

The *Riba*-Interest Equation and Islam: Reexamination of the Traditional Arguments

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NOTE: Because this topic involves what is haram (prohibited) and halal (permissible) in Islam, every Muslim MUST do his/her own due diligence and conscientiously reach own position/decision in regard to personal practice.

[**Abstract:** Islamic finance and banking movement has now become mainstream with participation and competition from the leading, multinational conventional banks. The movement is based on the Qur'anic prohibition of *riba* and the presumed *riba*-Interest equation. The literature of Islamic economics and finance routinely mention and articulate the rationales for Islamic prohibition of interest. This paper examines the merit and relevance of traditional arguments, especially in light of the claims and conduct of the Islamic financial institutions.]

I. Introduction

From a very modest beginning of Islamic banking in the early 1970s,¹ now there are Islamic banks or other financial institutions in 70 countries, including some in which the Muslims are not a majority.² With total capitalization of \$200+ billion as of 2000 [Warde, p.1], the Islamic banking movement is now entering an enviable and formidable phase, as even the conventional financial institutions in the West are not only opening Islamic windows for their Muslim clients, but also are aggressively working toward dominating this otherwise religious niche.

The crux of Islamic banking is freedom from *Riba*, which is commonly equated with interest³ (the fee charged by a lender to a borrower for the use of borrowed money). The relevance and Islamicity of Islamic banking movement, away from conventional banking based on interest, rests on the claimed prohibition of interest in Islam. *Riba*, of course, is categorically and indisputably prohibited in the Qur'an.

Those who devour *riba* will not stand except as stand one whom the Evil one by his touch hath driven to madness. That is because they say: "Trade is like *riba*," but Allah has permitted trade and forbidden *riba*. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (The offence) are companions of the Fire: They will abide therein (for ever).

Allah will deprive *riba* of all blessing, but will give increase for deeds of charity: For He loves not creatures ungrateful and wicked. [2/al-Baqarah/275-276]

O ye who believe! Devour not *riba*, doubled and multiplied; but fear Allah. That ye may (really) prosper. [3/Ale Imran/130]

Therefore, there is absolutely no controversy that *riba* - or at least, some types of *riba*⁴ - are prohibited in Islam. However, the meaning, scope, and relevance of the concept has generated lively controversy. The specific point of contention that has divided Muslims scholars is whether *riba* and bank interest is to be considered the same or equivalent. Another word, is interest, especially bank interest, *Riba*? Equating *Riba* with interest in general, the traditional Islamic literature, representing the Equivalence School [Ahmed, p. 28], refers to these two things interchangeably. As such, in explaining the rationale for prohibition of *Riba*, Islamic literature deals with the rationale for prohibition of interest, assuming that the two are completely equivalent.

The issue whether interest is *Riba* is important not merely as a scholarly discourse or polemics, but it is vitally important for Muslims, who want to abide by the guidance of Islam as entailed in the Qur'an and Sunnah, but also because they want to be convinced that nothing that is prohibited (*haram*) is made permissible (*halal*) and nothing that is *halal* is made *haram*. Among the contemporary educated Muslims, there is significant confusion and ambivalence about this issue of interest. The Islamic literature that equates interest with *riba* is voluminous and overwhelming, and may lead to the conclusion or impression that some consensus (*ijma*) has emerged regarding this issue.⁵

The reality is anything but. It has been a common practice among Muslim scholars and jurists to claim consensus (*Ijma*) about almost anything they have given their juristic opinion on. The very use of the word *ijma* inspires awe among faithful Muslims. However, the existence of multiple schools of jurisprudence (*Fiqh*) is not an evidence of, but lack of, consensus. Isn't there consensus within a particular school? Readers should verify this matter with their due diligence. Going through *Hedaya*, one of the leading classic texts of Hanafi *Fiqh*, one can almost randomly pick a page and see if even the three elders of Hanafi *Fiqh* (Imam Abu Hanifah, and his two disciples, Imam Abu Yusuf and Imam Muhammad) could agree on any of the issues covered in the book. The reality is that there is not even a consensus on the definition of *Ijma*. Indeed, it is reported that Imam Ahmad ibn Hanbal, founder of one of the four orthodox schools (*madhab*) made a general assertion: "Whoever claims consensus is a liar."⁶

Equating interest with *riba* is the prevailing, orthodox position. However, that position, and the claim that it enjoys a consensus among Muslims should be treated with a great deal of circumspection. Just as the voice of advocacy for Islamic banking and finance [IBF hereafter] is becoming overwhelming, there are other voices that have remained unconvinced about the relevance of such practices and even question their consistency with the *Shari'ah*.⁷ Despite the availability of fatwas (religious edicts) from the truly few *Shari'ah* experts, the literature on Islamic economics and finance so far has not convincingly removed lingering doubts about the alleged equation between interest and *Riba*.⁸ On the other hand, those who have argued against this equation, the Non-

Equivalence School [Ahmed, p. 28], have not made their arguments in clear and convincing terms so that the common Muslims can make up their own mind. Thus, this discourse needs to continue and more vigorously and engagingly.

In this essay, the focus is not on whether interest is *riba*, a topic which often gets bogged down in Islamic legalistic and scriptural sources. Rather, the focus is on the traditional arguments offered for prohibition of interest.

II. Orthodox rationales for prohibition

Here we examine the major arguments or rationales given in support of prohibition of interest and whether there has been any change or refinement in these arguments over the past few decades. We have selected two sources who take a conventional position on the issue: Yusuf al-Qaradawi and Sayyid Abul Ala Mawdudi. The reason for selecting these two polemical sources are as following: (a) While many others have written about prohibition of interest in a scattered manner, these two authors have enumerated a list of arguments against interest. (b) Modern Islamic banking/finance movement has been deeply influenced by the contemporary Islamic movements, in which these two authors are held in the highest regard. These movements seek to revive Islam as a complete code of life and as solutions to all the maladies the humanity in general is facing. In various works about Islamic economics, finance and banking, it is assumed that interest is *riba* and that the rationales for prohibition of interest is well established. Thus, the Equivalence School has rarely examined the traditional arguments or rationales from a critical perspective.

Before I continue with the above two authors, I would like to point out two more modern and recent works on this topic. The first is by M. Umer Chapra "Prohibition of Interest: Does it make sense?" which I didn't use as a source for the "traditional" polemical arguments. This work of Chapra - Research Advisor at the Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IDB), Jeddah and formerly a Senior Economic Advisor at the Saudi Arabian Monetary Agency (SAMA), Riyadh - is for readers who are more familiar with or educated about economics, as it tries to make the arguments based on the western economic experience and thoughts. Despite the fact that the work of Chapra appears to be quite sophisticated and modern to the eyes of the "believers," particularly those who have embraced the position about Islamic prohibition of interest, its superficiality, in some respects, becomes evident, when one notes how he incorrectly used some of the western references.

For example, one of the rationales Chapra invokes is "economic stability": interest causes instability, implying that interest-free economy would be less unstable. First of all, it is a fact that interest-based economies - that is, ALL modern economies - have shown tremendous vulnerability to economic instability. However, to suggest that interest-free economy would be less unstable or have smoother business cycles fundamentally begs the question: Where is the evidence? Since there has not been any true interest-free, modern Islamic economy and a few places where it is being attempted, the Islamic financial institutions (IFI hereafter) are moving closer to the conventional banks, this line of argument is also polemical in nature. A few countries that have officially (in varying

degree) gone into "interest-free" direction, Iran, Sudan, Pakistan, etc., are hardly examples of greater economic stability. If it can be empirically demonstrated that interest-free economies would be better performing in terms of (1) needs fulfillments, (2) full employment, (3) equitable distribution and (4) economic stability - the four universally-cherished humanitarian goals identified by Chapra - the pertinent discourse would rise to a new level. However, the real experience is that there is still hardly any true interest-free economy and the ones that have committed to go in that direction do not corroborate the relationship that Chapra postulates. Moreover, Chapra's use of western references to buttress his points is misleading. For example, in support of his "economic stability" argument, Chapra refers to Nobel Laureate Milton Friedman.

... economic instability seems to have become exacerbated over the last three decades as a result of turbulence in the financial markets. One of the important reasons for this, according to Milton Friedman, a Nobel laureate, is the erratic behaviour of interest rates. [referring to Friedman, Milton, "The Yo-Yo U.S. Economy", Newsweek, 15 February, 1982, p.72.]

In response to a personal query, Friedman wrote in an email [12/12/05] to this author: "The op-ed that was quoted in the article you sent me does not provide any support whatsoever for the zero interest doctrine. It was dealing with a special instance; it was referring to some time in the eighties. The period since then has shown relatively little volatility in interest rates. So it is simply out of context." In a follow-up email [12/16/2005], Friedman wrote to this author: "I do not believe there is any merit to the argument that an interest-free economy might contribute toward greater economic stability. I believe indeed it would have the opposite effect."

Indeed, there are many such leading western economists who have dealt with the "erratic" behavior of interest rates. Dar and Presley notes that "there is almost a 'tradition' in Western economic literature, albeit not mainstream, which blames interest rates and associated bank credit expansions and contractions for many of the economic evils of our time." [1999, p. 7] However, the misleading part of Chapra's use of such sources is the fact that rarely (if at all) such western economists, including Friedman or even most of the non-mainstream ones, make such arguments to propose elimination/prohibition of interest per se. In this context, it should be pointed out that Friedman, who is associated with the Monetarist school, but who is actually opposed to interventionist macro-stabilization policies, is referring here to the erratic behavior of interest rates that could, at times, be affected by activist monetary policies. Here Friedman is not indicting interest or interest rate as a problem, but "erratic behavior of interest rates." Indeed, in the same article, Friedman drives one of his common themes of Monetarism home: "stable monetary growth," which is a cardinal component of the short-list of Monetarist prescriptions. Has Friedman, anywhere in his writings, ever made even cryptic remarks to indict interest itself? This is an inappropriate reference to Friedman, who was not even be aware that his argument about interest in the context of activist stabilization approach is being used by some Islamic economists to articulate a rationale for prohibition of interest.

The second of the more recent works, and probably the most comprehensive of any of these, is by Muhammad Nezatullah Siddiqi. In a book *Riba, Bank Interest, and The Rationale of Its Prohibition* [2004], Siddiqi offers a thorough work in explicating the rationales of prohibition of bank interests, and lists the following reasons for the prohibition of *riba* [p. 41]:

Riba corrupts society.

Riba implies improper appropriation of other people's property.

Reba's ultimate effect is negative growth.

Riba demeans and diminishes human personality.

Riba is unjust.

Siddiqi flawed logic can be identified by simply examining his first point? That *riba* corrupts society. While *riba*-based transactions are unjust and thus may have corrupting influence on society, but the corruption studies or corruption-related literature does not identify interest anywhere as one of the determinants of corruption. Indeed, most of the Muslim-majority countries rank high in the Corruption Perception Index (CPI).⁹ But corruption-related studies pertaining to these countries done by either non-Muslims or Muslims have never identified interest as one such determinant of corruption. As we will see, Siddiqi's enumeration is generally not much different from the earlier ones by Mawdudi and al-Qaradawi/al-Razi, and is as polemical as well as empirically unsubstantiated and untestable as ever. However, he offers a detailed response to those who do not equate interest with *riba*, and those who argue against the *riba*-interest equation need to be able to effectively address such response.

Now, let me return to the two authors, al-Qaradawi [1926- AD] and Mawdudi [1903-1979 AD], who have enumerated a list of rationales for prohibition of interest. Interestingly, al-Qaradawi did not even bother to come up with his own (formulation of) arguments. Instead, he reproduced arguments given by Imam Fakhr al-Din al-Razi [1149-1209 AD], a towering Islamic scholar of 13th century. Implied in al-Qaradawi's view, the rationales for prohibition of interest is a settled matter and its articulation during 13th century AD remains equally valid and relevant.

One must note that these rationales are identified and articulated by human beings, who are liable to err. The Qur'an does not provide such detailed list of arguments. Only one rationale is identifiable from the Qur'an: exploitation/injustice (*zulm*): "If you do it not, take notice of war from Allah and His Messenger: But if you turn back, you shall have your capital sums: Deal not unjustly, and you shall not be dealt with unjustly." [*la tazlimoona wa la tuzlamoon*; 2/al-Baqarah/279] Hadith (Prophetic narrations) also does not provide in this context any specific rationale other than what is clearly identified in the Qur'an.

III. Rationales according to al-Qaradawi (actually, al-Razi)

According to al-Qaradawi: The strict prohibition of interest in Islam is a result of its deep concern for the moral, social and economic welfare of mankind. Islamic scholars have given sound arguments explaining the wisdom of this prohibition, and recent studies have confirmed their opinions, with some additions and extensions of their arguments." Then,

Al-Qaradawi merely refers to and quote al-Razi's four arguments: (1) *Unfair exchange* (taking something from a party without giving him something in return); (2) *economic argument*: similar to Mawdudi's idle class argument; (3) *moral argument*: Undermining of charitable attitude among people; and (4) *social argument*: Lenders are usually wealthy and borrowers are generally poor, a disparity leading to exploitation and undermining of human kindness and charity. [al-Qaradawi, pp. 265-266].

Let us first note that the real issue about interest involves commercial transactions, not non-commercial (or charitable) transactions. However, it seems that the traditional arguments against interest are inseparable from non-commercial transactions, and the arguments against interest do not really distinguish between commercial and non-commercial context.

Now let us examine al-Razi's arguments, articulated by al-Qaradawi.

First: The taking of interest implies appropriating another person's property without giving him anything in exchange, because one who lends one dirham for two dirhams gets the extra dirham for nothing. Now, a man's property is for (the purpose of) fulfilling his needs and it has great sanctity, according to the hadith, A man's property is as sacred as his blood. This means that taking it from him without giving him something in exchange is haram. [p. 265]

One can argue that, in trade, taking something from someone without giving something in exchange is *haram* (prohibited). However, the argument is misleading and erroneous. When a non-charitable transaction is involved, both the parties know what the lending and borrowing entails. The borrower is borrowing for some commercial or personal benefit and the lender is lending for profit motive. In such non-charity context, the lender is giving up or foregoing the purchasing power for a specific period. Even without taking into consideration the time value of money argument, why a profit-orientated lender would lend at zero interest? We will ignore here the issue of nominal vs. real interest.¹⁰ In case of the extra *dirham*; it is the agreed compensation to the forgone purchasing power for the fixed duration. The lender is getting interest for transferring something; it is not something for nothing.

The Islamic economics/finance literature generally denies that Islam recognizes time value of money. [El-Gamal 2000, quoting Mawdudi and al-Sadr]. "[I]n *Shari'ah*, there is no concept of time value of money." [Usmani, p. xvi] Some authors think that time value of money as pertaining to sales (deferred sales, to be specific) is allowed in Islam, but that it is not the same kind of time value of money as in case of loans. [Saadallah; M. Akram Khan cited in Vogel and Hayes, p. 202] Others even suggest that there should not be any profit-motive on the part of Muslims, seeking service from Islamic Banks.¹¹ However, whether it is denied at the polemical level, the Islamic financial institutions at the operational level have not been able to avoid time value of money. Cost of short-term and long-term financing from such institutions does differ, which is a clear evidence of time value of money. [Zaman & Movassaghi, 2001] Indeed, in modern commercial and

economic context, interest is recognized as the time price of money, and its equivalent is found in *Murabaha*, cost-plus financing in purchase and resale.

Murabaha finance and the higher credit price involved therein has clearly shown that there is a value of time in *murabaha* based finance, which leads, albeit indirectly, to the acceptance of the time value of money. It has been conveniently ignored that accepting the time value of money logically leads to the acceptance of interest. [Saeed, p. 95]

Yet, there is a routine denial by many practitioners and advocates of Islamic banking and finance that Islam does not recognize time value of money. Interestingly, such proponents of Islamic banking often cite the growing interest of western banks in Islamic banking as one of the achievements of the movement. "Another achievement of Islamic banking may be gauged from the fact that many conventional banks have also started using Islamic banking techniques in the conduct of their business, particularly in dealing either with Muslim clients or in dominantly Muslim regions." [Iqbal and Molyneux, p. 58] However, denying the time value of money in theory, but embracing it in practice helps to explain the western interest in "interest-free" banking, which is not because the conventional western banks are now convinced about the claimed superiority of Islamic finance/banking in general, and Islamic financial products in particular,¹² but because from their perspective they don't find *any* substantive difference between their conventional banking and the current practice of Islamic banking, which has shifted away from profit-loss sharing (PLS)/Risk-sharing-based transactions. With basically comparable performance of Islamic banks, as documented by Samad and Hassan, it is just another vast untapped market for the western conventional banks to penetrate. In this regard, they also have serious comparative advantage in terms of credibility, experience, and capitalization.¹³

Imtiaz Uddin Ahmad (1995) points out those *Murabaha* transactions are generally highly profitable and relatively less risky. Heavy dependence of Islamic Banks on *Murabaha* as the primary mode of operation leads to relatively high return. Hassan [2005] reports the following result: "The average cost efficiency ... is 74%, whereas average profit efficiency ... is 84%. Although Islamic banks are less efficient in containing cost, they are generally efficient in generating profit." Of course, if this result is valid and replicable for the Islamic banking industry, then it is easily understandable why the western banks would seek opportunities for higher return, when no substantive or fundamental change in their mode of operation is necessary.¹⁴

Second: Dependence on interest prevents people from working to earn money, since the person with dirhams can earn extra dirhams through interest, either in advance or at a later date, without working for it. The value of work will consequently be reduced in his estimation, and he will not bother to take the trouble of running a business or risking his money in trade or industry. This will lead to depriving people of benefits, and the business of the world cannot go on without industries, trade and commerce, building and construction, all of which need capital at risk. (This, from an economic point of view, is unquestionably a weighty argument.) [p. 265]

There are several problems with this argument. First, there is confusion here between individual lender and institutional lender. In modern times, commercial lending and borrowing usually does not take place involving an individual lender at a personal level. Rather, there are lending institutions that mobilize savings from savers/depositors and channel such savings to the borrowers. The lending institutions do have to work. They employ a lot of people. Also, they usually work in a competitive environment (in some cases, in an environment of near-perfect competition), where they have to work harder - in every possible sense - to survive and succeed.

Second, the context of modern commercial banking has changed fundamentally since the days of al-Razi of 13th century. Actually, modern banking system even did not exist during those periods. The primary source of capital of banks is savings and demand deposit of the depositors. Demand deposits actually come from people irrespective of their financial status. A good part of the savers who use banks as their sources of return, instead of financial markets involving stocks and bonds, are usually who are older, retired people, who generally engage in risk-averse behavior. They want guaranteed or safe return. It is a need that covers, again, people of all financial backgrounds - wealthy and not-so-wealthy. Indeed, these older people can't be asked to engage in works as laborers to seek "earned" income. They are past that age. Also, at this age, they can't be expected to take risk.

Third, the movement for Islamic banks and financial institutions originally began with identifying *Mudaraba* [investment partnership involving (a) active or managing and (b) silent or capital-contributing partners] and *Musharaka* [partnership] as the primary modes of operation, arguing that Islam believes in profit-loss-sharing (PLS and thus, risk-sharing). "The most important feature of Islamic banking is that it promotes risk-sharing between the provider of funds (investor) and the user of funds (entrepreneur)." [Iqbal and Molyneux, p. 28] According to one of the leading Shari'ah experts, who also serves on almost a dozen different Islamic banks or banks with Islamic operations, Muhammad Taqi Usmani, "The real and ideal instruments of financing in *Shari'ah* are *musharakah* and *mudarabah*." [Usmani, p. xv]

However, it is now clearly established that most of the Islamic banks have now given up or marginalized those two (risk-sharing/PLS) modes, and have turned to the predominant mode of *Murabaha*, a mode that allows them to ensure that they avoid risk almost altogether in their transactions¹⁵ and earn relatively high return. These banks have found *Mudaraba* and *Musharaka* to be inoperable in the modern context. [Saeed, chapter "Murabaha Financing Mechanism," pp. 76-95; Aggarwal and Yousef, p. 106; Vogel and Hayes, p. 7] Thus, quietly they have disengaged from the PLS/risk-sharing modes and embraced *Murabaha*, which is described by many as "*murabaha syndrome*: "the strong and consistent tendency of Islamic banks and financial institutions to utilize debt-like instruments" particularly in external financing. [Yousef, p. 65]

Murabaha, which is the dominant method of investment of funds in Islamic banking, is, for all practical purposes, a virtually risk-free mode of investment, providing the bank with a predetermined return on its capital. As the Council of Islamic Ideology Report

recognises, in *murabaha* there is 'the possibility of some profit for the banks without the risk of having to share in the possible losses, except in the case of bankruptcy or default on the part of the buyer.' [Saeed, p. 87]

Murabaha was originally recognized in Islamic Fiqh as a type of sale only, not as a mode of financing. Islamic finance movement adopted and adapted it as a mode of financing "only as a device to escape interest." [Usmani, p. 41] An official document of Islami Bank Bangladesh Limited (IBBL), [Concept and Ideology](#) [Chapter 12: Issues and problems of Islamic banking] asserts: "The first action that deserves immediate attention is the promotion of the image of Islamic banks as PLS-banks. Strategies have to be carefully devised so that the image of Islamic character and solvency as a bank is simultaneously promoted. ... Islamic banks, step by step, have to be converted into profit-sharing banks by increasing their percentage share of investment financing through PLS-modes." However, an empirical study of Islami Bank Bangladesh Limited exposes an eye-opening reality: "As regards the overall investment position of the Islami Bank Bangladesh it may be concluded that, since the beginning of banking activities the bank has not invested any amount in any project on the *Mudaraba* mode of investment. Although, the Islamic banking theory as regards investment of funds and acceptance of deposits is based on two fundamental techniques such as *Mudaraba* (capital financing) and *Musharaka* (Partnership), still these principles are being applied only for collecting deposits and not for the investment." [Alam, p. 17]

Interestingly, Siddiqi, one of the leading proponents and experts of Islamic economics and banking, asserted during his earlier writings in the 1980s: "For all practical purposes this [the mark-up system or *Murabaha*] will be as good for the bank as lending on a fixed rate of interest." [Issues in Islamic Banking, p. 139] After providing some international and national statistics that illustrate the seriously skewed distribution of wealth, Sufyan Ismail writes: "Any neutral observer can see the problems the above [Capitalist banking] system causes on a macro basis in any economy. Islamic finance operates a system called *Musharaka* which ensures that the above inequalities do not occur. ... *Musharaka* lies at the heart of the Islamic Financing philosophy, where the notion of sharing in risk and return between investors and entrepreneurs finds its natural home." [pp. 16, 21] The same viewpoint was clearly echoed in The Text of the Historic Judgment on Interest by the Supreme Court of Pakistan: "The Council has in fact suggested that the true alternative to the interest is profit and loss sharing (PLS) based on *Musharakah* and *Mudarabah*. However, there were some areas in which financing on the basis of *Musharakah* and *Mudarabah* were not practicable." [1999]

"... Islamic banking has come under increasing criticism, from its ranks and from the public, for its heavy reliance on synthetic *murabahas*. Even the OIC Academy's approval of the contract is accompanied by language urging that its use be minimized and replaced by profit-and-loss-sharing investments." [Vogel and Hayes, p. 143, quoting Decision 3, 2, fifth session, 1988, Fiqh Academy Journal, 2:1599]

So, what's the solution? Let's continue to talk about *Mudaraba* and *Musharaka*, but use what is operable, i.e. *Murabaha*. The Supreme Court of Pakistan document continues:

where those two desired methods do not work, "for these areas the Council has suggested a technique usually known in the Islamic banks as *Murabaha*." According to Yousef, "the predominance of the *murabaha* represents a challenge to the very notion that Islamic finance would provide an alternative to interest-based conventional financial systems." [p. 64]

Siddiqi went much further to warn the Islamic finance industry:

... we cannot claim, for an interest-free alternative not based on sharing, the superiority which could be claimed on the basis of profit-sharing. What is worse, if the alternative in practice is built around predetermined rates of return to investible funds, it would be exposed to the same criticism which was directed at interest as a fixed charge on capital. It so happens that the returns to finance provided in the modes of finance based on *murabahah*, *bay' salam*, leasing and lending with a service charge, are all predetermined as in the case of interest. Some of these modes of finance are said to contain some elements of risk, but all these risks are insurable and are actually insured against. The uncertainty or risk to which the business being so financed is exposed is fully passed over to the other party. A financial system built solely around these modes of financing can hardly claim superiority over an interest-based system on grounds of equity, efficiency, stability and growth. [Siddiqi, 1983, p. 52]

Siddiqi did not consider *murabaha* to be Islamically an unacceptable mode. However, he did not envision and still can't reconcile with the predominance of such debt-like instruments, where PLS/risk sharing were to be the primary modes. In a more recent work, Siddiqi, one of the pioneering Islamic economists, expressed his dissatisfaction in suggesting that "As a result of diverting most of its funds towards *murabaha*, Islamic financial institutions may be failing in their expected role of mobilizing resources for development of the countries and communities they are serving." [2004, p. 75]

It is noteworthy that, contrary to popular perception of the believing Muslims, *Murabaha*, as practiced, may not be quite *Shari'ah*-compliant as generally claimed and it is heavily criticized or repudiated by many Islamic scholars and even some Islamic financial institutions.¹⁶

A number of scholars have recently cast doubts upon the acceptability of one of the most widely used forms of Islamic finance: the type of *Murabaha* trade financing practiced in London. These investors and well-known multinationals seeking lowest-cost working capital loans. Although these multi-billion-dollar contracts have been popular for many years, many doubt the banks truly assume possession, even constructively, of inventory, a key condition of a religiously acceptable *murabaha*. Without possession, these arrangements are condemned as nothing more than short-term conventional loans with a predetermined interest rate incorporated in the price at which the borrower repurchases the inventory. These 'synthetic' *murabaha* transactions are unacceptable to the devout Muslim, and accordingly there is now a movement away from *murabaha* investments of all types. Al-Rajhi Bank, al-Baraka, and the Government of Sudan are among the

institutions that have vowed to phase out *murabaha* deals. This development creates difficulty: as Islamic banking now operates, *murabaha* trade financing is an indispensable tool. [Vogel and Hayes, pp. 8-9]

However, things have fundamentally changed relative to the originally postulated principles of Islamic banking, and despite the criticisms or lack of the desired Shariah-compliance,¹⁷ cost-plus financing or *Murabaha* (mostly debt-like instruments) continue to be the mainstay of Islamic banking. In the chapter "The Performance of the Islamic Banks - A Realistic Evaluation" Usmani, a quintessential *Shari'ah* expert in the field of Islamic banking and finance, makes a stunning revelation as he laments:

"This [i.e., Islamic] philosophy cannot be translated into reality unless the use of *musharakah* is expanded by the Islamic banks. It is true that there are practical problems in using the *musharakah* as a mode of financing, especially in the present atmosphere where the Islamic banks are working in isolation, and mostly without the support of their respective governments. The fact, however, remains that the Islamic banks should have advanced towards *musharakah* in gradual phases and should have increased the size of *musharakah* financing. Unfortunately, the Islamic banks have overlooked this basic requirement of Islamic banking and there are no visible efforts to progress towards this transaction even in a gradual manner, even on a selective basis. ... [T]he basic philosophy of Islamic banking seems to be totally neglected." [p. 113; emphasis is mine]

Yet, even though PLS/Risk-sharing mode has been virtually abandoned, quite deceptively, "Profit Loss Sharing (PLS) dominates the theoretical literature on Islamic finance." [Dar and Presley, p. 3] Thus, the second polemical argument of al-Razi/al-Qaradawi involving risks, as explained above, now stands on its head.

Moreover, "no fixed rate of return", a long-standing dictum of Islamic economics and finance, has also been abandoned. Mohamed Ariff succinctly states: "Islam allows the owners of capital a share in a surplus which is uncertain. To put it differently, investors in the Islamic order have no right to demand a fixed rate of return." Ariff then reports that Iran, a country that has publicly and officially committed itself to interest-free economy and banking, "has decreed that government borrowing on the basis of a fixed rate of return from the nationalized banking system would not amount to interest and would hence be permissible." [pp. 46-62]

Third: Permitting the taking of interest discourages people from doing good to one another, as is required by Islam. If interest is prohibited in a society, people will lend to each other with good will, expecting back no more than what they have loaned, while if interest is made permissible the needy person will be required to pay back more on loans (than he has borrowed), weakening his feelings of good will and friendliness toward the lender. (This is the moral aspect of the prohibition of interest.). [p. 266]

This whole argument is contrary to the profit-motive that is recognized by Islam. Unless we are talking about charities, then this entire argument is misplaced and erroneous. This might also imply that people in the interest-based societies have diminished goodwill toward others and they don't do as much charitable acts. Is there any empirical corroboration behind such comparative observation? Others can find out and determine on their own. However, during my 25 years of personal experience in USA, a leading interest-based society, I have found probably more, and certainly no less do-gooders, charitable and caring people among non-Muslims, than in the fellow Muslim communities. The comparison can also be extended to Muslim countries. Those who claim that interest? Discourages people from doing good to one another? Must provide supportive empirical evidence in favor of their contention.

Fourth: The lender is very likely to be wealthy and the borrowing poor. If interest is allowed, the rich will exploit the poor, and this is against the spirit of mercy and charity. (This is the social aspect of the prohibition of interest). [p. 266]

Once again, "the spirit of mercy and charity" should not be brought up in the commercial context. However, the observation that the "lender is very likely to be wealthy and the borrowing poor" is based on stereotyping of the lending-borrowing process at the personal level. In the institutional context, savers are lenders to the banks and financial institutions, as these deposits are treated as liabilities of the banks on their balance sheets. Many of these savers are not necessarily rich. Indeed, until savers have sufficient capital to invest in the capital market (long-term securities, such as bonds, stocks or mutual funds), many younger or not-so-well-to-do people stick to the savings accounts of the banks. Based on US data in 2001, top 1% income class constitutes 44.1% in stocks/mutual funds investments; next 9% income class constitutes 40.4%; and bottom 90% income class constitute 15.5%. In terms of bank deposits (all categories included), top 1% provide 21.7% of bank deposits; next 9% provides 35.5%; and bottom 90% provides 42.8%. [See Table 6 in Wolff, 2001] Thus, stereotyping lenders as rich and borrowers as poor is not supported by the changed reality of our modern times. "Today ... debt is not necessarily associated with poverty." [Saeed, p. 29]

There is another important twist to this "lenders are rich and borrowers are poor" argument. Either required by the central banks of the respective countries to maintain certain level of reserves with the central banks or due to lack of appropriate investment opportunities, many Islamic financial institutions deposit their funds in interest-bearing accounts, even in foreign countries, for which Shari'ah-experts have provided the necessary fatwa of *Shari'ah*-compliance based on the rules of necessities (*darurah*).

Scholars in Islamic finance and banking have invoked necessity to permit exceptional relaxations of rules. They have issued fatwas (opinions) allowing Islamic banks to deposit funds in interest-bearing accounts, particularly in foreign countries, because these banks have no alternative investments at the necessary maturities. Typically, however, they place conditions on such fatwas, such as requiring that the unlawful gains be used for religiously meritorious purposes such as charity, training, or research. Such fatwas are particular to the circumstances in which they are issued. [Vogel and Hayes, pp. 38-39]

Many Islamic banks have been explicitly and openly earning interest on their excess funds, often invested in safer, debt-like or debt instruments overseas. Even Islamic Development Bank (IDB), a "multilateral development financing institution, established to foster social and economic development" of its 55 member countries, follows this practice. "Some Islamic institutions have steadfastly refused to receive interest, whereas others, including the Islamic Development Bank and the Faisal Islamic Bank of Egypt (FIBE), have always placed their excess funds in interest-bearing accounts, usually overseas. ... The Saudi Arabian Monetary Agency (SAMA) acts as the depository institution for IDB funds. One occasional source of controversy has been the fact that those funds were receiving interest - in fact becoming the main source of profits for the bank. The bank's charter expressly permits it to invest excess funds 'in an appropriate manner', and the criterion of overriding necessity (of development in the Islamic world), in addition to the lack of suitable investments has been repeatedly used to defend the policy." [Warde, p. 50, 144]

Islamic finance and banking movement also was expected to contribute toward broader economic development. "An interest-free Islamic system of financial intermediation will be more just and fair. This will make it more conducive to growth and development as all members of society will be assured of a fair treatment." [Siddiqi, p. 113] However, instead of focusing on poverty alleviation and development, many Islamic financial institutions, similar to the case of Egypt, have shown a bias toward the urban and the rich. "... most of the activities of Islamic banks have been in large cities as opposed to the countryside, where they are most needed; and that their main customers were likely to be well-to-do, and not the poor or the lower middle class." [Warde, p. 174] Usmani, with his personal and direct experience with a dozen of Islamic banks in the capacity of a Shari'ah expert echoes: "Unlike the conventional financial institutions who strive for nothing but making enormous profits, the Islamic banks should have taken the fulfillment of the needs of the society as one of their major objectives and should have given preference to the products which may help the common people to raise their standard of living. They should have invented new schemes for house-financing, vehicle-financing and rehabilitation-financing for the small traders. This area still awaits attention of the Islamic banks." [p. 115] It should be noted that these incisive comments of Usmani are not from the earlier decades of 70s or 80s, when it was popular to argue that these institutions were in their infancy, but reflects a more contemporary period in the 21st century.

IV. Rationales according to Mawdudi

Now let us turn to the arguments given by Mawdudi.

The main reason why Islam abolishes interest is that it is oppression (*zulm*) involving exploitation. ? The second reason why interest has been abolished is that it transfers wealth from the poor to the rich, increasing the inequality in the distribution of wealth. This is against social interest and contrary to the will (Mardi) of God, Who would like an equitable distribution of income and wealth. ? A third reason why interest is abolished is that it creates an idle class of people who receive income from accumulated wealth. The

society is deprived of the labour and enterprise of these people. ? [Khurshid Ahmad, pp. 253-254]

From a rational perspective, it is not quite clear as to what is the oppression/exploitation element in the modern commercial lending/borrowing. Usually, based on mutual agreement, a financially capable and creditworthy party borrows either for profitable ventures or for personal needs, and the bank lends at a competitive rate, subject to applicable governmental regulation. Is the interest rate exorbitantly high? Are the modern lending arrangements designed to dispossess or exploit the borrowers? Where is the oppression/exploitation element here? Indeed, in modern economies, savers or depositors of all financial backgrounds - rich and poor - are the providers of capital to the depository institutions. In that sense, these savers/depositors are lenders to the depository institutions. The oppression/exploitation argument here lacks either any polemical merit or empirical foundation. Of course, some financial services company (including credit cards) may charge high, exorbitant or predatory rate of interest, which is especially risky, if based on variable rates. Such financial arrangements can be too risky and expose the borrowers to serious vulnerability. The excesses of exploitative, interest based transactions, operating in an unregulated environment, may be covered by *riba* and thus islamically prohibited.

Secondly, interest as a contributing factor to income inequality is a polemical argument at best. Does it have any empirical basis? What the western countries have achieved in terms of rising above mass poverty and higher standard of living, that's more important than the income inequality issue. Indeed, interest "transfers from the poor to the rich" in an interest-based society is an erroneous argument, because as explained above, most individual investors, during their advanced age, seek less risky investments. Thus, they often put their money in the savings accounts, money market mutual funds, or investment grade bonds, etc that generally provide guaranteed and fixed, or at least, safe return. In many wealthy societies, such group of people comes from both rich and ordinary financial background. Unless, supporting empirical evidence can be presented, such arguments are merely polemical.

As can be observed from the above presentation, the traditional arguments about the prohibition of interest, which is based on equating it with *riba*, is not either sound or strong. While the movement of Islamic economics and finance has advanced quite a bit, the arguments traditionally invoked to rationalize the alleged Islamic prohibition of interest, even though they don't hold up, has not changed at all.

The profile of lenders/borrowers and the nature of the lender-borrower relationship in the modern context of institutionalized financial intermediation has fundamentally changed particularly after the industrial-capitalist revolution in the 17th and 18th centuries. The rationale for prohibition based on exploitation/injustice argument is not supported by the contemporary reality. Traditional arguments for prohibition of interest also call for profit-loss sharing and risk sharing on one hand and avoidance of fixed rate of interest on the other. In reality, even the Islamic banks and financial institutions are failing to uphold those provisions based on traditional arguments. *Mudaraba* and *Musharaka*, based on

PLS/risk-sharing modes, have been virtually (and quietly as well as deceptively) abandoned. And, in some respects, even fixed rate of return has now been accommodated and rationalized. Much religious juristic and other opinion that modern bank or commercial interest (when not exploitative) is not *riba* is readily and vehemently rejected and repudiated by the Equivalence School. However, with the support of economically and financially lucrative *fatwa* (religious edict) industry, there is no dearth of *Shari'ah* scholars or board to deliver or supply the relevant *fatwa* to offer debt-like instruments that are interest-free in but name. Even investing excess funds in interest-bearing accounts abroad has also been made *Shari'ah*-compliant.

In theory, the *Shari'ah* board's opinions are authoritative in that their refusal to endorse a product should automatically result in the bank scrapping that product. Also in theory, *Shari'ah* boards perform a religious audit of all accounts. The reality however is more complicated. Interviews revealed that in many cases the review is perfunctory, with boards 'rubber stamping' decisions already made by the bank's management or shunning controversial issues. The model for the role of the *Shari'ah* board is that of the account auditors. Although remunerated by the bank, their members should retain their independence. Like the auditors, they 'certify' at the end of the year that the bank's operations were in conformity with religious teachings." [Warde, p. 227]

Now, there is also *fatwa* that interest and profit can be interchangeably used in certain contexts. Lariba, an interest-free bank's site refers to a "consensus" *fatwa* (meaning a consensus reached by a small committee), which includes even Sheikh Yusuf al-Qaradawi: "we have reached a consensus that there is no objection to using the term 'interest' as an alternative to the term 'profit' or 'rate of return'."¹⁸

Monzer Kahf, one of the ardent advocates and exponents of Islamic economics and finance, made some rather illuminating observations in regard to "The Rise of a New Power Alliance of Wealth and *Shari'ah* Scholarship": This alliance also gives the *ulama* a new source of income that by far exceeds what they were used to earning. It gives them an opening to a new lifestyle that includes air travel, sometimes in private jets, staying in five-star hotels, being under the focus of media attention and providing their opinions to people of high social and economic ranks, who are anxious to listen. In addition, they are frequently commissioned to undertake paid-for *fiqh* research and to find solutions to problems that the new breed of bankers face. [p. 26]

[T]his alliance also causes a real change in the lifestyle of many allied *ulama*. Bestowing a new income and new associations, it exposes them to experiences that were hard to even imagine in the past. The *ulama* that in the 1950s had weather-affected, dried-skin hands and humble clothing, sitting in the cold, teaching on the ground of mosques in Cairo, Damascus, Aleppo and Baghdad, are now replaced with soft-living *ulama* who are used to luxurious garments and services of five-star hotels and expensive restaurants. This new lifestyle of the Islamic banks' *ulama* has resulted in certain changes in viewpoint as well. Many of them are now accused of being bankers' window-dressers and of over-stretching the rules of *Shari'ah* to provide easy *fatwas* for the new breed of bankers. These allegations have caused negative reactions from *ulama* who are either not

recruited by Islamic bankers or could not find opportunities to benefit from the expanding research agenda in the well-paid *fiqh* of finance. [p. 27]

Of course, neither all such *ulama* or experts of "*fiqh* of finance" can be stereotyped, nor the entire IBF movement should be dismissed for such concerns.¹⁹ While this new alliance can be beneficial to bring the otherwise traditional *ulama* from their mold that is out of sync with the modern times, the alliance of wealth and scholarship, especially in regard to determination of *Shari'ah* compliance is a matter of grave concern. This is especially so in the context of a long-standing legacy of the "court *ulama*" in the history of the Muslim world, who served the tyrannical status quo, in contrast with noble and righteous *ulama*, who often were shunned or even persecuted by the political authorities of their time. Is there any evidence of any *Shari'ah* board running amuck?

"Bank al Taqwa's management failed in 1998. The bank's report at the end of the year showed a loss of over 23 per cent of principal to both *mudaraba* depositors and shareholders. The *Shari'ah* board exceeded its limits in stating that the management did not violate the *Shari'ah* rules and went as far as stating that the board of directors and the management did their best and took sound finance and investment decisions, and the loss was a result of the South East Asian disaster as claimed by the management itself in its report. Facts were revealed in the year 2000, however, in a letter from the management indirectly indicating that in violation of well-established banking rules, regulations and wisdom, the management put most of its eggs in one basket, as it invested in one single project more than 60 per cent bank's assets." [Kahf in Henry and Wilson, note #18, p. 35]

V. Interest, profit and exploitation

In the preceding parts, we have dealt with the serious problems with the traditional rationales for the prohibition of interest. However, there is a larger issue of exploitation that seems to be missed by the traditional position.

Islam's position regarding justice is unequivocal and universal. It sets the highest standard in this regard.

O ye who believe! Stand out firmly for justice, as witnesses to Allah, even as against yourselves, or your parents, or your kin, and whether it be (against) rich or poor: for Allah can best protect both. Follow not the lusts (of your hearts); lest ye swerve, and if ye distort (justice) or decline to do justice, verily Allah is well-acquainted with all that ye do. [4/an-Nisa/135]

While the Qur'anic message of justice and egalitarianism are categorically on the side of protecting the weak and vulnerable, the entire notion of justice in this regard is supposed to be blind, whether dealing with the rich or the poor. As part of this quest for justice, Islam is against all kinds of exploitation of humans by other humans, whether individuals, groups or institutions. Therefore, anything, including Islamic economics/finance/banking, that takes exploitation as a serious and fundamental concern, can't be belittled or ignored. Indeed, many Muslims who have taken interest in interest-free Islamic banking is not merely because it is Islamic, but also because it would help move society toward an exploitation-free society.

However, Islam in general has become a victim of overly legalistic approach, where form has overtaken the spirit and substance. If exploitation is truly our concern, and it definitely should be, then it is important to note that the *riba*-interest equation actually suffers from a myopic reductionism. In the Islamic literature on interest-free economy and finance, one finds animated polemics about exploitation caused by interest. Ironically, as much as the exploitation argument is polemically invoked in the pertinent Islamic literature, focused attention to or studies of exploitation is rather absent. Khurshid Ahmad's [ed., 1980] book includes a rather comprehensive bibliography of Islamic economics, finance and banking. The bibliography, *Muslim Economic Thinking: A Survey of Contemporary Literature*, by Siddiqi includes 700 entries under 51 subcategories over 115 pages. However, there is not a single citation for exploitation or injustice. Nor are these categories to be found in the comprehensive index found in the book. The same is true about Khan's book [1983; 221 pages] on annotated sources for Islamic economics. Thus, while anti-exploitation rhetoric is commonplace, no specific empirical or focused studies on economic exploitation is listed in such bibliographic works.

The reality is that, while the pervasiveness of exploitation that have existed and continue to exist in the world is more due to the pursuit of greed and profit in general, pertinent Islamic literature is preoccupied with interest as the source of exploitation.

For example, just consider the case of the British East India Company. It was a joint stock company that received its royal charter from the British crown in 1600. In one and a half century, the "Company transformed from a commercial trading venture to one which virtually ruled India as it acquired auxiliary governmental and military functions, until the Company's dissolution in 1858."²⁰ The world knows the rest of the story, as that Company's role ultimately led to complete subjugation and colonization of South Asia. This entire British venture, driven by the quest for power and profit, serves as one glaring example of exploitation. What role did "interest" play in this as well as other ventures to colonize? While the colonial period is gone, during the post-colonial period, especially in the era of globalization led and controlled by the corporate multinationals, exploitation in different forms is as rampant as before. However, what role is interest playing in causing or facilitating such exploitation around the world? It is important that any pertinent explanation must not be limited to merely the polemical level.

Through almost an exclusive focus on the presumed interest-exploitation connection, the proponents of Islamic economics and finance have entrapped themselves into a seriously myopic reductionism. Indeed, global financial and corporate power houses of the world, that also plays a vital role in worldwide exploitation, are becoming the patrons of Islamic banking industry, and these Islamic financial institutions do not complain about such exploitation, because their focus is ironically on rendering the world interest-free, not exploitation free.

As articulated in *The Corporation: The Pathological Pursuit of Profit and Power* by Joel Bakan and *Empires of Profit: Commerce, Conquest and Corporate Responsibility* by Daniel Litvin, for examples, one can find a compelling portrayal and understanding of

exploitation, where the driving force behind such exploitation is not "interest", but the unbridled quest for power and profit to dominate and exploit others.²¹ Does this mean that interest has no role in exploitation? No, interest may have some role in exploitation. However, the ongoing exploitation of human beings by others (individuals, groups, institutions) is a much larger story than interest. The myopic reductionism involving *Riba*-interest equation and the search for exploitation primarily within that equation are causing the Islamic economics/finance movement to miss the mark in a big way. It is no wonder that many oil rich Arab countries, that are founded on and practice tyranny and exploitation, have been the primary source of capital for the Islamic banking movement. It is also not surprising that the Islamic movements that have been spearheading the Islamic banking/finance movement are patronized by those very same tyrannical regimes and the movements are muted against them.

One of the fundamental quests of Islam is to take a stand against injustice and exploitation. Also Muslims, as part of the humanity, are to engage themselves in this noble quest. However, the reductionism of *Riba*-interest equation, within which the Islamic finance/banking movement and its rationales search for exploitation and miss the larger picture of exploitation, should be a matter of serious concern.

One of the economic principles laid out in the Qur'an is that the wealth should not get too much concentrated. "What God has bestowed on his Messenger (and taken away) from the people of the townships, - belongs to God, - to his Messenger and to kindred and orphans, the needy and the wayfarer; *in order that it may not (merely) make a circuit between the wealthy among you. ...*" [59/al-Hashr/7]

The reality of the Islamic finance is, of course, otherwise. "The ownership structure of the Islamic financial industry is highly concentrated. Three or four families own a large percentage of the industry. ... This concentration of ownership could result in substantial financial instability and possible collapse of the industry if anything happens to those families, or the next generation of these families changes their priorities. Similarly, the experience of country-wide experiments has also been mostly on the initiatives of rulers not elected through popular votes." [Iqbal and Molyneux, p. 122]

Even in case of individual banks, there are reports about a few people gaining controlling interest or authority, which may not be conducive for proper "sharing" of profits and such concentration, can lead to other types of exploitations, even in a so-called interest-free framework.

Indeed, the field of Islamic banking and finance emerged as part of the broader field of Islamic economics. In turn, the interest in Islamic economics developed as part of the revivalist movements seeking to bring about Islamic society, where an Islamic economy would be in lieu of other systems of economy, including capitalism and socialism. As a vibrant civilization that spanned near a millennium, Islam always had to deal with issues, laws, policies and institutions pertaining to economy and finance. The western colonial rules over the Islamic world ultimately gave rise to Islamic revivalism: movements that took inspiration from the Qur'an and the life of the Prophet and wanted to chart a new,

forward-looking course for the Islamic world. IBF movement emerged as part of a broader revivalist ethos that was partly in response to the western civilization, including its economic system.

The contemporary Muslim is groping to perform the uphill task of establishing a New Social Order based on the ideals and values of Islam and capable of leading Muslims through the rough waters of the modern age. .. The emerging discipline of Islamic economics is one tiny but radiant element in this creative enterprise. [Naqvi, p. 10]

Many Muslim authors and visionaries have convincingly made the case to their fellow Muslims that Islam has its own comprehensive vision about society and civilization and even in dealing with the economic dimension of life, it has something valuable and relevant to offer as a critique as well as alternative to other economic systems. Notably, in the course of development of Islamic economic perspectives, Islamic revivalism has made its most visible mark in the field of Islamic banking and finance. However, with its growing success in meeting the demand for Islamic financial services and attracting the participation of conventional western financial institutions, IBF movement seems to have eclipsed the works in the field of Islamic economics, which was part of the overall struggle to overhaul the entire Islamic world by remaking it in light of Islam's vision and values. The revivalist Islamic trend has envisioned a challenge to both the capitalist and socialist economic system that has been intricately linked with imperialism, colonialism and exploitation of other societies. Internally too, particularly the capitalist society has shown a remarkable tendency to be debt-prone. From personal debt to corporate debt, from private to public debt, from domestic to foreign debt, there seems to be a debt-culture that is going out of control. However, the crux of the issue may lie more in a culture of commercially-induced, rampant consumerism, than in interest, which is merely an allocative tool. It is in this regard Islam as a way of life has some important contribution to make, where Islam discourages the culture of debt.

However, with the reductionist preoccupation with the *riba*-interest equation, the entire IBF movement seems to be vulnerable to be sucked into the global capitalist enterprise. During the earlier phase of the IFB movement, Naqvi (1981), former director of Pakistan Institute of Development Economics and the head of Pakistan's Economic Affairs Division, asserted that "the abolition of *riba* is one ... element of a comprehensive Islamic reform to establish an exploitation-free economic system" [p. 124] and warned "against thinking in terms of mechanical substitution of profit for interest." In his view, it "would indeed be dangerous should such a substitution take place *within the framework of capitalism*" [p. 125] or socialism, and not in the framework of a broader Islamic economy, distinguished by its own axioms and features. Even for the believers of the Equivalence School, Naqvi warns: "it is important to bear in mind that *the abolition of riba is not powerful enough by itself to engineer a smooth transition from an interest-laden economic system to an exploitation-free Islamic economy.*" [p. 153; emphasis is Naqvi's]

Comfortable with political tyranny, patronized by the few wealthy rentier classes in the Muslim world, and increasingly managed by the global financial powerhouses, the IBF

movement is more than vulnerable to be confined in the realm of rhetoric against exploitation, or worse, inadvertently may even become an instrument of exploitation. The world in reality is full of exploitation: child exploitation, sexual exploitation, labor exploitation, etc. Interest is probably, if any, a small component in accounting for global exploitation. Yet, the proponents of Islamic economics and finance are fixated with interest. It is no wonder that within the contemporary Islamic discourse in general and the discourse pertaining to Islamic economics/finance/banking in particular there is hardly any focused work on exploitation.

VI. Conclusion

Fixed or guaranteed rate of return, at least for public debt, is not unislamic any more. Profit/loss-sharing and risk-sharing, as inoperable, are now marginalized, if not discarded. What was shunned before, *murabaha* for example, as permissible but undesirable is now the mainstay of Islamic banking system. Indeed, "synthetic *murabaha*" that is not *Shari'ah*-compliant has become commonplace in many banks through their own respective *Shari'ah* boards. The predominance of *murabaha* and other debt-like instruments is considered by even some leading advocates and experts in Islamic banking as so serious that "it can be characterized as a crisis of identity of the Islamic financial movement." [referring to Siddiqi, 1983, Iqbal and Molyneux, p. 125]

Thus, not only the traditional arguments for prohibition of interest, even at the polemical level, do not hold (and are almost abandoned at the practical level), but also the Islamic banks and financial institutions have virtually eliminated any substantive or fundamental distinction between Islamic and conventional banking, attracting and facilitating the participation of the western conventional banks in the Islamic arena.²²

So, why is it easy to understand the rationales for the prohibition of *riba*, but not the rationales for the blanket prohibition of interest? Why do the traditional arguments for the prohibition of interest do not hold up? Why have the evolving Islamic financial institutions marginalized the equity-based, risk-sharing modes and have embraced debt-like instruments as their mainstay? Why are these institutions still concentrating on short-term products than on long-term products, where the latter is more important for production-oriented projects and long-term economic development? Why is the IBF movement facing an increasing need to resort to *Hiyal* (legal stratagem) to claim *Shari'ah*-compliance of its products?²³ Why are the conventional western banks so easily not just penetrating this Islamic niche, but are even becoming backers and financiers of this "Islamic" movement?

Some common explanations offered by the Islamic banking movement are that (a) the problems and challenges are part of its learning curve, and (b) Islamic banking and finance can't operate in its essence in a society and environment that is not Islamic. This essay's limited scope will not allow us to examine those explanations here.

However, there is another explanation that also is, in my view, more relevant and applicable, and that's the one explored here. This suggests that the blanket Riba-interest equation is not tenable from Islamic viewpoint and, maybe, that explains why the traditionally offered rationales for prohibition of interest do not hold up. Through the

riba-interest equation, it is not just that the Islamic financial institutions have entrapped themselves into a situation where they often have to resort to *Hiyal* [legal stratagem, trick or even gimmick] to maintain an Islamic veneer, but also that they have to adopt things (e.g., fixed rate of interest; or a mark-up that is indexed, pegged, benchmarked to the interest rate) that they have otherwise rejected as Islamically unacceptable.

Interest *can be riba* (and thus prohibited in certain situation), if it has an exploitative element or dimension. Indeed, in such case, a more relevant equivalent of *riba* is usury. Also, the relationship between *riba* and exploitation/injustice is evident, but not between commercial bank interest (in a competitive environment and under government regulation to especially protect the borrowers). In any case, if one is to generalize the prohibition of all interests (commercial and non-commercial, nominal and real), and then we have to come up with better and more convincing rationales. Furthermore, the discourse has to be elevated from a polemical level to a more substantive level, supported with empirical works/studies, especially about claims about the deleterious effects of interest on western economies.

Lest it is misunderstood, the purpose of this article is not to establish that commercial interest is okay from the Islamic viewpoint. It might or might not be. There needs to be further discourse. But the primary purpose of this paper is to expose the serious and fundamental weakness in the traditional arguments that are offered as rationales for prohibition of interest.

Finally, while the traditional rationales for prohibition of interest are indicative of an apparent anti-exploitation concern, the reality is that the intellectual and theological framework within which this discourse is framed, does not demonstrate a genuine and adequate understanding of the extent and nature of the exploitation in the contemporary world. Islamic scholars of finance and economics should go beyond the reductionist obsession with freedom from interest, and perhaps should be engaged in a more substantive and critical discourse that focuses on freedom from exploitation

Endnotes:

1. Answer to the question as to which was the first Islamic bank varies. Some may trace it to the first interest-free bank to Nasser Social Bank in Egypt in 1971. First interest-free bank with "Islamic" label [Iqbal and Molyneux, p. 36] or the "first private commercial interest-free bank" is traced to Dubai Islamic Bank in 1975. [Zineldin, p. 56]
2. Warde, p. 2.
3. "One body of scholarly opinion defines *riba* to include not only interest but also transactions involving speculation and capital gains, monopoly, hoarding, and absentee rents, in other words, any appropriation of value for which an acceptable counter value is not forthcoming. ... The reader can easily read through and conceptualize the implications of using more and more restrictive definitions, in the limit (to borrow mathematic term) equating *riba* simply with interest." [Khan, 1987, p. 1, 3] Also, Saleh, pp. 47-48]
4. Since the scope of this paper does not require to provide detailed explanation of each pertinent Islamic term, it would suffice to point out here that Islamic discourse identifies

three different types of *riba*: *riba al-fadl* (primarily related to sales transactions), *riba al-Nasiya* (sales or debt involving deferment) and a variation of the previous two, *riba al-Jahiliyyah*. According to Ibn Abbas, one of the major companions of the Prophet and earliest of the Islamic jurists, and few other companions (Usama ibn Zayd, 'Abdullah ibn Mas'ud, Urwa ibn Zubayr, Zayd ibn Arqam) "considered that the only unlawful *riba* is *riba al-jahiliyyah*." [Saleh, p. 27] Of course, the prevailing, orthodox position is contrary to this observation.

5. "... general consensus among Muslim scholars clearly is that there is no difference between *riba* and interest." Tariq Talib al-Anjari. "Islamic Economics and Banking," http://islamic-world.net/economics/economic_banking_01.htm; "The Shari'ah disallows *Riba* and there is now a general consensus among Muslim economists that *Riba* is not restricted to usury but encompasses interest as well." "Principles of Islamic Banking," November-December 1995, <http://www.usc.edu/dept/MSA/economics/nbank1.html>; "The renowned Islamic scholar Dr. Yusuf Ali Qaradawi holds that the question of prohibition of interest is a settled issue and that 'there is no provision left in it for any reformist to re-interpret and provide any excuse for stating anything otherwise'. He states that it is 'an issue which has withstood the test of consensus (Ijma) of ummah of the present day as well as of the past'." [Syed Thanvir Ahmed. "Attempt to Justify Interest an Exercise in futility," <http://www.islamicvoice.com/april.99/economy.htm>.] "The consensus of Islamic jurists, *fuqaha'*, as well as specialists in Islamic Economics has been that interest is equivalent to what is termed in the *Shari'ah* as *riba*, which is strongly condemned." Mabid Ali Al-Jarhi and Munawar Iqbal. "Islamic Banking: Answers to Some Frequently Asked Questions," Islamic Development Bank, Occasional Paper No. 4, 2001. <http://irtipms.iskandertech.com/OpenSave.asp?pub=92.pdf>; "All the school of thought of Muslim jurisprudence hold the unanimous view that *riba*, usury and interest are strictly prohibited. [Siddiqui, p. 15]

6. Quoting Ibn al-Qayyim. I'lam al-Muwaqqi'in, pt. 2, p. 179.

<http://ourworld.compuserve.com/homepages/Abewley/usul5.html>

7. For example, Abdullah Yusuf Ali equated, not interest but, usury with *riba* and wrote in The Holy Qur'an: Text, Translation and Commentary [Tahrike Tarsile Qur'an, 2nd ed., 1988] footnote #324:

"Usury is condemned and prohibited in the strongest possible terms. There can be no question about the prohibition. When we come to the definition of Usury, there is room for difference of opinion. Hadhrat Umar, according to Ibn Kathir, felt some difficulty in the matter, as the Apostle left this world before the details of the question were settled. This was one of the three questions on which he wished he had had more light from the Apostle, the other two being Khilafat and Kalalat. ... Our Ulama, ancient and modern, have worked out a great body of literature on Usury, based mainly on economic conditions as they existed at the rise of Islam. I agree with them on the main principles, but respectfully differ from them on the definition of Usury. As this subject is highly controversial, I shall discuss it, not in this Commentary but on a suitable occasion elsewhere. The definition I would accept would be: undue profit made, not in the way of legitimate trade, out of loans of gold and silver, and necessary articles of food, such as wheat, barley, dates, and salt (according to the list mentioned by the Holy Apostle

himself). My definition would include profiteering of all kinds, but exclude economic credit, the creature of modern banking and finance."

Among others who have rejected the simple equation between Riba and interest are late Fazlur Rahman [refer to the bibliography below]. Late Shaikh Muhammad Abduh (al-Azhar) and Rashid Rida have also been identified as having variant views on this. [El-Gamal: "Rashid Rida on Riba"; Saeed, p. 43].

Among others, "In the 1930s, Syrian scholar Marouf al-Daoualibi suggested that the Qur'an bans interest only on consumption loans, not investment loans, and in the 1940s Egyptian jurist al-Sanhuri argued that the Qur'an sought chiefly to ban interest on interest. A more extreme and recent example is the opinion of the mufti of Egypt, Shaykh Muhammad Sayiid Tantawi, who in 1989 declared that interest on certain interest-based government investments was not forbidden *riba* (because the gain is little different from the sharing of the government's profits from use of the funds or because the bank deposit contract is novel), thus joining the thin ranks of prominent religious figures who have issued fatwas declaring clear interest practices permissible. This fatwa aroused a storm of controversy, with opposition from nearly all traditional religious scholars and warm praise from secular modernizers. Later he went even further, saying that interest-bearing bank deposits are perfectly Islamic, and more so than 'Islamic' accounts that impose disadvantageous terms on the customer. Laws should change the legal terminology used for bank interest and bank accounts to clarify their freedom from the stigma of *riba*." [Vogel and Hayes, p. 46]

Even among the classical scholars, the definition and interpretation of *Riba* leave significant room for difference of opinion. "The Qur'an vehemently condemns *riba*, but provides little explanation of what that term means, beyond contrasting *riba* and charity and mentioning exorbitant 'doubling.' Commentators describe a pre-Islamic practice of extending delay to debtors in return for an increase in the principal (*riba al-jahiliyya*). Since this practice is recorded as existing at the time of the revelation, it is one certain instance of what the Qur'an prohibits. Hence Ibn Hanbal, founder of the Hanbali school, declared that this practice - 'pay or increase' - is the only form of *riba* the prohibition of which is beyond any doubt." [Vogel and Hayes, pp. 72-73, quoting Ibn Qayyim al-Jawziyya, d. 1350, *I'lam al-muwaqqqa'in 'ala rabb al-'alamin*, ed. Taha 'Abd al-Ra'uf Sa'd, Beirut: Dar al-Jil, 1973, 2:153-4]

8. Of course, this might be the only area of Islamic Fiqh or law that has hundreds of billions of dollar at stake. Also, the so-called Sharia experts can amass serious worldly riches. See Owen Matthews, "[How the West Came To Run Islamic Banks](#)," Newsweek [October 31, 2005] While the evolved orthodox position about *riba* was not necessarily tainted by worldly considerations, the contemporary IBF discourse does note "the debate on 'fatwas for sale' ... 'fatwa wars'", etc. [Warde, p. 227] It is important to note that the classical orthodox position revolved around *riba* and the modern, contemporary discourse revolves around not merely *riba*, but *riba*-interest equation. The contemporary Shari'ah experts serving the IBF industry hardly have anything to say about the political tyranny, or concentration of wealth, involving the patrons of the IBF movement.

9. Transparency International. *Corruption Perceptions Index 2005*
http://www.transparency.org/cpi/2005/cpi2005_infocus.html.

10. Defining *riba* (interest) as "any unjustified increase of capital," some argue that inflation premium is not unjustified, and "to keep the purchasing power of ... money

constant ... nominal interest should be permitted." [Zineldin, pp. 50-51]. However, most proponents of Islamic economics and finance do not make any distinction between nominal vs. real interest, as far as the applicability of their claimed Islamic prohibition of interest. However, except in a sustained zero inflation economy, which is virtually unthinkable in practical terms, an interest-free transaction would mean gain or loss by one of the parties due to redistribution of purchasing power. Interest-free "loan" transactions should not involve gain or loss by either of the parties.

11. Interestingly, some proponents of Islamic economics & banking believe that Muslims should not be using the Islamic banking service with any profit motive.

"Applying this principle to the banker-customer relationship would mean that the customer should not be discouraged by the low profits or limited success of Islamic banks. ... In light of these three principles, Islamic bank customers are expected not to be guided by the profit motive. Instead, the reason for placing their monies with the Islamic banks is directed towards receiving a blessing from Allah and this action is considered the best way of managing the resources given by Allah." [Haron & Ahmad, p. 3]

Of course, such a view is utterly naive and contrary to the Islamic approval of profit motive, which underlies trade and business.

12. "Islamic or syariah-compliant products are equivalent or even superior to conventional products. ... We always said that Islamic products should be equivalent or superior to conventional so that Muslim and non-Muslim would use it. ... Islamic Banking's popularity was on the rise not only among the Muslim countries but also in the West as the Islamic products could be superior in terms of viability and risk return compared to conventional products." [comments made by the Malaysian second finance minister at a high level Islamic Development Bank meeting. "Malaysia To Showcase Islamic Banking's Success At IDB Meetings," June 23-24, 2005; <http://www.bernama.com/events/idb/news.php?id=139803>] "Islamic Banking- A Superior Form of Finance" [FAQ: Dubai Islamic Bank, http://www.alislami.co.ae/en/aboutdib_faq.htm]; "... Islamic Banking based on the concept of profit and loss sharing (PLS) is theoretically superior to conventional banking from different angles" in A.L.M. Abdul Gafoor, Islamic Banking, 1995; <http://users.bart.nl/~abdul/chap4.html>; " ... [P]roponents of Islamic banking argue that profit-sharing contracts (equity) are superior financial instruments to debt for a variety of reasons including the risk-sharing properties of equity." [Aggarwal and Yousef, p. 95]. As per expectations of its idealistic proponents, "Islamic finance should experience great worldly success, yielding moral, financial, and social reward, thus proving to the world the superiority of Islamic norms. Its successes should not only be individual, but social, leading to a more just society, enjoying a fairer distribution of wealth, greater support for the poor and needy, and less corruption and dishonesty." [Vogel and Hayes, p. 26]

13. "... [S]ome indigenous and Western commercial banks have substantial Islamic operations, including National Commercial Bank, Saudi American Bank, Citibank, Kleinwort Benson, Grindlays, the recently-merged Chase Manhattan Bank, and Bankers Trust. A number of these were initially reluctant to initiate Islamic deposit programs with profit-sharing structures for fear of cannibalizing their conventional account base in which some Muslim depositors were accepting no interest. This fear later proved to be justified. While the indigenous institutions appear to have the dominant share of Muslim deposits in the Gulf region at this time, fortunes may be looking better for some Western

banks. Notable scandals and failures - and the political impact of the Gulf War - have cast a cloud over some domestic institutions. By comparison, Western operators enjoy an aura of deep pockets, geographic diversification, and reputation for sophisticated, reliable, and innovative banking." [Vogel and Hayes, pp. 6-7]

14. The interest of the western, conventional banks in Islamic banking and finance did not begin after seeing the success of the Islamic banks. Rather, the relationship between these conventional banks and Islamic finance movement goes much further back. "The international banking system was also instrumental in the very creation of Islamic banks. The fledgling Islamic banks, lacking expertise and resources, had little choice but to rely on the expertise of their international counterparts." [Warde, p. 108]

15. "While the distinction from a mere loan is compelling in theory, in practice Islamic banks often employ various stratagems to reduce their risks in *murabaha* almost to zero, particularly in international trade." [Vogel and Hayes, p. 141]

16. "One of the basic rules governing the *murabah* contract" is "the subject of the sale must be in the physical or constructive possession of the seller." [Iqbal and Molyneux, pp. 22-23] Also, see Chapra, 1985, p. 170] In many cases, Islamic banks minimize or eliminate the risk of a transaction by requiring collateral and guarantee from the buyers that they will take delivery, which is also not allowed by *Shari'ah*. [Mills and Presley, p. 17] "The Fiqh Academy in Jeddah went on record in 1988 against an 'artificial' *murabaha*," whereby a bank or a financial institution does not really own the object of the sales contract - that is, it has not taken possession of the object. [Henry and Clements, p. 4] The lack of standardization as to what mode or product is Islamic and what is not is another important issue of concern. "... [T]here are considerable disagreements among Islamic scholars as to which financial instruments are religiously acceptable." [Warde, p. 2] "Each of the 186 or so Islamic banks (as indicated by the Directory of the International Institute of Islamic Banks) has an advisory committee of Islamic jurists, and they issue rulings that are not always mutually consistent. Conventional banks like Citibank or HSBC that have opened Islamic subsidiaries also have their religious advisory committees. Standardization is a major problem." [Henry and Clements, p. 4]

17. The routinely-used expression "*Shari'ah*-compliant" is often misleading. As in this case, to be *Shari'ah*-compliant, *murabaha* requires that seller must take possession of the product before it can be sold to a buyer. However, most Islamic financial institutions routinely violate this provision, because they have the necessary backing of *fatwa* from their respective *Shari'ah* experts. So, by *Shari'ah*-compliant generally what is meant is not that it is necessarily compliant with Islamic rules, but that it is considered acceptable by a board of *Shari'ah* experts that is handpicked and employed by these institutions with quite a high level of monetary compensation. Such experts often resort to *hiyal* (legal stratagem) that is used to pronounce such transactions as *Shari'ah*-compliant.

Also notable is the lack of any uniformity in determining *Shari'ah*-compliance. "In Sunni Islam four schools of Islamic jurisprudence apply Islamic teachings to business and finance in different ways. Disagreements on specific points of religious law occur both between those four schools and within them. Furthermore, *Shari'ah* boards sometimes change their minds, reversing earlier decisions." [Vogel and Hayes, p. 10]

"At present, most Islamic banks have their own *Shari'ah* Boards. Questions have been raised about the autonomy and powers of these Boards. *Shari'ah* Boards of different banks could issue different rulings on similar practices which may raise doubts in the

minds of clients. ... If Islamic banking is not perceived to be 'Islamic', it will not be long before the existing Islamic banks lose much of their market." [Iqbal and Molyneux. p. 109]

Usmani, one of the leading Shari'ah experts who are closely involved with the Islamic finance movement, makes a revealing statement: "These institutions are passing through their age of infancy. They have to work under a large number of constraints, therefore, some of them have not been able to comply with all the requirements of Shari'ah in all their transactions, therefore, and each and every transaction carried out by them cannot be attributed to Shari'ah." [p. xviii] However, any such disclosure or disclaimer by the Islamic financial institutions is virtually non-existent. What is routinely, consistently and persistently claimed is that these institutions and their operations are Shari'ah compliant.

18. Lariba Bank. Documented Shari'ah - Jurisprudence - Opinions.

<http://www.lariba.com/fatwas/qaradawi.htm>

19. Due to lack of expertise in economics and finance, there are also Shari'ah experts, especially from the traditional religious backgrounds, sometimes tend to "over conservative." [Iqbal and Molyneux, p.109]

20. http://en.wikipedia.org/wiki/British_East_India_Company .

21. Joel BAKAN. *The Corporation: The Pathological Pursuit of Profit and Power* [Free Press: 2004]; Daniel Litvin. *Empires of Profit: Commerce, Conquest and Corporate Responsibility* [Texere; 1 edition, 2004]; Arvind Ganesan and Alex Vines. [Engine of War: Resources, Greed, and the Predatory State](#) (Human Rights Watch: World Report 2004); Hannah McCann. [Review](#) of Jonathan Neale *what's Wrong with America?* Vision, London 2004; .A. Waller Hastings. [Historical Background? European Colonization and the Colonial and Postcolonial Worlds](#) [September 5, 2003]

22. "Until now Islamic finance has largely been confined to the activities of Islamic banks which have tried to practice a Muslim version of conventional retail commercial banking. Regardless of theory, Islamic banks have found that their competitive and regulatory context compels them to mimic conventional banks ... pushing them into short-term, low-risk investments in an effort to offer their depositors returns similar in quantity and risk to those obtained by conventional bank." [Vogel and Hayes, p. 292]

23. Since the earliest period of Islamic jurisprudence, jurists have shown impressive expertise in inventing ways to come up with *riba*-free transactions. However, "some of these contracts were in fact so clever as to be considered *hiyal* (singular: *hila*), meaning ruses or wiles; that is, lawful means used, knowingly and voluntarily, to reach an unlawful objective. Provided that certain formalities were used, interest, albeit by a different name, could be charged and paid. Certain schools of jurisprudence - in particular the Hanafis and Shafiis - took a tolerant view of such *hiyal*, and entire treatises were written, detailing how Muslims could use such contrivances while staying on the right side of the Shari'ah." [Warde, p. 48]

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*At the [Study Resources Page](#) of this author, there is a collection of works that deals with the issue of equating interest with Riba from a critical perspective. See the entries under [Islamic Economics/Finance/Banking](#).

http://globalwebpost.com/farooqm/study_res/default.html
