.

[53] Asian Infrastructure Investment Bank, 'The Role of Law at AIIB' (AIIB, n.d.) <https://www.aiib.org/en/about-aiib/who-we-are/role-of-law/index.html> last accessed 6 Oct. 2021.

participation in financial assistance for development projects in countries of mutual interest."[54] Given that the AIIB is active in a number of Muslim states, it would appear that such initiatives would be well received but work is required at the implementation stage.

In short, despite a flurry of events, initiatives, and MOUs, the intersection between the Chinese financial industry and Islamic banking remains embryonic. While the respective governments of China and different Muslim states may support greater economic links through Islamic finance, the result of such ties at the industry level are not yet robust. The next section examines the potential for Islamic finance from the perspective of Chinese enterprises as would-be users of such products.

IV. Chinese Enterprises' Demand for Islamic Finance

Having assessed some of the initiatives between Chinese, Islamic, and multilateral banks, the question is whether Chinese enterprises are willing to purchase such products and services. As a threshold matter, how and to what extent Chinese enterprises and financial institutions engage with sharia-compliance and Islamic banking, in particular, is partly a factor of the relevant legal frameworks of the relevant Muslim host states. While, as mentioned in the preceding section, Islamic banks supply financial instruments in accordance with sharia, there is no single "Islamic legal system" or "Islamic regulatory order" that governs Islamic finance. Instead, Muslim countries feature a range of mixed or hybrid systems—including common law and civil law—that to a greater or lesser degree incorporate sharia.[55]

On one end of the spectrum, a minority of countries such as Saudi Arabia, Sudan, and Yemen feature robust sharia, including sharia provisions in criminal law, and on the other end of the spectrum, a greater number of countries like Oman, India, North African states, and most Southeast Asian countries include sharia in more limited domains, such as for personal status concerns. Among these latter countries, their legal systems may insulate cross-border business and foreign investment in particular from sharia. In other words, foreign businesses, including Chinese enterprises, can use non-sharia-compliant institutions and financial mechanisms. A brief tour of several of these Muslim states' investment environments with particular respect to their legal systems shows not only that there may be an absence of legal requirements for Chinese enterprises to use Islamic finance but also there may be a lack of political will to require them to do so.

Given its centrality to the BRI, Pakistan is a natural starting place for analysis. Pakistan's legal system shows a deep inheritance from English common law given that the state had historically been incorporated into the British Raj. Beginning in the late 1970s, the Pakistani legal system underwent "Islamicization." Pursuant to the 1979 constitution, the Federal Shariat Court was established with the power to review legislation to ensure conformity with the principles of Islam.[56] Thereafter, judges expansively applied Islamic principles to a broad array of legislative and regulatory rules, including criminal law.[57] However, for the most part, foreign investors are shielded from sharia review of their transactions, with possible exceptions, for example, if

[54] Memorandum of Understanding between Islamic Development Bank Group and the Asian Infrastructure Investment Bank, signed June 25, 2018, art. 1.2, <https://www.aiib.org/en/about-aiib/who-we-are/partnership/_download/islamic-development-bank.pdf> last accessed 6 Oct. 2021.
[55] Shaheed Sardar Ali, *Modern Challenges to Islamic law* (CUP, 2016), 31; Mauro Bussani & Ugo Mattei, *The Cambridge Companion to Comparative Law* (CUP, 2012), 296.
[56] Martin Lau, *The Role of Islam in the Legal System of Pakistan* (Brill, 2016), 6.
[57] Id at 211.

the nature of the transaction contravenes Islamic values (e.g., the object of trade involves some prohibited substance, like alcohol). Further, as opposed to reliance on Islamic financial products, conventional financial instruments are available. A Chinese investor, however, may be in a scenario where local debt must be raised, and in that situation, it is likely that some of it would be sharia-compliant. In short, while there are opportunities to engage in the Islamic finance industry, there are just as likely channels for Chinese enterprises to avoid sharia-compliance.

This situation is similar in a number of Muslim states with mixed legal traditions. For example, the UAE, which has sought to position itself as an "investor-friendly" jurisdiction in the Gulf, has a legal system that is fundamentally based in sharia and yet most legislation contains elements of continental civil law, and in particular, an inheritance from French civil law via Egypt. As the UAE is a federal system, the judiciary of each Emirate operates under the UAE Federal Judicial Authority yet Dubai and Ras al Khaimah have their own independent courts, including both sharia courts and civil courts.[58] Similar to Pakistani courts, judges have broad discretion to apply sharia to an array of legal questions, even in regards to those non-expressly sharia statutes. Yet, in practice, sharia rarely applies to foreign-related transactions to the extent that the parties want to keep sharia out. A lawyer practicing in the region put it this way:

Most Chinese companies operating outside China are SOEs. It doesn't matter where they operate. They always have internal reporting and approvals to seek. Decisions are political. Islamic finance is seen as a religious thing. China wants to veer away from anything religious…The borrowers of SOEs want to stick with something tried and tested because of the crazy approval regimes. So there is no incentive to go to Islamic financing.[59]

The lawyer further claimed that Islamic finance may not necessarily be "off-putting" to Chinese investors; rather, its novelty dis-incentivizes them from purchasing Islamic financial products. Loans are cheap and can be obtained from any number of sources—not necessarily banks located in the Middle East. A transactional lawyer from a major firm in Egypt made a similar point. In that country, which combines sharia with the Napoleonic Code, Egyptian business parties themselves often prefer conventional lending to Islamic finance as the former is cheaper.[60] A concrete example of this decision-making process was the purchase of United Energy Group (UEG), the largest privately-owned Chinese oil company, of Kuwait Energy Company (KEC) for $651 million in 2018. KEC had used Islamic financing, which UEG was surprised to discover in the course of the acquisition as previously they had used U.S. bond offerings, U.S. term loans, or international bank loans. At the time of the acquisition, the Islamic financing was coming due, and so ultimately UEG substituted the loans for conventional ones after the acquisition.[61]

To summarize, for Chinese investors in the Middle East, there may be little to gain in opting into Islamic finance. Neither local counter-parties nor the host government may mandate the use of Islamic finance. Further, and specific to Chinese investors, the domestic politics of Islamophobia can shape Chinese investor behaviour overseas, as well. This latter point suggests

[58] Dr Ahmed Aly Khedr, "UPDATE: Overview of United Arab Emirates Legal System," Hauser Global Law School Program (NYU, Jan. 2018) <https://www.nyulawglobal.org/globalex/United_Arab_Emirates1.html#legalsystem>.
[59] Interview by video-conference, 31 Aug. 2021. Note that due to the sensitivity of the material and in conformity with the ethical requirements of the ERC, the interviewees are rendered anonymous herein to protect their identity.
[60] Interview by video-conference, 31 Aug. 2021.
[61] Interview with lawyer for UEG by video-conference, 3 Sept. 2021.

that while Chinese investors must adapt to local conditions to address the various risks encountered, they may also bring with them some of the encumbrances of their home state.

V. The Future of Islamic Finance in Global China

While it is clear that Chinese enterprises are expanding their presence in Muslim states, based on available data, it is less clear whether Islamic finance is also part of that expansion. On the one hand, there is a push from Muslim states, from the UAE to Pakistan, to attract Chinese enterprises to raise debt in accordance with sharia and also to tap Chinese capital markets. Consequently, there is a great amount of excitement generated around the potential of Islamic banking to meet the needs of Chinese enterprises.

On the other hand, Chinese enterprises are not incentivized to use Islamic finance. For the most part, it is not part of their own industry practice, and where possible, Chinese enterprises seem to prefer, at least at this current stage, to rely on conventional banking which is both more familiar and may be cheaper than Islamic banking. It is important to again stress that this finding needs to be qualified. More empirical research is needed on Chinese enterprises' availing of Islamic finance in Muslim states, especially in regions such as Southeast Asia where there may be more integration. With this caveat aside, tentative interpretations are possible. Despite attempts to severe the domestic situation from the international one, Chinese corporate and financial institutions may bring those perceptions of any practice of institution labelled "Islamic" with them to their overseas commercial transactions. The lack of incentives frustrates a viable Chinese entry into sharia-compliant banking.

The disconnect between supply and demand may continue into the foreseeable future. It is clear that Chinese corporate and financial entities will continue to expand into new markets, including in Muslim-majority states. For instance, the major Chinese banks are conducting feasibility studies on entering the Nigerian market,[62] including a population of 206 million of whom over half are Muslim. It remains to be seen whether Chinese banks operating in such Muslim-majority states are incentivized to offer sharia-compliant products or whether they will forego Islamic banking through, for example, recourse to conventional banking or jurisdictional carve-outs like the DIFC. Whether in terms of product pricing or product quality, Islamic finance may not be advantageous over conventional forms. Ethic and sustainable development, sometimes earmarked as environmental, social and governance indicators, is gaining wide acceptance, whether through the IDB or China-supported multilateral institutions like the AIIB, and Islamic banking could be part of this broader trajectory.[63] Sustainable development is increasingly a priority of Chinese regulators who are seeking to correct for decades of unequal growth, lopsided urbanization, income disparity, and environmental deterioration.[64] Yet a true commitment to ethical and sustainable development would require a

[62] Agency Report, 'Envoy Mulls Establishment of Chinese Banks in Nigeria to Boost Economy' (Independent, 22 Sept. 2021) <https://independent.ng/envoy-mulls-establishment-of-chinese-banks-in-nigeria-to-boost-economy/> last accessed on 6 Oct. 2021.
[63] See M. Kabir Hassan et al. eds., *Islamic Finance and Sustainable Development* (Springer, 2021).
[64] Zhonghua renmin gongheguo guojia fazhan he gaige weiyuanhui [National Development and Reform Commission], Yi xin fazhan linian yinling jingji xin changtai tuijin Zhongguo jingji pingwen jiankang ke chixu fazhan – fang guojia fazhan gaige wei dangzu shuji, zhuren [Leading the New Normal of the Economy with the New Development Concept, Promoting the Steady, Healthy and Sustainable Development of China's Economy--Interview with He Lifeng, Secretary of the Party Leadership Group and Director of the National Development and Reform Commission] (NDRC, 19 Aug. 2017) <https://www.ndrc.gov.cn/fzggw/wld/hlf/lddt/201708/t20170819_1166859.html?code=&state=123> last accessed 6 Oct. 2021. See also EU-China Comprehensive Agreement on Investment, signed 22 Jan. 2021, Sec.

thorough-going reassessment of domestic policies that are having negative spill-over effects in terms of Chinese business practices overseas. In short, the disconnect between supply and demand in Chinese Islamic finance cannot be resolved before addressing the greater and underlying disconnect between Chinese authorities' treatment of Islam domestically as a "problem" to be solved and internationally as a market to be won.

IV (providing rules for investment and sustainable development) <https://trade.ec.europa.eu/doclib/docs/2021/january/tradoc_159346.pdf> (last accessed 7 Oct. 2021).