

Lending, the Poor & Islamic Scripture: Islamic Finance versus Welfare Islam

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Abstract. This paper contributes to Islamic studies literature, by exploring why many Islamic scholars believe that Islam bans conventional lending and mandates Islamic finance, and how the scriptural injunction against *ribā* is redefined when we consider the features of modern economic systems. The article advocates the view that *ribā* and *charity* are inextricably linked, and must therefore be considered together. The latter emphasizes helping the poor and the former prevents exploiting them. Islamic finance, however, has been incepted by erroneous juxtaposing trade with lending. The study also discusses the fallacies raised by many Islamic scholars against conventional lending. This manuscript demonstrates the necessity of modernizing our religious understanding to accelerate poverty reduction in the Muslim world.

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INTRODUCTION

THE RELATIONSHIP between religious belief and economic behavior is pivotal to socioeconomic studies (Keister 2008; see Iyer 2016 for review of the economics of religion literature), and empirical research shows the influence of religion on individuals' financial conditions (Lenski 1961; Keister 2008). This influence is expected to be stronger in Muslim countries, given that religion is more pervasive in such countries than today's secularized Western world. According to the research conducted by Pew Research Centre (2013, 15), in many countries the majority of Muslims¹ believe that *sharī'ah* (Islamic canonical law) should be the official law of the land. Nevertheless, Kuran (2004) claims that the Middle East became economically underdeveloped because of perpetuity of *fiqh* (human understanding of *sharī'ah*) over a long period of time. This underscores the importance of modernizing our understanding of religious economic orders to stimulate economic development in the Muslim world.

This paper investigates one of the key economic orders of Islam, that is *ribā*. The main objective is to elucidate how the scriptural injunction against *ribā* is redefined when we consider the features of modern economic systems. This study assumes that the sacred text is divinely revealed and inerrant, but its application is not immutable and must be revisited with regards to cultural context. The assumption lies in the middle of the two classical religious orthodoxy/modernism extremes put forward by Hunter (1991)² and hereinafter is called “*modernist*” Islam. Orthodox Islam, the belief of the vast majority of Muslims that takes the *Qur'ān* literally (Marty and Appleby 1992, 138), bans conventional lending because *ribā* is understood as “interest” (Azhar 2010, 287) and mandates establishment of “Islamic finance” to address the increasingly significant need of having access to formal financial service providers in everyday life.

¹ In twenty-four of thirty-seven countries of study, at least 50 percent of the Muslims support making *Sharia* the official law of their countries.

² The assumption is based on the fact that almost all Muslims believe that the *Qur'ān* is divinely revealed and inerrant (Marty and Appleby 1992; Davis and Robinson 2006); moreover, whereas the moral cosmology theory classifies people based on their beliefs regarding whether God or mankind is the ultimate judge for moral values (Hunter 1991), in Islam, morality is constituted by both God and individuals. A *ḥadīth* attributed to the Prophet Muhammad says that he has been appointed to supplement the moral virtues (Bayhaqi 2003, 192), suggesting that his mission is not establishment of ethical codes, but rather completing the codes and giving extra incentive for greater commitment to them.

Advocates of this novel financial engineering argue that it is superior to conventional finance, because it is based on equity participation and risk sharing (Khan 1988; Khan and Mirakhor 1990).

In practice, however, Islamic banks mostly use the nonprofit-and-loss sharing paradigm (Mills and Presley 1999) and seek the same objective as their conventional counterparts (Kuran 1993). As a result, Islamic finance is regarded by academic researchers (el-Gamal 2006; Hamoudi 2007) as a merely formalistic method to circumvent the doctrine of *ribā*. Maurer (2001) highlights the discontent of many Muslims about Islamic finance as a mechanism that mimics Western finance solely for the purpose of profiteering rather than encouraging organizational philanthropy. Islamic banking and finance have largely similar objectives to their conventional counterparts, but they follow different formalities to achieve their goals.

The review of the *Qur'ān* shows that it condemns *ribā* but encourages *charity* instead. However, these can only be two sides of one coin. Believers must treat the poor and needy as an instance for *charity* rather than an opportunity for making profit from their needs. Some Islamic scholars,³ however, have merely focused on avoiding *ribā* to make the contemporary finance and banking legitimate for Muslims. They adopted a formalistic approach and designed Islamic finance based on the loophole they observed in the prophetic injunction against *ribā* in trade, whereas the main objective of the doctrine of *ribā*, which is treating the poor with justice and not opportunistically, has been neglected.

The most probable explanations of how the sacred injunction against *ribā* initiates Islamic finance are (1) treating the scripture more as statutes than as guidelines, (2) adopting a more literal than purposive approach in interpretation, (3) relying excessively on *aḥādīth* (Prophet Muhammad's words) for exegesis of the holy book, and (4) overlooking the features of the modern economic systems. This study contributes to several bodies of literatures. First, it adds to the literature on the influence of religion on economic behavior and shows how orthodox Islam shapes financial systems. It also contributes to the literature on *usūl al-fiqh* (principles of Islamic jurisprudence) and brings to light the importance of adopting purposivism

³ In this paper, I define "Islamic scholars" and "Islamic jurists" as Muslim specialists in Islam and Islamic law.

and considering *maqāsid al-sharī'ah* (the higher objectives of *sharī'ah*) in exegesis of sacred texts to avoid absurdity.⁴

Second, this paper is related to the extensive literature on Islamic finance. It examines the criticisms brought up by proponents of Islamic finance against conventional finance as the *ḥikmah* (purpose) of the prohibition and claims that they are invalid or not applicable. This reemphasizes the importance of realizing the features of the modern economic system in deducing economic orders of Islam. Indeed, conventional lending practiced in formal financial systems is not against the doctrine of *ribā* so long as it is fulfilled on the basis of justice and does not consider the poor as a profit-making opportunity.

Third, this study contributes to the religious literature, in particular the small but growing literature on Islam and modernity, which tries to renew Islamic thoughts by understanding Islamic scripture within its historical context and establish its implications in line with the current circumstances (Rahman 1982; Cooper, Nettler, and Mahmoud 1998; Kersten 2011). This article advocates the view of several cosmopolitan Muslim intellectuals such as Fazlur Rahman, Muhammad Asad, and Abdullah Saeed and proposes to redefine *ribā* as oppression of the poor and an exploitative approach toward the needy in any form within a macroeconomic setting, in lieu of replicating conventional financial products and labelling them as “Islamic.” Interest-based lending was an instance of oppressing the poor in the medieval era. Today, however, the doctrine of *ribā* is broader than lending. One can consider “payday lending” and “corporatocracy” as prevalent examples of *ribā* in the modern world. Moreover, *ribā* must be considered together with the doctrine of *charity* in one package. The latter encourages helping the poor, whereas the former bans exploiting them. Ignoring this inextricable relationship can probably explain why the modern definition of *usury* as lending at “excessive” interest rates in the Christian tradition has been inadequate in

⁴ *Maqāsid al-sharī'ah* is defined by al-Ghazali as to promote well-being of all humankind (see, e.g., Opwis 2010, 78). Shatibi indicates that Islamic laws are means but not ends. Hence, we cannot maintain the legal forms without preserving their substance (Al-Raysuni 1997, 129 as quoted in el-Gamal 2006, 44). Among contemporary Islamic scholars, Ibn Ashur was the first who attempted to adopt a *maqāsid* approach in *fiqh* (Islamic jurisprudence) (Ibn Ashur 2013). A number of recent Islamic scholars have also advocated a *maqāsid* approach (see, e.g., Kamali 2011). In the common law system, which is similar to Islamic law in the *Sunni* school of thought, the trend has been changed toward purposivism (Burrows 2002), and since 1969 several commonwealth countries such as England, Wales, and Canada have adopted the purposive interpretation of statutes (Barak 2005, 86; Sullivan 2008, 1).

preventing predatory lending practices (Mews and Abraham 2007). Therefore, the whole economic system should be designed such that the poor are treated fairly and become less vulnerable to economic exploitation. This is in line with the general belief that Islamic scripture acknowledges differences among people and does not mandate government intervention in the economy other than responsibility towards the poor (Kamali 2002, 136–38, cited by Davis and Robinson 2006).

This paper indicates that the modernist Islam has the potential to surpass its orthodox counterpart in effective support for the poor, and revisiting our religious understanding can accelerate poverty alleviation in the Muslim world. This is particularly important considering the fact that many Muslim-majority nations are among the poorest in the world (Pew Research Center 2011).

THE DOCTRINE OF *RIBĀ*

Ribā versus Charity in the Qur'ān

In the *Qur'ān*, there is a considerable emphasis on helping the poor and needy in different forms such as *zakāt*, *sadaqah*, *infāq*, and *qard al-hasan* (collectively called “charity” in this paper). *Zakāt* is one of the main pillars of Islam and the most important duty of Muslims after prayer (“*salāt*”).⁵ The *Qur'ān* encourages *charity* and emphasizes that helping the poor for the sake of God is highly valued and is a prerequisite for attaining righteousness (3:92; 2:177; 63:10; 64:16; 70:15–25; 73:20).

Knowing that it is difficult for human beings to sacrifice their own utility for the sake of others, God inspires believers to participate in *charity* in different ways, for example by instructing them to purify their properties by *charity* (9:103), promising them reward (2:110, 262, 272, 274; 9:121; 57:7; 73:20), multiplying the reward (2:245, 261; 28:54; 64:17), assuring them that the reward will not perish (35:29), and promising that *charity* will keep them away from Hell (70:15–25). In this context, a person who

⁵ In twenty-six verses, *zakāt* follows *salāt*: Chapter 2: verses 43, 83, 110, 177, 277; 4:77, 162; 5:12, 55; 9:5, 11, 18, 71; 19:31, 55; 21:73; 22:41, 78; 24:37, 56; 27:3; 31:4; 33:33; 58:13; 73:20; 98:5. In seven verses, *infāq* follows *salāt*: 2:3; 8:3; 13:22; 14:31; 22:35; 35:29; 42:38. The charitable nature of *infāq* in the *Qur'ānic* context is elaborated in chapter 2: verse 215. In chapter 9: verse 103, wealth and properties are purified by *sadaqah*. In six verses, Muslims are encouraged to grant *qard al-hasan*: 2:245; 5:12; 57:11, 18; 64:17; 73:20.

considers the financial need of the poor as a profit-making lending opportunity, rather than a religious obligation, indeed attempts to enervate the order of God and discourage believers from observing one of the main principles of Islam. Hence, the *Qur'ān* considers taking *ribā* as one of the worst sins and establishing a war against God and His Prophet (2:279).⁶

Ribā in Sales in Aḥādīth

Ribā is not precisely defined in the *Qur'ān* (al-Sanhuri 1956, 196), it is merely contrasted with *charity* (Hamoudi 2007; Farooq 2009), yet it has been attributed by major *Sunni* Islamic schools of thought to the practice of increasing an outstanding debt against postponing the due date. It is called *ribā al-jāhilīyyah* (or *pre-Islamic ribā*). This is the *ribā* that the Prophet Muhammad points out at his farewell pilgrimage (Ibn Rushd, 1999, 158). *Ribā* in the *Qur'ān* has a wider definition in *Shī'ah* school, and it includes the accrued interest of a debt in the first place (Bojnordi 2010). In *aḥādīth*, the term “*ribā*” is used to elaborate some *harām* (forbidden by *sharī'ah*) forms of business “*ribā in sales*” (or *ribā al-buyu*) (Ibn Rushd, 1999, 158). *Ribā in sales* is classified into two groups: *ribā of excess* (*ribā al-fadl*) and *ribā of delay* (*ribā al-nasi'ah*).⁷

Ribā of excess occurs in transactions when a product is exchanged for the same type of product but with a different quantity, for example one kilogram of high-quality dates against three kilograms of low-quality ones. *Ribā of delay* occurs in deferred transactions of certain commodities even without any excess in them, for example, selling gold in return for receiving silver in the future. There are different views on the nature of stricture imposed by *ribā in sales*. The majority of Islamic jurists, however, believe that *ribā in sales* is “concealed” *ribā* and *ribā al-jāhilīyyah* is “manifest” *ribā* (Abu Zahra 1970, 21; al-Zuhayli [1997] 2003, 342; Rida [see al-Munajjid and Khuri 1970, 606]; al-Sanhuri 1956, 242–64, among *Sunni*

⁶ In the *Qur'ān*, *ribā* is discussed against *charity*: In chapter 2, verses 261–74 and 277 elaborate the importance of *charity* (*infāq*, *sadaqah*, and *zakāt*), and encourage believers to help the poor, whereas *ribā* is condemned in verses 275–76 and 278–80. In chapter 3, verses 130–34, believers are advised not to take *ribā* to avoid Hell, whereas paradise is promised to those who obey God and His Messenger, do *charity* (*infāq*), restrain their anger, and forgive people. Verse 39 of chapter 30 points out that *charity* (*zakāt*), contrary to *ribā*, will be increased and multiplied by God.

⁷ Some authors (see, e.g., al-Zuhayli [1997] 2003, 311) call it *ribā al-nasā*. They use *ribā al-nasi'ah* for *ribā al-jāhilīyyah*.

jurists; Bojnordi 2010, from *Shī'ah* school of thought). “Concealed” *ribā* is forbidden as a preventative measure to avoid by-passing the ban on “manifest” *ribā*, that is, the *ribā* that is prohibited for itself (Saleh 1986, 26–27). In other words, the stricture against *ribā in sales* aims at closing the loopholes for attaining *ribā al-jāhilīyyah*. Rahman (1964) believes that we have not found a precise definition for *ribā* in *aḥādīth*. He, nevertheless, claims that the rationale behind the prophetic injunction against *ribā* is banning any form of unfair and immoral commercial practices as quasi or “concealed” *ribā*.⁸

THE MOTIVES FOR ISLAMIC FINANCE

Several contemporary Islamic scholars, such as Mawdudī, advocate devising an Islamic state to enforce Islamic rules and govern Muslim community on the basis of Islam (Nasr 1996, 80). As a corollary, this completely Islamic society requires an Islamic economic system, which—among many of its distinctive features—must be free of *ribā*. Hence, abolishing *ribā* in the Muslim community can conceptualize instituting Islamic economy straightforwardly (Nasr 1996, 103–4; Azhar 2010, 374). This ideology launched Islamization of the economy in Pakistan in 1977 and made a significant contribution to the establishment of Islamic economics and Islamic banking thereafter (Azhar 2010, 375). Kuran (1997) describes Islamic economics as a way to distinguish Muslims from the rest as a distinct “nation.” In his view, it was as “a reaction to Westernization and itself a form of Westernization” (quoted in Maurer 2001: 11).

The idea of instituting an Islamic economy mandates devising an Islamic financial system, because interest-bearing lending even for commercial purposes is considered *ribā* by many Islamic jurists (al-Kasani, al-Shirbini, al-Zuhayli, and Abu Zahra, among others).⁹ To abolish *ribā* and fulfil the requirements

⁸ Please see Saleh (1986), Ibn Rushd (1999), and Fadel (2008) for a detailed discussion on *ribā of excess* and *ribā of delay*.

⁹ Al-Kasani (1997, 4983 cited by Fadel 2008) argues that self-interested loans are prohibited because of their resemblance to *ribā*. Al-Zuhayli ([1997] 2003, 321, 342–43, 346–47) claims that commercial lending cannot be exempted from the injunction against *ribā*, because the ban was first introduced about a wealthy person, namely Al-Abbas. He also believes that it is analogous to *ribā al-jāhilīyyah*, it is unfair, and it exacerbates wealth inequality. Abu Zahra (1970, 23–24) outlaws commercial lending and argues that allowing interest in lending would change money into an object of commerce, whereas it is merely an instrument for measuring the value of commodities. Al-Shirbini

of *sharī'ah*, Islamic scholars initiate the so-called “Islamic finance” on the basis of the Islamic rules on transactions, wherein Islamic financiers play the role of a trader in lieu of a lender or use a profit and loss sharing paradigm. To grant credit, Islamic financiers enter into sale contracts instead of loan agreements,¹⁰ because credit sales are excluded from the injunction imposed by the doctrine of *ribā in sales*, as it comprises the exchange of items from different genera with different units of measurement (Saleh 1986, 47–48; al-Zuhayli [1997] 2003, 342). One can sell a product on credit at a higher price by incorporating the time value of money (interest). Because default penalties are subject to *ribā al-jāhilīyyah* by major jurists, Islamic financiers use rebates to encourage their clients for timely payment (Khan and Ahmed 2001). They embed an excess to the credit sale price, which will be paid back to clients if they fulfil their payment commitment on time. In some countries, such as Pakistan, the default penalty is allowed only if it is spent on charity (Baele, Farooq, and Ongena 2014). In Iran, to collect default penalties, a covenant is added to Islamic finance contracts that commits clients (borrowers) to remunerate financiers for a prespecified damage/loss to be incurred by financiers due to clients’ nonfulfillment of payment commitment on due dates (Bojnordi 2003).

(1994, 363 cited by Fadel 2008) also believes that self-interest loans are forbidden. Among *Shī'ah* scholars, Mousavian (2005) points out that in a *ḥadīth* attributed to Musa al-Kadhīm, the seventh Imam of Twelver *Shī'ah*, commercial lending is classified as *ribā*. There are a number of jurists, however, who exempt this type of lending from the doctrine of *ribā*. Rashid Rida claims that interest-bearing lending is lawful, though charging further interest for postponing the due date is forbidden (see al-Munajjid and Khuri 1970, 606–69 cited by Saleh 1986, 28). Al-Sanhuri believes that today the nature of lending has changed, and interest-bearing lending has a pivotal role in the modern economy. Therefore, the ban on such loans can be lifted (see al-Sanhuri 1953, 240–41 cited by Saleh 1986, 36). Muhammad Abduh, the Grand Mufti of Egypt, argues that interest in the modern financial system is different from *ribā* (see Azhar 2010, 372). Rahman (1964) claims that the rate of interest functions as the price for loans and equalizes supply and demand for bank credit; hence, setting it to zero in the current economic structure is not practical. Asad (1980, 845) points out that the rationale behind the injunction against *ribā* is preventing exploitation of the economically weak borrowers by wealthy and strong lenders; therefore, the moral aspect of a financial transaction determines whether it is subject to *ribā*. Azhar (2010, 284–85) reports that the Grand Sheikh of al-Azhar University in December 2002 states that interest in modern banking is not subject to the prohibition of *ribā*. Among *Shī'ah* jurists, Bojnordi (2010) and Saanei (2004) claim that commercial lending is not subject to the ban imposed by *sharī'ah*. They believe that the prohibition of interest in lending is merely attributed to *qard* to the poor and needy.

¹⁰ Islamic terminology for lending is *qard* (or *qard al-hasan*). The exegesis of the *Qur'ān* suggests that *qard* has a charitable nature (chap. 2:280). As such, the person making a *qard* cannot expect any benefit or excess from the receiver of the *qard*. Because of its charitable nature, *qard* is excluded from the rule of *ribā of delay*, although it embeds a deferred settlement. *Qard* with interest loses its charitable nature and hence is considered *harām* by the *Sunni* doctrine of *ribā of delay* (Fadel 2008). It is prohibited according to the *Shī'ah* school of thought on the basis of the charitable nature of *qard* (Bojnordi 2010). Please see el-Gamal (2006) for structure and mechanism of Islamic finance products.

CRITIQUES OF MAINSTREAM ISLAMIC FINANCE

Lack of Distinctive Economic Merit

Islamic banks finance their clients using trade transactions. For instance, in *murābaḥa*, Islamic banks purchase the underlying goods on the spot and then resell them at a higher price to their clients. For the purchase of the goods, they normally give agency to their clients to avoid a real trade. Because ownership carries its specific risks, clients are required to foresee necessary arrangements to avoid any loss to Islamic banks. This framework follows the objective of a simple loan contract in conventional finance, but through a more complicated procedure.

Several scholars believe that functionally, there is little difference between Islamic and conventional financial products; Islamic banks are merely mimicking conventional banks (Kuran 1993, 2004a; el-Gamal 2006; Hamoudi 2007; Khan 2010). Kuran (1993) attributes the similarity of the two systems to the fact that both are practiced in an asymmetric information environment. As such, Islamic banks have no choice but to follow the same techniques and principles that are adopted by conventional banks. Saeed (1999, 17) argues that for many Muslims the scriptural injunction against *ribā* aims at preventing exploitation of the poor. Therefore, the current interpretation of *ribā* in *fiqh* is insufficient for them, because it does not account for the ethical aspect of the injunction. He also indicates that the substitution of loan agreements with sale contracts transformed *ribā* into a legal concept, whereas it initially carried an economic sense (Saeed 2011, 55–56).

El-Gamal (2006) argues that Islamic finance provides little economic value and suffers from economic inefficiency because of its higher transaction costs. He attributes this problem to the inference method of major *Sunni* scholars, which, similar to common law tradition, is based on reasoning by analogy from juristic precedent.¹¹ He points out that we should focus more on the substance and spirit of Islamic

¹¹ He believes that although the *Shī'ah* school allows its jurists to use different means of judicial inference such as reason (*aql*), the principle of caution (*ihtiat*) has tempted the accorded freedom. Moreover, *Shī'ah*-dominated countries have extrapolated Islamic finance from *Sunnis*.

law (*maqāsid al-sharī'ah*), which in his opinion avoids excessive indebtedness and risk taking. He further claims that we should stick to forms, though they are inefficient, to ensure adherence to religion and, at the same time and more importantly, follow the economic substance of Islamic law. However, Hamoudi (2007) argues that a formalist approach, which is applicable in particular religious rituals, cannot be used in finance because finance has a functional nature and financial institutions have emerged for functional reasons; therefore, approaching financial institutions in a highly formalist manner seems meaningless. He puts forth the case of *murābaḥa* and points out that it can be easily manipulated to function exactly the same as interest-based loans.

Farooq (2008) points out that despite great emphasis of Islam, poverty alleviation is not the focus of Islamic economics and indeed is not able to mitigate widespread poverty in the Muslim world, because it suffers from lack of sufficient economic substance.¹² Khan (2010) argues that after three decades from its inception, Islamic banking and finance is functionally very similar to conventional banking despite its advocates who claim that Islamic finance will distinguish itself by stronger promotion of justice and wealth equality (Chapra 1985; Usmani 1998, 15–16). Overall, many scholars (Vogel and Hayes 1998, 86; Fadel, 2008) do not find the theories forwarded to explain the doctrine of *ribā* convincing.

There is a general consensus among Islamic jurists that default penalties are a “manifest” *ribā*; however, the way it is treated under Islamic finance shows how formalistic the existing approach is. The other example is the relationship between Islamic banks and their depositors. Islamic banking theory claims that realized profit or loss must be shared between Islamic banks and depositors. In practice, Islamic banks pay a market rate of return to their depositors irrespective of the actual outcome to avoid runs on the bank (Obaidullah 2005). Chong and Liu (2009) show that in Malaysia the payout to Islamic banks’ depositors

¹² Interestingly, concurrent with the inception of Islamic finance in the mid-1970s, microfinance was introduced by Muhammad Yunus, an economist in Bangladesh, as a new paradigm for lending to the poor without collateral at a relatively lower interest rate than what informal moneylenders or classical commercial banks offer (Armendáriz de Aghion and Morduch 2005).

are pegged to conventional banks' deposit rates. Hence, deposits in Islamic banking serve the same function as deposits of conventional banks, but with a different form.

Treating the Holy Scripture as a Legal Text

Islamic jurists treat the sacred scripture as a legal text and attempt to make it possible for Muslims to carry out their financial activities without violating religious orders and, where necessary, use the loopholes and benefit from regulatory arbitrage. Saleh (1986, 48) explains that preagreed excess in lending makes a loan usurious, but tricks (*hiyal*) can be used for by-passing the law:

Furthermore resorting to *hila*, with intent to overturn the prohibition of agreeing beforehand on the payment of an interest or a premium, is lawful at least for the *Hanaḥīfs* and *Shāfi'īs*, the two main Islamic schools of law which allow the use of *hiyal*. (Saleh 1986, 48)

He defines *hiyal* as follows: “*Hiyal* (sing. *hīla*) are described as lawful means used, knowingly and voluntarily, to reach an unlawful objective” (Saleh 1986, 48). Interestingly, during the Ottoman Empire, it was common to by-pass the injunction on *ribā* by selling a worthless handkerchief at a price equal to the accrued interest to the borrower (Fadel 2008).

Overreliance on Aḥādīth for Exegesis of the Qur'ānic Injunction

Islamic finance has evolved primarily to address prophetic stricture on certain types of trades rather than *Qur'ānic* injunction on *ribā*, whereas Rahman (1964) underscores that to understand the prophetic injunction against *ribā*, we should first find out the rationale behind the *Qur'ānic* stricture. This is in line with the principles of Islamic jurisprudence that mandates referring to the *Qur'ān* in the first step and then *aḥādīth* for clarification of any ambiguity (Azhar 2010, 280). Tabatabai ([1973] 1983, (1) 25) also questions exegesis of the *Qur'ān* by *aḥādīth*, because in his view the sacred book must be interpreted in the first instance on its own, using other verses from the *Qur'ān*, and *aḥādīth* must be in accordance with the *Qur'ān* (to obtain credibility) and complement it. This methodological disorder and excessive reliance on *aḥādīth*

can also explain how the attempt to observe stricture on *ribā* has led to the emergence of the so-called “Islamic finance.”

FALLACIES AGAINST COMMERCIAL LENDING

Many Islamic jurists (al-Kasani, al-Shirbini, al-Zuhayli, and Abu Zahra, among others) believe that restriction of interest in lending also includes lending for business and investment purposes.¹³ They attempt to justify their view on the scope of the prohibition by explaining the *ḥikmah* of banning interest in commercial lending. In this section I examine the rationale set forth by them.

Interest in Lending is Injustice

A number of Islamic jurists (see, e.g., Abu Zahra 1970 and al-Zuhayli [1997] 2003) believe that taking interest in lending in any form is injustice and oppression of borrowers, because they have to repay debt irrespective of their earnings. This argument could be true during the medieval era, because at that time lenders were wealthy and had more bargaining power compared with those borrowers who were poor. In his exegesis of the *Qur’ān* and explaining the stricture on *ribā* (chap. 2: 275–81), Tabatabai [1973] 1983 mentions that the debtors must be poor to borrow on interest to procure their necessities. Contemporary financial systems, however, have evolved to mobilize small savings to meet the financing needs of entrepreneurs who are generally wealthier than savers, because modern theory of finance suggests that borrowers must have adequate wealth to convince lenders that they have enough incentive to exert effort and properly implement the underlying projects (Stiglitz and Weiss 1981; Tirole 2006). In addition, as of the 1920s, borrowers are protected by limited liability and, in the case of default, there are no (or at least limited) nonpecuniary penalties such as physical penalties or jail as was practiced in ancient history (Diamond 1996). Moreover, in many countries, interest stops accruing from the time bankruptcy is filed (for instance Chap. 11 U.S.C. § 502(b) (2006) in the United States).

¹³ Azhar (2010, 287, 338) claims that the dominant view in *fiqh* is that interest at any rate is unjust and is equal to *ribā*.

In a perfect market condition, which is described by Modigliani and Miller (1958) as a world without asymmetric information problems, profit and loss sharing is the best choice and serves the purpose of fairness. In the real world, people may use equity contracts in informal markets so long as they know each other very well; however, in the formal financial system we have the asymmetric information problem. On the one hand, people currently live individually in big cities rather than being clan members in small communities; on the other hand, exploiting economies of scale requires huge savings mobilization and asset allocation at a relatively long distance. This dictates the establishment of a formal financial system operating on an impersonal basis to cope with the asymmetric information problem associated with financial intermediation in the contemporary world. Townsend (1979) and Gale and Hellwig (1985) show that when the revenue of an underlying project is not easily verifiable, debt finance is the optimal contract. From the borrower's point of view, Myers and Majluf (1984) prove that with the presence of information asymmetry, equity finance is the most expensive and hence least favorable source of funding.

The context within which the prohibition of *ribā* was initially introduced has been thoroughly changed during recent centuries. The injunction made sense at the time of its emergence even for commercial lending, because entrepreneurs were not protected by limited liability, and there were no supportive laws for bankrupt firms; moreover, individuals made their investment decisions in an informal financial market with enough information from their counterparts. Now lending can even lead to the oppression of lenders; Jensen and Meckling (1976) show that debt in capital structure creates incentives for moral hazard, because managers—acting on behalf of equity holders—may follow risky projects at the cost of debt-holders.

According to premodern Islamic law, both debt-based and profit-and-loss sharing models are equally valid, and the profit-and-loss sharing paradigm is not superior to debt-based credit models (Fadel 2008). It is interesting to note that Islamic banks use mainly debt- and lease-based contracts rather than profit-and-loss sharing (Mills and Presley 1999; Aggarwal and Yousef 2000; Dar and Presley 2000; Chong and Liu 2009). This is in line with the idea of Kuran (1993) that Islamic banks follow the techniques adopted by conventional banks, because they also operate in an asymmetric information environment.

On the basis of the aforementioned arguments, one can posit that interest in commercial lending should not be considered as illicit, so long as it does not breach the justice pillar of Islam. Therefore, businesses such as payday lending, which treat needy people in an opportunistic manner, can be considered as the subject of the doctrine of *ribā*. In Colorado, for instance, the payday loans originated between July 2000 and December 2008 on average are \$300 in value, bear a \$55 charge at an annual interest rate of 452 percent for a period of seventeen days, and renewed several times (DeYoung and Phillips 2009).

The other issue raised by a few jurists is that interest-based lending put capital in a better position than labor. For instance, Abu Zahra (1970) claims (as quoted in Fadel 2008): “the spread of lending at interest is nothing other than the severe tyranny of capital over labor and all other means of production.” This argument is not valid, because within Islamic modes of finance, *muḍarabah* is a form of contract under which a party provides capital to the entrepreneur and the return would be shared between them. Entering into this contract in lieu of debt does not guarantee a fair treatment of capital versus labor because in economies with less developed financial systems and scarcity of capital, an investor can claim a higher proportion of profit or demand the full return of her capital before any payoff to the entrepreneur.

Interest in Commercial Lending Must Be Forbidden as a Prophylactic Rule

Another argument is that because of its resemblance to *qard al-hasan*, interest in commercial lending is prohibited, because the popularity of this type of *ribā* discourages Muslims from charity and granting *qard al-hasan*. For instance, Abu Zahra (1970) claims (as quoted in Fadel 2008: 677): “The proliferation of lending at interest has encouraged many to become extravagant and neglect to save.” This argument may be valid and true; however, the existing Islamic finance cannot be a solution because it suffers from the same criticism. Prohibition as a prophylactic rule is not relevant in the contemporary world with developed financial systems, because there are so many alternatives for investment.

Money Does Not Have Any Intrinsic Value

In response to critics of mainstream Islamic finance and its resemblance in function to conventional finance, for example the case of *murābaḥa*,¹⁴ several Islamic jurists argue that interest in lending is essentially unlawful, because money does not have any intrinsic value and is merely an instrument to measure value. For instance, Abu Zahra (1970) claims (as quoted in Fadel 2008): “Currencies are the means of valuation, so time by hypothesis does not affect them.” This argument is also stated by prominent Islamic scholars such as al-Ghazali (see Islahi and Ghazanfar 1998, 36), Ibn Khaldun (see Ibn Khaldun [1377] 1967, 298), and Ibn Taymiyyah (see Islahi 1988, 139).¹⁵ This claim, which is similar to and possibly based on Aristotle’s view that money is sterile (Glaeser and Scheinkman 1998), has little connection with the verses of the *Qur’ān* that condemn *ribā*. Azhar (2010, 287) examines equality of interest and *ribā* in both the *Qur’ān* and *aḥādīth* and finds no sufficient evidence for it.

The argument that money does not have any intrinsic value is not true because money by definition also serves as a means for storing purchasing power; this is exactly why one is ready to pay interest to borrow money. Interest represents the time value of money, because one unit of money today, in general, is worth more than one unit of money in one year. Interest rate is, therefore, an exchange rate across time; it helps us to convert money from one point in time to another (Berk and DeMarzo 2011).

IMPLICATIONS OF THE DOCTRINE OF *RIBĀ* IN THE MODERN WORLD

¹⁴ If interest in lending is an injustice, then credit sale at a higher price that includes an excess similar to interest in lending must be also considered unfair.

¹⁵ Interestingly, the *fiqh*, which believes money does not have intrinsic value, implicitly recognizes the time value of money in trade, because it is permissible to include interest in the price of goods to be sold on a deferred payment basis (Obaidullah 2005). This allows us to show that, under two conditions, money has intrinsic value even in view of the *fiqh*. (1) The monetary authorities issue money based on the volume of all goods and services in the economy, which implies that the underlying assets of money are all goods and services in the economy. This condition is in line with the view that the volume of money in the economy is fixed, and this is why a money system is also called a discipline system, whereas the volume of credit in the economy expands and contracts, that is, a credit system has elasticity (Mehrling 2013). (2) The rate of return on money should be equal to the expected growth rate of the economy. This is in line with Piketty (2014) who argues that interest rates on government bonds more than economic growth can exacerbate inequalities. Money, under these two conditions, similar to hybrid *sukūk* (Islamic equivalent of conventional bonds issued based on a pool of assets), has intrinsic value, and therefore its trade is permissible.

Juxtaposition of *ribā* with *charity* in the *Qur'ān* shows that the poor should not be treated opportunistically. The holy book also emphasizes that trade is not the same as *ribā* (2:275). The formalistic approach toward the scriptural injunction leads to reshuffling the process of taking interest by replacing loan contracts with trade agreements. However, if we consider *maqāsid al-sharī'ah* and the features of the modern economic system, we will come to a different conclusion. The injunction will then mandate the ban on any form of exploitation of the needy. For instance, trade is intrinsically allowed. Yet, it can be usurious when it is established based on the need of the poor. In other words, one can exploit a needy person either in the form of a conventional loan or a *murābaḥa* agreement. Moreover, the prohibition of *ribā* under a purposive approach will not imply the illegitimacy of conventional lending per se, because it does not necessarily treat the poor opportunistically.

To understand the contemporaneous implications of the doctrine of *ribā*, we should answer two questions. The first question is whether the doctrine of *ribā* is applicable in the contemporary world considering that people have the right to enter into financial contracts at their own discretion. There are two arguments that highlight the necessity of placing protective regulations to prevent exploitation of the poor. Firstly, prospect theory proposed by Kahneman and Tversky (1979) shows that people generally make decisions based on certain heuristics rather than rational principles. In addition, the theory explains that people are extremely conscious about losses at the reference point and therefore are vulnerable to exploitation. Secondly, Bocian et al. (2013) outline how different forms of predatory lending trap borrowers in long-term debt and prevent them from progress and savings. They also point out that during the last decade, American households have become more vulnerable to predatory lending due to macroeconomic conditions. Moreover, several studies reveal that loan churn accounts for about 76 to 80 percent of total payday loans (Parrish and King 2009; Consumer Financial Protection Bureau 2014). This volume of loan churning is estimated to increase the fees by at least \$2.6 billion per year (Montezemolo 2012).

The second question is: How should the doctrine of *ribā* be enforced? Would it be sufficient if we redefine it as “*excessive interest*” versus “*fair interest*”? Today, Oxford Dictionaries define *usury* as “the practice of lending money to people at unfairly high rates of interest,” and almost all the US states have

determined interest rate ceilings to prevent exploitation of the poor and at the same time recognize a just compensation to the lender; however, the efficacy of this policy is questionable, because it is not clear how we should determine a “fair” interest rate and the poor pay very high rates of interest (Lewison 1999; Mews and Abraham 2007). Interest rates are established by market forces, and lenders demand a higher compensation from poor borrowers because they are presumed to be riskier. Hence, setting the ceiling just slightly above the market rate will dissuade the lender from lending to the poor who may then have no choice other than to accept predatory lending practices (Lewison 1999).

Mews and Abraham (2007) argue that it is not merely interest rates that make a loan usurious; other conditions surrounding the loan should be also considered. They suggest that *usury* must be confronted systematically to reduce the need for predatory loans. In fact, limiting *ribā* or *usury* to fairness in financial transactions has proved its insufficiency.

The doctrine of *ribā* attempts to prevent oppression of the poor and exploitation of the needy. It complements the emphasis on helping the poor prescribed by the doctrine of *charity*. Implications of the doctrines of *ribā* and *charity* need to be revisited by paying sufficient attention to the features of the contemporary world and the fact that they are inextricably linked. Rahman (1964) also believes that any form of immoral financial and economic transactions is subject to the doctrine of *ribā*, and we should establish the economic system based on *sadaqah* (*charity*).

Interest-based lending in the medieval era was an instance of exploitation of the poor. Nowadays the poor can be oppressed and exploited through a wide range of macroeconomic policies and not merely through lending mechanisms. “Corporatocracy” can be considered as a prevalent instance of *ribā* in the modern world; the existing literature has discussed the features of this phenomenon and how it exploits the nations. Perkins (2004) describes various interventions in the Middle East and Latin America for the benefit of large US corporations, primarily in the form of indebting developing countries for construction of huge projects that mainly benefit the wealthiest families and local elites rather than low-income people. Phelps (2010, 2013) argues that the economic slowdown in the post-1960s was caused by the influence of large corporations over government that repressed free market dynamism and innovation. Stiglitz (2011) claims

that income inequality is caused by manipulation of financial systems in favor of the wealthiest individuals. Hyman (2011) argues that in the post-Bretton Woods era, due to abundant liquidity and asset-price appreciation, increase in wage is replaced by expansion of consumer credit, resulting in a significant rise in household's indebtedness. Kane (2015) claims that most financial crises occurred because governments attempted to channel credits disproportionately to politically connected firms. Saez and Zucman (2016) point out that US income growth primarily occurs among the richest families in the top 0.1 percent of income distribution. Their wealth share increased from 7 percent in 1978 to 22 percent in 2012.

Thus, to observe the scriptural injunction in the modern world, we should revisit our economic and political systems to mitigate the influence of special interests on government and legislation and provide the poor and low-income households with fairly equal opportunity for education, health, and any other basic necessities in order to reduce the need of the poor for predatory lending and their vulnerability to any other forms of economic opportunism.

CONCLUSION

Islamic jurists mostly overlook the emphasis of God on forgoing the speculative view on the need of the poor and helping them as demanded by the doctrine of *charity*. They juxtapose trade with lending vis-à-vis *ribā* with *charity*. They overlook the objective of the injunction against *ribā* and reshuffle the process of taking interest and embed it in trade in an attempt to omit it from lending. Rahman (1964, 31) also questions juxtaposition of *ribā* with trade in lieu of *charity* and claims that because of this confusion “juristic hair-splitting was substituted for the moral importance attaching to the prohibition of *ribā*.”

I share the idea with those who believe that Islamic jurists adopt a formalistic approach and Islamic finance serves no substantial end. Treating the sacred text as statutes combined with literal interpretation of the scriptural injunction and lack of sufficient knowledge of the modern economy results in the establishment of the so-called “Islamic finance,” which has been criticized by many scholars. Indeed, failing in its utopian ambitions, Islamic finance has contented itself with seeking the same objective as their conventional counterparts.

The *Qur'ān* is a book for guidance towards human bliss, and its social injunctions specifically must be considered and inferred purposively and with the view of the corresponding environment. This is in line with the view of prominent Islamic scholars, such as Shatibi and Ibn Ashur, who advocate consideration of *maqāsid al-sharī'ah* in Islamic jurisprudence and also the view of the Egyptian modernist, Muhammad Abduh (1849–1905) (see Moaddel 2005, 90) that we should have a different approach for *fiqh al-mu'āmalāt*—the part of *fiqh* that deals with interactions with people—compared with *fiqh al-'ibādāt*, which is about devotional rituals such as prayer. For the latter, we refer to definitions and details provided in sacred text and prophetic traditions and adhere to the forms. For the former, however, definition and solutions must be reached by interdisciplinary work considering the features of the contemporary world and the difficulties of integrating *sharī'ah* with the social science that is devised within the frames of Western epistemology (see, e.g., Khan 2013).

This study shows how differently the scriptural injunction against *ribā* can be enforced when we consider *maqāsid al-sharī'ah* and the cultural dimensions and macroeconomic settings of the modern world. The doctrine of *ribā* is broader than lending in the modern world and should be considered alongside the doctrine of *charity*. Today, the doctrine of *ribā* applies to general economic policy and designing an economic system under which the poor and needy are treated on the basis of justice and become less vulnerable to opportunistic behavior. This paper also highlights the importance of modernizing religious understanding to foster poverty reduction, in particular in societies where religion is prevalent.

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