How could Europe avoid the Convergence Paradox?

a sociological analysis

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Outline of Argument

I. The Convergence Paradox
II. Three social forces creating the Convergence Paradox
III. How can Europe avoid the Convergence Paradox?

Part I: The convergence paradox

- **Islamic Banking and finance** is a niche ‘moralizing market’ that competes with the established conventional market.
- **The radical intent of Islamic finance:** prohibit *riba* & *gharar*, advocates fairness between transacting parties
- **The convergence paradox:**
  - Despite this radical intent, Islamic financial instruments are surprisingly similar to those in conventional markets.
- **Simplest resolution to paradox:** Islamic finance is simply marketing conventional finance in Islamic garb
- **Sophisticated resolution to paradox:**
  - 1) Islamic jurists emphasize form over substance
  - 2) An absent vision of an Islamic moral economy; thus the industry merely replicates conventional finance
  - 3) Corporate Islamic banks favor growth over development

Part II: Three social forces promoting the Convergence Paradox

DiMaggio & Powell (1983, *American Sociological Review*) identifies in economic life three mechanisms that promote a convergence of form (isomorphism):

1. **Coercive isomorphism**: formal & informal pressure by organizations and technologies outside of IBF.
   - E.g., secular legal and regulatory system that coevolved with interest-based finance
   - E.g., software used by banks unable to record and monitor constraints imposed by Shariah scholars

Part II: Three social forces promoting the Convergence Paradox

DiMaggio & Powell (1983, *American Sociological Review*) identifies in economic life three mechanisms that promote a convergence of form (<u>iso</u>morphism):

1. **Coercive isomorphism**: formal & informal pressure by organizations and technologies outside of IBF.
2. **Competitive isomorphism**: competition pushes organizations and products to resemble one another, either by learning from successful competitors, or because dissimilar organizations and products do not survive market competition.
   – E.g. Islamic products benchmarked against interest rates

Part II: Three social forces promoting the Convergence Paradox

DiMaggio & Powell (1983, *American Sociological Review*) identifies in economic life three mechanisms that promote a convergence of form (iso morphism):

1. **Coercive isomorphism**: formal & informal pressure by organizations and technologies outside of IBF.
2. **Competitive isomorphism**: competition pushes organizations and products to resemble one another.
3. **Mimetic processes**: As a consequence of uncertainty and risk aversion, organizations imitate with minor variations preexisting products and organizations.
   – E.g. uncertainty from clients
   – E.g., uncertainty from two key gatekeepers – Shariah scholars and market regulators

Part III: How can Europe avoid the Convergence Paradox?

PROPOSAL: Radical moralized markets, like Islamic finance, that compete with a larger, older conventional market, require an additional regulatory project to ameliorate convergence.

The case of Islamic finance outside Europe suggests these three proposals are not tangential niceties. They are requirements:

- **Coercive isomorphism:** alternative financial products require that regulators adopt new Islamic regulatory categories, not pigeon-hole Islamic products into conventional categories.
- **Competitive isomorphism:** reduce competition in moralized markets using cooperative rather than corporate firm structures. (Agree with Asutay!) Second-best alternative: infant industry protection.
- **Mimetic processes:** government role for: a) **reducing regulatory uncertainty** by standardizing national fatwas, publishing position papers, forming centralized Shariah councils, etc.; b) **reducing demand uncertainty** with public education of what makes Islamic products distinctive.

Thank you! Aaron.Pitluck@IllinoisState.edu