Theories and Practices of Islamic Finance and Exchange Laws: Poverty of Interest

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Abstract

While Islamic scriptures clearly prohibit profiting from the poor, supposedly sharī'ah-compliant Islamic financial and exchange laws circumvent prohibitions and limitations on ribā, monopolism, debt, and risk while failing to address the fundamental purpose behind the prohibitions—mitigating poverty. This study provides a historical survey of the principles that shape Islamic finance and exchange laws, reviews classical and modern interpretations and practices in the banking and exchange sectors, and suggests a normative model rooted in the interpretation of Islamic sources of law reconstructed from paradigmatic cases.Financial systems that overlook the nexus between poverty and usury harm both the economy and poor and middle class consumers and investors rather than addressing the causal relationship between interest-charging models and poverty. This study shows how Islamic Financial Institutions (IFIs) have failed to meet the social requirements they were intended to address and also presents a theoretical framework for Islamic finance and exchange laws that proscribes usurious transactions involving people caught in the cycle of poverty and need.

Keywords: Islamic banking, Islamic finances,Jewish law, investment, trade, usury, lending, debt, mortgages, finance, business, poverty reduction, commercial instruments, risk management, contracts

Introduction

While religion has always played a prominent role in public life, including economic life, during times of crises it can becomean even more significant factor, as witnessed during the uprisings in the Middle East. The global financial crises of the early 21st century have contributed to the revivalof religion- and culture-based ideas and a renewed interest in community-focusedservices. In particular, this general trend has created increased interest in the foundations and operations of Islamic financial institutions.

In the Islamic context, the entire web of financial and exchange transactions—banking, business, partnerships, investment, and mortgages—is guided by the religious prohibition on *ribā*, which is generally understood to mean usury. In attempting to define and legitimize an emerging Islamic financial sector,the majority of Muslim scholars converge on a single principle: avoidance of interest while mitigating risk.

In this paper, I not only provide evidence that the primary texts of Islamic law do not support the notion that fixed interest amounts to *ribā*, I argue that charging interest is—or should be—a secondary concernto managing poverty. Indeed, the role played by subprime loans, which are essentially need-based lending instruments designed to profit from low-income consumers, was not only abusive but contributed to the financial crisis of 2007–2008. Muslim scholars who help design financial services and products thatoverlook the nexus between poverty and usury consequently end up harming both the economy and poor and middle class consumers and investors.

Crisis, Innovation, and Renewal

The Occupy movement of 2011 targeted the financial sector in the name of the 99% of the people. The movement's popularity reflected public frustration caused in part by the collusion between governments and powerful financial corporations that were too big to let fall but too weak to stand on their own without government bailouts. The complexity of the problems with the banking and financial sectors is so daunting that experts on both sides of the argument have used mutually exclusive evidence to support opposing views.

In the wake of the crisis of the last two decades of the twentieth century, some scholars have arguedthat the financial sector collapsed because of too much regulation, while others hold that it collapsed because of lack of regulation.[1] Some economists question the theoretical foundation of the modern financial system altogether.

While many factors contributed to the financial crisis and loss of trust in the system, subprime loans and mortgages clearly played a major role. Yet the connection between loans to the needy, profit-driven practices, and the eventual collapse of the financial sector has rarely been a central focus of critical scholarship. Instead, rather thanleading society to address the causal relationship of interest-charging models to the poverty that continues to burden more than 80% of the world's population,[2] the crisis has merely opened the door for activists, communities, and organizations to propose ideas and paradigms that continue to generate wealth from capital.

The global financial and social crises of 2002, 2008, and 2011 encouraged communities around the world to return to local practices and neglected paradigms as ways of coping with the effects of collapsing global systems. Some Muslim countries have relied on the huge cash reserves they have built selling natural resources to start financial services and products that seemingly comply with sharī'ah principles. The financial institutions adopting these approaches exploit the good faith and anxiety felt by many people by promoting sharī'ah-compliant products as socially responsible, recession-resistant, and profitable. But to date, the increased popularity of sharī'ah-compliant products and services has not beensupported by increased critical scholarship, especially theoretical (as opposed to primarily descriptive)analysis. While a review of the scholarship on Islamic law governing finance and exchange shows a significant increase in output in many disciplines,[3] very few of these are actually multidisciplinary and attempt to go beyond being merely descriptive.

The doctrinal principles that distinguish Islamic financial and exchange practices from their Western counterparts remain unclear. Islamic financial institutions are managed through corporate governance structures that differ from country to country.In many instances, Islamic financial institutions are deemed Islamicsimply when owned by Muslim individuals or Islamic governments. Others provide products that are usury-free or avoid Western practices because they are non-Islamic in origin rather than based on reasoned principles derived from classical Islamic law. This lack of established standards diminishes the reliability and reputation of Islamic financial institutions. These challenges also could explain the alarming rate of failed and/or troubled Islamic institutions such as Ihlas Finance House (Turkey), Islamic Bank of South Africa, Islamic Investment Companies (Egypt), Dubai Islamic Bank (UAE), and Bank Islam Malaysia Berhad (Malaysia)—to name just a few.

In this work, by reconstructing classical Islamic finance laws from paradigmatic cases, I provide a historical survey of key principles that shape Islamic finance and exchange laws,[4] review classical and modern interpretations and practices in the area of banking and exchange sectors, and suggest a normative model that is rooted in the textual and linguistic interpretation of Islamic sources of law. This research is not intended to reproduce any particular version of Islamic law, but rather to provide a synthesis of what might be the consensus among Muslim scholars belonging to different schools of jurisprudence. I therefore outline the major principles that guide Islamic financial and exchange practices prescribed in religious texts and as developed by religious and jurisprudential authorities from the three major schools of legal thought—Sunnism, Ibadism, and Shi`ism. I assumethat classical Islamic finance and exchange laws are built on the basis of the balance of all of its pertinent legal proofs and stated principles, not just isolated, categorized statements.

The Letter and Spirit of the Law

In law, interpretation plays a key role in bridging theory and practice, particularly in legal systems where rulings are determined through adversarial contestation between two parties. But even in religion-based legal systems, where outcomesare determined by compliance instead of enforcement, interpretation remains a powerful mode that allows one to prevail in legal cases. Because of the diversity within religion-based Islamic legal thought and the lack of universal regulatory instruments, the practices and regulations of Islamic financial institutions are governed by the principles of compliance, not control.[5]In a society where law and religion are intertwined, people ask for legal advice for different reasons. Some seek legal counsel to act in accordance with the letter of the law. Others seek informed legal opinion in order to align their business dealings with the ethics and spirit of their faith. While the former will be interested in compliance, the latter will be concerned for the integrity of the ethical code that provides justification for legal sanctions (*`illah*).

In Islamic law, not only does interpretation play a major role in shaping the principles and outcomes of sharī`ah-based legal determination, but an entire genre of legal reasoning known as *ḥiyal*—that is, loopholes or legal tricks—has been developed to help secure favorable rulings. A representative anecdote will illustrate the way *ḥiyal* reconciles conflicting aims by weaving together the theology of faith and the pliability of words.

Very worried for his sick son, a father wished for a divine miraculous intervention to heal him. He resorted to a special prayer called *nadhr*, in which he declared that if God would heal his son, he would sell his biggest bull and donate its full price to a charity. Not a week had passed before his son recovered, and the father resigned himself to meet his obligation. He took the bull along with a rooster to the livestock market and displayed them both for sale. Buyers interested in the large, fat bull inquired about the asking price, to which he replied: $1 for the bull and $1,000 for the rooster—but they must be bought together. When he had sold the pair, the clever father was able to donate$1 to the charity—the price of the bull—and keep the $1000—the price of the rooster. In his mind at least, the father had met his obligation as promised in his *nadhr*.

This popular anecdote, originating in African-Islamic cultures, is an example of the *ḥiyal* employed in a legal tradition that is rooted in religious creed. It demonstrates the complexity and interconnectedness of Islamic finance and exchange laws on one hand, and human greed, as the driving force behind economic growth, on the other. Governments and individuals like this father use interpretation and legal tricks to find ways around apparently restrictive and rigid legal rules governing financial transactions in general. Islamic law, like many other legal traditions, is, in many cases, about finding ways around limitations, not about creating a perfect or just system.

In addition to these internal challenges arising from Islamic culture and the lack of central authority across schools of thought, the development of financial models based on Islamic law has been further distorted by the dominance of Western financial paradigms and Western markets. Modern corporate executives are driven to maximize profit because that is the task shareholders charge them with. But what is the motive for religion-based institutions to create legal mechanisms that end up being an affront to their explicit religious principles? If history is any indication, religious teachings are always subverted by institutional authorities to produce a paradigm that allows for maximizing profit for stakeholders. Ultimately, the gap between theory and practice in Islamic finance and exchange would seem to be unbridgeable.

This is not just an issue for Islamic systems. Before Muslim jurists invented legal tricks to subvert the interest in poverty solutions and preserve interest-charging in other forms, Jewish scholars, too, had invented tools to do the same.

Jewish law and a few Islamic schools, under certain conditions, permit lending at interest under restricted circumstances. Yet in practice the Jewish prohibition has been circumvented through *heteriska*, a mechanism that probably would not meet with the approval of strict Islamic authorities. Additionally, many Arab nations openly permit interest or allow transparent ruses that evade the Islamic standard for *riba-free* transactions.[6]

Just as the primary sources of Islamic law link usury and poverty, the primary sources of Jewish law also prohibit usurious transactions with needy persons:

> The Jewish law of usury derives from a trio of Scriptural verses. First, Exodus 22:24 reads: "If you lend money to my people, to the poor who are in our power, do not act toward them as creditor. Take no interest from them." Second, Leviticus 25:35-37 states that:
>
> If your brother is poor, and his means fail with you, then you shall uphold him… Do not take interest from him nor increase, but fear your God. Let your brother live with you. Do not lend him money on interest, or give him food on interest.
>
> Third, Deuteronomy 23:20-21 warns: "You shall not deduct interest from loans to your countryman, whether in your money or food or anything else that can be deducted as interest. You may deduct interest from loans to foreigners, but not from loans to your countryman.[7]

Jewish and Islamic laws on usury agree in prohibiting charging interest on loans to the needy. But in both Islamic and Jewish law, loopholes, contractual instruments, and legal tricks have made it possible to circumvent the scriptural prohibition on usury and earning interest charged to needy borrowers.

For instance, not only does Jewish law grant permission to charge interest to non-Jews, excluding poor Gentiles from the benefit of the prohibition on usury, and also provide specific analytical tools that allowed investors to profit from financial transactions, but Jewish legal authorities also devised mechanisms by which charging interest even to Jews became possible. In Jewish law "the *heteriska* came into existence [to make] the prohibition on interest [lose] all practical significance in business transactions."[8] Moreover, "[d]espite the fact that *heteriska* is not mentioned anywhere in the Mishnah or Torah, almost all rabbinical authorities now approve of it."[9]

Contractual stipulations allow Muslim jurists to bypass the Qur'an prohibition on interestin the same way.*Heteriska* has done to financial transactions among Jews what the relabeling of interest charges into "service charges" or mark-up-and-trade has done for financial transactions among Muslims. Both practices provide religious communities with instruments to bypass religious ordinances.

The process of delinking usury from poverty begins with definitions. But although the prohibition on *ribā* is explicit in the primary sources of Islamic law, the Qur'an and the Hadith do not provide an explicit statement as to the cause of the prohibition,and Muslim scholars have therefore disagreed over its definition.

Three positions demarcate the range of opinions about *ribā*. Some Muslim scholars define *ribā* the same way usury is defined in Common Law: the charging of *excessive* interest. Others have identified specific practices in specific traded commodities and precious metals as the only instances of usury. A third influential view considers all interest-charging practices to be usurious. These differences can be explained by what scholars see as the cause of or justification of the prohibition (*`illah*).

The justifications for the prohibition on all kinds of interests under all circumstances are the "prevention [of] unfairness and exploitation in financial transactions, limiting hoarding, the need for either risk or labor to be a part of any investment, and preventing the destabilization of business planning."[10] But despite the existence of a plurality of causes for the prohibition on usury, in practice, such a prohibition became a prohibition on interest. The primary sources' focus on poverty and need became secondary to avoiding interest. Scholars and architects of Islamic finance products converged on dealing with the issue of interest and ignored an important question: How can Islamic financial products and services serve the poor and the needy and remain profitable to the extent that such businesses would continue to exist as opposed to creating business models that simply avoid interest?The justification (*`illah*) provided by Muslim jurists remains vague when compared to the scriptural linkage between usury and poverty and need.

The restrictions on financial transactions that require a return forces those needing investors either to find alternative paths and formulas, or simply to repackage the business agreement to avoid usurious transactions or the appearance thereof. Since money is the blood of the economy, usury can be seen as the virus against which Islamic economies must be immunized. Therefore, one cannot understand the definition and function of usury in isolation from other financial and exchange enterprises.

Because the majority of Muslim scholars consider any financial transaction that generates positive and stable interest (profit) to be usurious and therefore prohibited, the entire discussion is reduced to avoiding interest and creating contractual and instruments that allow for profit without interest. The prescription becomes simple: the validity of any financial transaction rests with its structure. In other words, if the transaction guarantees results and if one party earns a guaranteed interest, be it small or large, then it is legally suspect if not downright prohibited as a form of usury. The prohibition, however, can be removed if the instrument of exchange spreads the risk among all parties involved. The outcome of this reasoned determination is an oversimplified paradigm that can be described like so:

> Proponents of Islamic financial institutions (IFIs) regard their conventional counterparts as Islamically unacceptable, because the latter are interest-based, not based on fair profit-loss sharing (PLS) and risk sharing. Idealization of the PLS mode is questionable as it is not explicitly mandated in Islam's primary texts.[11]

Indeed, risk-sharing transactional instruments have no basis in the primary sources of Islamic law. Although they were invented to make itappear that these transactions meet the standard of fairness,essentially they merely mask interest-generating transactions while failing to meet all the other concerns for the poor and needy that areraised in both the Jewish and Islamic primary scriptural texts. The process that led to this determination is rooted in classical Islamic legal theory and what might be considered to be the foundational cases upon which Islamic law on finance and exchange stands.

Foundation of Classical Islamic Law

Theoretically, Islamic law and Islamic jurisprudential principles are rooted in two primary sources: the Qur'an and the Hadith (Sunnah). That for which there is no clear and explicit legal proof (*dalīl*) in those two sources is governed by a legal ruling that is analogically, deductively, or inductively derived from these sources through a process known as informed reasoning (*ijtihād*).[12] When a majority of jurists independently converge on a single finding, such a finding is categorized as consensus (*ijmā`*).[13] If no consensus is established, all well-reasoned scholars' opinions become part of the Islamic canon. It then falls to the individual to choose whichever opinion he or sheprefers.[14]

These general processes are further complicated by theological and political considerations. During the lifetime of the Prophet Muhammad, dissent was never an issue, since his followers generally believed that his decrees were infallible divine revelations and inspirations. After his death, however, leaders of the Muslim community struggled to retain control, unity, and stability. Given the size of the community both demographically and geographically, preserving uniformity became an insurmountable challenge. In the first fifty years after the death of the Prophet Muhammad, Muslim leaders faced civil wars and armed rebellions that resulted in the creation of the first split in the community between the mainstream (*`āmmat al-muslimūn*) and opposition groups (*khawārij*), from which the persistent school of thought known as the Ibāḍīyyahemerged.[15]

By the end of the first Islamic century, ethnic and tribal tension, corruption, and the abuse of power had grown unmanageable, resulting in a bloody revolution that brought the Abbasids to power, a significant event that cemented the role of the descendants of the Prophet (*ahl al-bayt*) as beacons of morality and religious piety and allowed the supporters of Ali, the son-in-law of the Prophet, to coalesce into the theological and political trend known as Shiism.[16]During this formative period of Islamic civilization the three branches of Islam arose that havesince shapedthe development of Islamic legal and political legacy—Sunnism, Ibadism, and Shiism.

These three traditions form the ultimate filter through which legal reasoning is applied to all cases, including finance and exchange laws.Islamic finance and exchange laws must, therefore, be seen in the context of sectarian, historical, and jurisprudential principles. In all cases, according to Muslim scholars from the various established persuasions, the explicit texts of the Qur'an and the Hadith provide the outer limits of legal prescriptions and proscriptions. But whatever is not explicitly sanctioned falls under the domain of informed reasoning, and the resulting legal rulings vary from one school of jurisprudence to another and from one jurist to another.

Regarding the position of classical Islamic laws on finance and exchange of goods, Muslim jurists from all three schools of thought recognize the significance of three things: (1) the nature of the object being exchanged; (2) whether or not the rules of *ribā* apply to it; and (3) have the risks (*gharar*) and trustworthiness and goodwill of the parties been assured? These questions are so common in the legal literature that many scholars simply gloss over these terms without attempting to critically define them. But because definitional and functional determinations of these three things are foundational for making proper legal judgmentsor findings, I consider it crucial to begin by establishing clear definitions so that the scope and methodology of this paper are clearly defined.

Ultimately, however, thegoal of the present work is not merely or even primarily descriptive. Many works introduce Islamic finance and exchange laws from that perspective and through that methodology. I intend to look into the deeper meaning of what I consider to be paradigmatic cases in order to present a theoretical framework for Islamic finance and exchange laws and explain how Islamic Financial Institutions (IFIs) have failed to gain traction, especially among the socially conscious communities they were intended to serve.

Foundation of Islamic Finance and Exchange Laws

Although the Qur'an is the primary source of Islamic law, it is not primarily a legal code. In fact, most of its passages are non-legal. This scarcity of legal prescriptions in the Qur'an adds special value to the few legal injunctions that are explicit and unambiguous. Such cases become archetypal models that can be used to expand the corpus of Islamic law in a way that would keep it true to the letter and spirit of Qur'anic injunctions.

Islamic finance and exchange lawsmust be derived from the areas of intersection between the rules covering *ribā* and those covering property and inheritance laws. Additionally, laws dealing with contracts (*`uqūd*), lending (*qurūḍ*), and sales (*bay`*) provide additional context for framing Islamic finance and exchange laws.The link between trade, *ribā*, contracts, and banking has allowed many banks in Muslim societies to circumvent the prohibition on *ribā* (defined as the charging of interest).

For instance, in many Muslim countries, a person wanting to buy a car would seek help from an "Islamic bank." The bank would buy the car from the dealer (or any third party), then would turn around and sell the car to the client for a price higher than that paid to the third party. The client is then able to pay off the car in monthly installments without the appearance of paying interest on a loan. This scheme is legitimate in the view of Muslim scholars because profitable trade is acceptable, whereas usurious (interest-based) transaction is not, according to the Qur'anic rule in [Q2:V276].

The General Prohibitive Factor: *Ribā*

For a large segment of the Muslim community, especially those living in Western countries, any financial transaction that pays interest is seen as usurious. Many Muslim-Americans, for instance, refuse to take any additional amount above the exact amount they deposit in their bank accounts, including sums that offset currency devaluation, inflation, or other market conditions that may have impacted the value of the deposited capital. For them, any amount of money, be it large or small, above the money they actually own is a form of usury. This attitude among Muslims is significant for several reasons. First, it underscores the fact that, for many Muslims, obeying Islamic law is rooted in compliance rather than coercion and enforcement. Second, refusing to collect interest underscores the lack of clarity in defining *ribā* from practical, economic, and social perspectives. Lastly, the fact that some Muslims consider interest-bearing accounts to be in conformity with Islamic law while others do not underscores the lack of any central religious authority that could issue a definitive decree for all Muslims regardless of the school of jurisprudence to which they belong. If Muslims feel apprehensive about holding a simple interest-bearing bank account, one can only imagine the difficulty of entering into transactions that are more complex and more dependent on value appreciation and depreciation. Given these complex issues, it is necessary toconsider the origins and definitions of *ribā*.

Explicit restrictions on *ribā* are derived from three passages in the Qur'an: [Q3:V130], [Q2:V275-276], and [Q2:V278]. The gist of these passages can be summarized in the following translation of the second passage:

> Those who *eatribā* do not stand unless standing like a neurotic person [possessed by the *jinn*] because they say trade is the same as *ribā*. However, God allowed trade and forbade *ribā*. If one heeds this advice then God will reward him as promised and those who revert to taking *ribā* will be cast as the people of hell. In it, they reside for eternity. God blights *ribā* and increases charity and God does not love all disbelievers and evildoers.[17]

Muslim jurists of the classical period have often defined *ribā* by offering examples of usurious practices that were prevalent during the time of the Prophet Muhammad and that were prohibited by these passages. For instance, it was reported that it was common during that era for a person to borrow a thing or money from another for a *specific time.* When the deadline cameand the borrower failed to pay it back, the lender would then allow an extension on the condition that the original sum or value was augmented, or that the borrower paid a small fixed amount monthly while owing the full sum perpetually.[18] In fact, the Arabic wording which states *ya'kulūna al-ribā* [they eat usury][19] suggests the habitual use of usurious practices to make a living—as the common phrase would suggest in English as well. That is to say, making *ribā* charges has become a revenue stream for a person or an entity.

Before the end of the first Islamic century, Muslim jurists' opinion on *ribā* coalesced to produce a theoretical definition of *ribā* that emphasized the elements of time and kind. By the second Islamic century, it was possible to provide a definition for *ribā* that more or less articulated a shared understanding that continues to influence Muslim legal scholars even today:

> Anything that people would augment by way of trade or lending within a time period is proscribed. However, that which people augment by way of immediate trade [*yadan bi-yad*] is legal. Similarly, anything—even of different kind—traded in an immediate transaction [*yadan bi-yad*] or delayed by forgetfulness [*nasī'atan*] is also legal [*ḥalal*] regardless of augmenting the return or not.[20]

This definition differs from *ribā* as defined in in the Qur'anic context, which is tied to need-based lending that forces the borrower to agree to settlement terms that are not dependent on wealth generation or profit. In all cases that are associated with usurious practices that are condemned, the borrower needed money for purposes other than profitable adventures or investment enterprises.

Nonetheless, the lender asks for a flat sum above the original value of the loan or fixed installments that would last until the loan is paid in full. Profiting from these kinds of transactions is clearly prohibited regardless of the amount above the original loan.

These cases can be to some extent analogically categorized as instances of predatory lending. In a sense, all need-based lending transactions run the risk of being categorized as usurious if the payment involves interest and/or fees. What is debatable, because it is not explicitly treated in the primacy sources of Islamic law, is the legal status of non-need-based loans and the interest rates and fees that can be assessed.

In other words, the Qur'anic prohibitions describe a scenario for a transaction that allows the lender to profit from need-based loans. They do not fix a percentage under which profit-taking is acceptable or over which profit-taking is proscribed. And while most Muslim scholars historically have held that it is an excessively high interest rate that makes a transaction usurious, some scholars have disagreed.[21]

Modern Muslims scholars are divided over the issue as well. Some have generalized the classical principle, arguing that "proscription applies to cases where one takes an amount above the initial sum of the loan."[22] In other words, neither the interest rate nor the intended use of the loan is of consequence. The only way to avoid usurious transactions and profit from lending money, in their view, is by re-arranging the terms so that the "the proscription can be removed on the basis of equal partnership in sharing profit and loss between the contracting parties."[23] This view, which is representative of Sunni, Shiite, and Ibadi perspectives, is specific to the prohibition on interest-bearing bank accounts:

Bank deposits that pay interest, even when consensual, are still prohibited by the same rules that proscribed usury in Islam, which does not allow any loan that stipulates an increase above the principal. If deposits (*īdā`*) are not considered loans, can one then use the deposits? Does Islamic law allow the depositor to take interest from a deposited money used for profit?[24]

To stress the rootedness of the prohibition on interest-bearing bank account, the second source of Islamic law[25] is invoked as well: "The Prophet said that whoever takes interest or imposes interest is involved in *ribā*."[26]

Although modern Muslim scholars derive their legal determination logically and analogically, pegging the ruling to a specific tradition or a specific case from the formative period is necessary to preserve authority and bolster credibility. Reason has a function only in the realm allowed by tradition. The invocation of examples that involve dates and camels to answer a question in a country that has neither of those is an example of the continued contextualization of Islamic law in its historical and cultural environments. This means that usury, for instance, is not defined based on its functions, effect, or origins. It is, rather, defined based on the examples used when first prohibited in Arabia.

In this sense, it is usurious if the lender penalizes the borrower for "forgetting" to pay back a loan, regardless of whether the loan was for profit or non-profit purposes. Similarly, it is usurious to trade in dates of low quality for half the amount of dates of high quality. But to trade two units of buttermilk for one unit of milk or vice versa is not usurious because they are not of the same kind.

Here is an example of attempting to explain a modern problem using ancient cases:

> Islamic definition of *ribā* (or interest) is when one of the parties takes or asks for an increase above the original amount of the thing traded (in kind) without having something that justifies the increase. This definition would include *ribā al-nasi'ah* and *ribā al-faḍl*… *ribāal-nasī'ah* is an increase (penalty?) resulting from borrowers' failure to return the loan within the agreed upon time frame… *ribā al-fadl* is when two things of the same kind are traded but with an increase in one; i.e., when a person sells dates of good quality for twice the amount of dates of lower quality.[27]

The definition of *ribā* becomes even more complex when we realize that in early Islamic societies some products (dates, barley, wheat, corn, etc.) were actually considered a form of currency. If dates are a currency just like gold and silver, trading unequal amounts (based on the quality) is similar to trading different amounts of gold, which is bona fide usury.[28]

As evidenced by the reasoning and language of the ethical and legal judgments above, Islamic finance and exchange laws are explained either categorically or logically. So-called literalist (sometime referred to as traditionist [*ahl al-ḥadīth*]) scholars rely on illustrative examples to conclude that *ribā* is concerned with the nature of the traded object and not its social or economic effects. Less traditionist scholars contend that fairness drives the laws on *ribā,* and since it is unfair to profit from high profit from guaranteed interest, all interest-generated wealth becomes suspect.

It is my contention, however, that the purpose of the loan can be used to determine whether a transaction is usurious on not. To those who object that such an argument could end up undoing the universal protections against usury, I would point out that certain legal instruments have already made usury acceptable in Islamic as well as non-Islamic institutional transactions. The model I propose, however, proscribes usurious transactions involving people caught in the cycle of paralyzing poverty and humiliating need. The discussion of other paradigmatic cases will provide more support to my argument.

The Qualifying Condition: Dayn

The same way *ribā* played a central role in shaping Islamic finance and exchange Islamic laws, the condition of being burdened by debt became a qualifying factor in proscribing *ribā* and restricting profit from interest. Islamic primary legal sources express aversion to debt, and the importance the Qur'anic discourse awards to the elimination of debt reframes Islamic financial law in a different light. It envisions an economy with a positive balance at all times, not one built on speculation and capital-driven income. This principle is derived from two main Qur'anic passages that established the mandatory inheritance rules (*farā'iḍ*).

The verses dealing with inheritance rules explicitly establish strict guidelines for the manner and priorities of disposing and distributing the legacy of a deceased person. The heirs are barred from taking full possession of the estate before clearing all debt and testaments:

> God [thus] directs you regarding your children's [inheritance]: to the male child, a portion equal to that of two females. If only daughters, two or more, their share is two-thirds of the inheritance. If only one daughter, her share is a one-half. For his two parents, for each one-sixth of what he left behind, if the deceased left children; if no children, and the parents are the (only) heirs, the mother receives one-third. If the deceased is survived by siblings, the mother's share becomes one-sixth. These shares are assigned *after the payment of all testaments he bequeathed (waṣiyyah) or debt (dayn)…*
>
> In what your wives leave, your share is a half, if they leave no child. But if they leave a child, your share is one-fourth—after the payment of all testaments he bequeathed (*waṣiyyah*) or debt. In what you leave, your wives' share is one-fourth, if you leave no child. But if ye leave a child, they receive one-eighth—*after the payment of all testaments he bequeathed (waṣiyyah) or debt (dayn)...*[29]

The refrain, *after the payment of all testaments he bequeathed or debt*, indicates that debt must be cleared before the legacy is passed on to the heirs. While debt does not transfer to the heirs, nonetheless priority is given to the payment of debt from the wealth left behind by the deceased, which serves as a disincentive for people to accumulate wealth through accruing debt that they have no intention of paying back.

Preventing Need by Prohibiting Monopolism: Iḥtikār

Need for goods and services iscreated when there is an imbalance in the supply and demand. Usury and debt are prevalent when need (demand) is high, and demand tends to be high when supply is low. Supply can be artificially suppressed when the market is under the influence of monopolism (*iḥtikār*). Islamic finance and exchange laws consider these three elements related and imposes restrictions on monopolism with the same strength they proscribe *ribā*: "Those who treasure and hoard gold and silver and do not spend it for the sake of God, offer them the good news: painful torture."[30]

The Sunnah is also explicit in its prohibition of monopolism, although scholars are divided in regards to the extent of prohibition: is it on money, food, or everything that is of value to people in general?[31]

In a sense, classical Islamic law treats monopolism as a form of usury in two ways at least. First, since monopolism creates the conditions for need and need forces people to borrow money, monopolism in this sense enables*ribā*.

Second, since *ribā* applies to augmenting wealth by exploiting the need for money (capital) and since money can take the form of other tradable goods like dates and grains, it follows, then, that hoarding goods is analogous to hoarding capital and using it for usurious transactions.[32] Thus, usury and monopolism are tied in classical Islamic law.

Spreading and Managing Risk: Gharar

Most Muslim scholars have justified the prohibition on *ribā* by pointing out that usurious practices give capital holders an unfair advantage. Moreover, usurious transactions relieve capital holders from responsibility in transactions that affect many stakeholders beyond the contracting parties.

Muslim scholars who embrace this functional definition of usury also hold the view that usury can be avoided by simply entering into an arrangement that provides for risk- and profit-sharing as explained above. Having said this, it must be noted that Muslim scholars hold that all contractual arrangements necessarily carry some risk. The task is to determine which risk is acceptable and tolerated and which risk can be grounds for voiding a transaction. The discussion of risk management in Islamic law is generally headlined as *gharar*.

Linguistically, the Arabic word *gharar* simply means danger. When used in law, it refers to a full range of risk levels that could invalidate a contract. Early Muslim jurists provided a number of definitions of *gharar*that remain influential in guiding modern understanding of risk management in Islamic finance and exchange laws. Sarakhsī, for instance, defines *gharar* as that "whose outcome is unknown."[33] Similarly, al-Qarāfī contends that *gharar* is "that whose probability of happening or not happening is very close—even if such a probability is known."[34] The Ḥanbalī jurist AbūYa`lā defines *gharar* as "the thing that oscillates between two states, while neither is more known than the other."[35] Most Muslim jurists favored the Ḥanafī definition, as formulated by al-Sarakhsī.

Risk management is a virtually universal legal principle, but the definition and application of risk in contractual law differs from one legal system to another. For instance, Western legal tradition has an established stipulation that protects buyers and more or less reflects the same concerns expressed in Islamic law:

> In Common Law, [Caveat Emptor] gives the buyer a right to investigate and verify that the goods he is purchasing are free from any defects before the agreement is concluded. This protects the buyer from any future risks arising from the purchase of defective goods… The doctrine of Caveat Emptor, however, does not impose any obligation on the seller to point out any defects in the goods to be sold.[36]

In the American legal system and customary practices almost all sales come with a stipulation that allows buyers to return goods or break a contract within a specific time period without much financial burden. In a controversial ruling, one American state court ruled in favor of a buyer who wanted to rescind a home purchase contract claiming that the seller failed to disclose that the house was haunted.[37]

In Islamic law, protection from risks associated with defective goods is extended under the doctrine of Options [*khiyār al-`ayb*]. "Under Islamic commercial law, the seller in a sale of goods agreement is under an obligation to allow the buyer to inspect or examine the fitness of the goods to be sold, not only before the conclusion of the agreement but also after it…" Nawawī defines this doctrine by stating that "a purchaser has a right of opinion on account of defects in the thing bought, of which he has become aware only after taking possession, but which existed previously."[38] In contrast to other legal systems, "Islamic law does not approve of a general rule in which the seller is under no obligation to disclose any defects in the goods before the agreement."[39]

As in Judaism, Islamic jurists recognize the prohibition on *ribā*, but they also consider it an issue within contracted transactions, making it subject to the general principles governing contract laws. That being the case, *ribā* can only be understood in the context of other paradigmatic cases, but circumventing it can also be achieved by the application of the general rules of contract laws. This context can have adverse effects on the efficacy of the prohibition on *ribā* if the latter is seen as an element of a broader area, namely contract law.

The language used by some modern Muslim scholars when discussing this subject expresses just that when they suggestthat sharī'ah-compliant contracts mean that "all transactions must be based on mutual trade and commerce and be free from unlawful elements such as riba, rishaw, maisir, and gharar."[40]*Ribā*, thus understood, is not a foundation case upon which the system is supposed to be built. It is a condition that can be present within any given transaction. Consequently, a transaction can be constructed in a way that avoids*ribā*, in reality or in formula, in order to make sure that a transaction is not made defective.

In summary, in my view, it is clear that finance and exchange laws in Islam are founded on a number of principles derived from specific practices, which I called paradigmatic cases, that are extremely blameworthy to the extent that they render any transaction null and void. These paradigmatic cases are the absolute prohibition on usury (*ribā*), the avoidance of debt (*dayn*), the proscription of monopolism (*iḥtikār*), and the eschewal of risk (*gharar*). These are the cases upon which Muslim jurists from all schools of thought have reached a consensus. All other financial and exchange transactions are then guided by these four rules.

Additionally, since these matters are essentially rules governing interpersonal arrangements, the definition of what can be construed as a legal entity is different from what we would call a "legal person" in most modern societies, especially in the West.

In classical Islamic law, only individual people and their legal representatives can enter into any contractual agreement. In other words, classical Islamic law would not recognize the "state" or a "corporation" as legal entities with which or against whom one can enter into a contract or initiate legal action. This definition of legal person being restricted to people, not fictitious legal entities, applies to political arrangements as well. For instance, the caliphate, which is essentially a relationship created by a contract between the leader and the representatives of the people [*ahl al-ḥall wa-'l-`aqd*], was a recognized institution. However, in terms of legal rights and responsibilities, the caliph and only the caliph could be held responsible for the actions of the government as a whole—not the institution. In relation to financial matters, in the view of classical Islamic law, not recognizing corporations has legal implications in terms of the ability of people to enter into legal contracts or make business transactions.

The notion of legal systems is based on the idea that certain legal traditions consist of a set of rules and principles allowing jurists and lawyers to predict legal rulings and legal findings. A legal system, thus understood, is made consistent by textual enunciations, precedent, and logically derived rules. I will not address the broad question of whether or not Islamic law is a legal system. Minimally, however, it is essential for the discussion of this topic to raise the question of whether Islamic finance and exchange law is a sub-system. If Islamic law is unified in the mind of Muslim jurists by the fact that explicit Qur'anic and sound Sunnaic traditions provide the foundation and primary source of law and legal reasoning, can the same be said about Islamic finance and exchange laws? The description of services and products as being sharī'ah-compliant is not substantively and normatively useful. I propose instead, that we look at specific cases upon which Muslim jurists from all major schools of thought have reached a consensus and explore the possibility of these cases being foundational for all other cases.

Elements of Islamic Finance and Exchange Laws

I have identified four red lines that must not be crossed for any transaction to be deemed sharī'ah-compliant: two absolute prohibitions (of *ribā* [usury] and *iḥtikār* [monopolism]), one measured proscription (of *gharar* [risk]), and one contemptuous judgment (regarding *dayn*[debt]). Theoretically, however, these restrictions are not sufficient to suggest the existence of an Islamic legal system that extends to Islamic finance and exchange dealings. Arguably, a legal system cannot be built on four negative declarations. We must look into the elements of Islamic finance and exchange laws in practice to see if there are qualifying characteristics that produce a unique system.

Moving from purely negative declarations to a positive formulation of a web of laws governing finance and exchange transactions would shed some light on the reasoning behind the various models that are in existence today. In other words, we must look at specific examples of legal instruments adopted by Muslim scholars to validate financial transactions and transition them from what is non-Islamic to what they see as an Islamic model of doing things in this realm.

Categorically, finance and exchange laws fall under the broad subdivision called transactional laws [*mu'āmalāt*], as opposed to worship laws [*`ibādāt*]. One of the distinguishing elements that separate transactional from worship laws is the fact that the latter require no contract. Transactions generally require contracts, and more importantly, dealings involving financial matters require written contracts, as per Qur'anic legal proof. From the point of view of Qur'anic laws and ethics, financial transactions are generally either for profit or for relief (charitable), though the distinction in Islamic law is not clear and the rules therefore are the same.

To clarify procedural and substantive matters, let us consider the nature and function of debt and several legal instruments of for-profit business arrangements.

In classical Islamic law, debt (*dayn*) and loan *(qarḍ*) are governed by the same principles, since their utility is need-based and since they must be remitted under most circumstances. A loan, however, is different from the general category of debt in that it must be remitted in kind; if the loan was issued in currency it must be repaid in currency. If it was issued as a thing (food, drink, clothes, etc…) then it must be remitted in kind.

Debt, on the other hand, covers a broad spectrum of arrangements that result in one party owing another either its value or its replacement—including but not limited to sales, rent, lease, loans, marriage, divorce, murder, child and spousal support, and similar transactions.Although classical Islamic law has prescribed intricate rules and regulations to govern debt disputes, the general ruling (*al-ḥukm al-`ām*) categorizes debt as undesirable or blameworthy for the debtor (*madīn*/*madyūn*) and praiseworthy for the debt-holder (*dā'in*).

Some Muslim legal scholars contend that accruing debt while knowing that it cannot be paid back is proscribed.[41]Most, however, hold that debt is merely undesirable. Preferably the debtor must prove special need and also provide a *guarantor*. If these two conditions are not met, the person must seek alms [zakāh] and charity (ṣadaqah) instead of risking the rights of others. According to religious authorities, "the legal ruling concerning one who accrues debt with the intent to default is the same as that for the thief (*sāriq*)."[42]

While Islamic law discourages people from accruing debt, it nonetheless encourages debt-holders to be generous. It is reported that the Prophet said that, "it is written on the doors of paradise that the reward for charity giving is tenfold whereas the reward for loaning is eighteen fold." Loaning money is better than giving charity because one who asks for a loan is in greater need than one who seeks charity.[43]

Procedurally, loan contracts must be written down. The Qur'an is explicit in this regard:

> Believers, if you enter into a time specific debt arrangement, then you shall write it down. [*yāayyahaal-l-dhīnaāmanūidhātadāyantum bi-dayninilāajalinmusamma f'-aktubūh*]."[44]

Despite this explicit positive command for writing down these kinds of contracts, which principally signals obligation as a legal rule, many Muslim jurists did not require a written contract. In fact, most Muslim scholars have argued that writing the terms of the contract is desirable, but not mandatory. As a contract, a loan is valid once an offer (*ījāb*) is made by the debt-holder and accepted by the debtor(*qabūl*). Some scholars insist that a contract is valid only upon receipt of the debt (*qabḍ*). Although the debt-holder may ask for payments before the date stated in the contract, the debtor can also be given extra time. The debt-holder may also ask for early payment and in return forgive part of the debt.

In addition to falling within the general rules governing contracted transactions [*`aqd*] and securing receipt [*qabḍ]* of the object of transaction, a number of other conditions must be met for the debt arrangement to be valid and have legal standing:

1. The debtor and debt-holder must both be of legal standing in terms of adulthood and mental stability.
2. The debt-holder must own or be authorized to dispose of the property of the transaction.
3. The property must be (legally) "ownable," known, and describable.

The first conditions—adulthood and sanity—reaffirm the view that non-person entities cannot enter into a contract in the view of classical Islamic law. The standing of corporations in modern Islamic law schemes is thusopen to discussion. This issue is one of the key challenges of developing a sharī'ah-compliant business model.

The second challenge that remains unresolved is the distinction between for-profit transactions and not-for-profit transactions, especially in the area of lending. Modern Muslim legal scholars, like their Western counterparts, have not created hard rules that separate the two areas. The distinction is voluntary or a matter of internal business strategy rather than a subject of governmental or jurisprudential regulation. For example, a bank may have a division for business lending and one for consumer lending, but the difference is dictated by standards of efficiency and valuation, not by legal or ethical restrictions. In classical Islamic law, however, the distinction between need-based transactions and profit-based enterprises is evident. It is established that a debt accrued to help a person deal with hardship is not subject to profit. According to the tradition of the Prophet Muhammad, "every loan attached to profit is proscribed."[45] However, if the debtorwillingly offers an addition out of gratitudewhen returning the full loan, then that is acceptable.

Classical Islamic law imposes limitations on parties involved in debt. The debt-holder is not allowed to harass a debtor who is under difficult circumstances, and the debtor is in turn prohibited from delaying settlement of the debt. The debt must be repaid in kind, not in value, unless that is impossible, in which case the market value at the time of repayment is due, not the value at the time it was received (offered). This rule is evidently enforced to preserve or extend the prohibition on usury. The debtor has the option of paying in full or in installments within the agreed-upon timetable. In other words, there is no penalty for partial or full payoff.

Classical Islamic law goes beyond making debt a subject of ethical and moral codes by linking debt payment to the most common wealth transfer mechanism in most legal systems: inheritance and bequest. As I have noted, the subject of debt is intricately interwoven within the system of inheritance and bequest, and Qur`anic and Sunnaic legal proofs are explicit in setting priorities. Meeting debt obligation takes precedence over all other financial rights. Specifically, while the legacy of a deceased person essentially transfers to the heirs, actual ownership of such a legacy is not cleared until all debt is paid first.

Moreover, in the case of a debtor who is killed and whose relatives (heirs) are designated to collect his blood money (*diyah*), the heirs must pay all debt that he had accrued, even if the debt payment exhausts the entire *diyah*. Additionally, if a debtorborrowssomething in good faith with the intentionof paying it back in full but fails to do so, it becomes the obligation of the treasury (*bayt al-māl*) to pay the debt on his behalf.[46]

In summary, Islamic law extends debt obligation beyond the lifetime of the debtor, which further dis-incentivizes accruing debt. A debtor is forced to pay all that he owns to meet his debt obligations. The fact that classical Islamic law does not recognize fictitious business entities as legal persons does provide some protections to indebted individuals. For instance, while a debt-holder may seek to recover his property by seizing properties not tied to the debt, the debt-holder cannot seize a home in which their debtor resides, the debtor's food for himself and his family for one night, clothes, or books. In other words, a debt-holder can pursue actions against a debtor through government-sanctioned foreclosure under the rules of *ḥajr*.

Classical Islamic law makes debt obligations so absolute that even if the debt-holder disappears, the debtor remains obliged to discharge the debt. For instance, if the debtor cannot find the debt-holder, his representative, or his heirs, the debtor must offer the debt to charity on behalf of the debt-holder.

Lastly, although heirs are not responsible for debts they did not personally accrue, debt obligations are automatically attached to the debtor's estate. Since a deceased person has no legal standing and the heirs are not responsible for previous actions undertaken by the deceased, a debt becomes automatically due upon the death of the debtor. In other words, even if the time for payment was not due when a debtor dies, the debt is attached to the estate of the deceased immediately.

The majority of Muslim jurists of classical Islamic law have also concurred that debt is not subject to a statute of limitationssimply because a long time has passed without the debt-holder claiming his rights. Some scholars, however, have argued that if a debt-holder has not made any claim for ten years or more, then his rights have lapsed.[47]

Mortgages

As stated above, debt can be accrued either to meet basic needs or to generate profit. In both cases, the person taking a loan is said to be accruing debt. Borrowing to meet other immediate needs can be secured by mortgaging personal property. Classical Islamic law recognizes this kind of transaction and provides rules to control it.

In terms of definition and legal proof (*dalīl*), the Qur'an provides some context for mortgages.[48] The Arabic word *rahn* is found in the Qur'an and was coined to refer to assurance for a debt. Muslim legal scholars from all schools of jurisprudence insist that *rahn* is legal according the Qur'an, the Sunnah, and the consensus of jurists. The Qur'an introduces the concept and the practice when it declares that, "if one is traveling and a written contract is not possible, then it would suffice to hold a mortgage (*rihān*)."[49] It was reported also that the Prophet mortgaged his shield while in Madīnah at one point.[50] In other words, Muslim scholars agree that primary sources of Islamic law provide precedent for using tangible property as security against defaulting on debt. However, as is the case with other instruments and by virtue of being a contracted transaction, mortgaging personal property is subject to strict rules and restrictions.[51]

For a mortgage to be valid, it must be documented through a contract established through valid elements, offer, and acceptance. Since the mortgage is in essence a form of assurance against defaulting on a debt, receipt cannot be a necessary element of the contract. A mortgage is thus like a hold placed on a property until the debt is paid in full. As such the mortgage contract cannot have a separate deadline from that attached to the debt. However, it is possible to attach legitimate conditions such as the sale of the mortgaged property to meet the debt obligation. Some conditions cannot be attached to a mortgage contract, such as a stipulation that requires the sale of the mortgaged property at a specific price. If the mortgager and the lender agree to sell the mortgaged property, then the initial mortgage contract will be dissolved automatically. If the price is designated to be used as the object of mortgage again, a new contract must be drawn.

The mortgaged property must be an actual thing that can be owned, sold, and bought. This excludes mortgaging profit, benefit, or utility in a thing. Also, it is not legal to mortgage things that are not in the possession of the mortgager, such as birds in the sky or fish in the sea, nor can one mortgage a loan or a borrowed thing. Lastly, the lender has the first right to the mortgaged property before all other debt-holders.

Any benefit (*manāfi`*) derived from the mortgaged property belongs to its owner (*rāhin*).[52] Muslim jurists, however, are divided over the question of the status of the usufruct: would it be considered as part of the mortgage, which means it remains under hold as is the case with the original mortgaged property?Or is there a difference depending on the kind of usufruct?Just as the original owner reaps the usufruct of the mortgaged property, any expenses associated with its maintenance remain his responsibility.

When considering the primary sources of Islamic and Jewish law, it becomes clear that profiting from the basic needs of others is at least blameworthy, if not explicitly proscribed. Profiting from misery is condemned in the Qur'anic discourse. With this principle in place, people who wish to invest their capital and put their money into circulation rather than hoarding itmust steer clear of investments that generate wealth out of needy people. Investing in a mortgage company that provides loans for home buyers (primary residence units, aka family homes), for example, is an area of legal and ethical concern. Religious investors might avoid such a sector altogether. If that is the case, where can Muslims invest their wealth with the intent to augment it without being found involved in usurious practices?

With the same zeal as it prohibits usury, the Qur'an promotes charitable work and fair trade that are governed by explicit contracts. Charitable business deals remain the primary funders of projects helping the poor. Even if they have no desire to augment their wealth,the wealthy are encouraged to keep their wealth in circulation by providing interest-free loans to home buyers, debtors, and other needy individuals.

Those wishing to increase their wealth can choose from among several other schemes that can be quite profitable. Classical Islamic lawyers have promoted a number of for-profit schemes, instruments, and services. For explanatory purposes, I will briefly introduce several of the most common ones.

One such for-profit scheme is a not-in-kind partnership [*muḍārabah*], which involves two parties contributing different things to a business adventure.[53] This type of agreement between two people, whereby one side provides the capital and the other side provides the labor and the two agree on a formula for sharing the profit, is widely used in Muslim countries. Although it has some restrictions, the contract can be very flexible in setting the terms for sharing the profit. Muslim jurists validate this arrangement on the ground that risk and profit is shared between the two parties and therefore it cannot be classified as usurious no matter the terms of the profit-sharing scheme. As envisioned by Muslim legal scholars of the formative period, this practice is useful for merging the resources of a person with capital and one who has the skill to do the labor. The risk here is generally shouldered by the investor should the business adventure collapse, since the laborer is contributing just his "sweat," as it were. Another arrangement that can be classified as a not-in-kind partnership is a land use scheme [*muzāra`ah*] in which neither side provides capital. This kind of agreement is generallybetween landowners and laborers wherein the laborers use the land to grow crops and other products. The benefits from the products are then sold and the revenues are divided between the two parties according to an agreed-upon formula.

A second category of for-profit enterprise is called an in-kind partnership [*sharikah*]. Thisrefers to any arrangement where two or more parties invest equal or unequal parts of the same kind into a business.[54] For example, joint ownership could arise either by necessity, as in the case of multiple heirs of real estate such as an inherited house, or by choice, as when two or more people pool their money to buy investment properties.[55]

Additionally, according to most Muslim jurists from all three denominations, Islamic law allows for schemes that combine an in-kind with a not-in-kind partnership. For example, to increase the size and capital of a partnership, a business may seek investment of capital in a real estate enterprise. In such a case, the provider of the capital can be more than one person. This arrangement, according to some Muslim jurists, results in yet a third category—hybrid partnership [*sharikat al-`inān*]. Such an arrangement ties the interest of two or more persons in the ownership of capital and property. The partners share the profit according to the percentage of their invested capital and resources as spelled out in a written contract without significant restrictions. If two or more people own a joint property such as a house and one of them decides to sell his or her share, the other partner or partners are guaranteed the first right to buy the share as per *shufu`ah* principle.

In both Jewish and Islamic religious scriptural traditions, the link between poverty and *ribā* is made explicit. Both traditions also recognize the rights of individuals to augment their wealth, profit from capital, and own property. It can be argued that Islamic law, in particular, envisions wealth as an inalienable individual right that cannot be usurped or nationalized. From this perspective, individual property rights supersede the sovereignty of the state, since the latter is required to pay debt on behalf of defaulters from the money it collects as alms [*zakāh*].

Based on Islamic legal proofs as well, it is evident that Islamic law is not forward-looking when it comes to distributing risk and benefit. In the Islamic paradigm, risk cannot be delayed or passed forward. Risk and debt must be resolved by the generation that creates them. This second point may be related to the fact that classical Islamic law did not recognize the state or corporations as legal "persons." The only legal person with precedence over future entities is a living individual and his or her heirs.

Like the Jewish rabbinic scholars before them, however, Islamic legal scholars usecontractual instruments to circumvent scriptural limitations in order to soften the impact of the prohibition on *ribā*—and therefore interest-generated profit. As part of the Abrahamic tradition, Islamic legal scholarship built on the Jewish tradition that shunned profiting from poor Jews and extended it to prohibit profiting from all poor people. But Muslim legal scholars did not answer the more important practical questions: Is it legal to profit from poverty? And does Islamic law, as envisioned by classical and modern Muslim legal scholars, curb excessive interest?The answer to these questions can be found in the discussion of the following scenarios.

Scenario A. Imagine a poor person wanting to find a way to support her family. She seeks help from an Islamic lender (Islamic bank) and applies for a loan to establish a restaurant. The lender, in its effort to protect the interests of shareholders (some would prefer stakeholders), conducts an elaborate feasibility study, risk assessment, and background checks to evaluate the risks and potential for profit. Then the lender comes back with an offer: the bank shall support this client's business adventure granted that some key termsare met and agreed to by the client. The terms include the bank's commitment to provide a loan to finance the entire project. In return, the client shall pay 1/40 of the principle every month starting a year after the business becomes operational and agrees to pay off the loan within 10 years. After five years, the client shall pay 30% of the net profit for ten years, unless the business fails, in which case, the bank shall share in the loss as well. The bank justifies its large stake in the profit for 10 years by the need to cover "service charges" associated with the upfront cost of feasibility and actuarial studies and by the need to make a profit for the investors who provide the capital. The question, then, is this transaction sharī'ah-compliant?

Technically, and according to most Muslim scholars, this is a valid contract. The terms ostensibly avoid being usurious byhaving the bank and client share the risk (sharing profit and/or loss) and by not charging any fixed interest, be it high or low. Thirty percent of the profit is indeed high, but it is not usurious in the view of most Muslim legal scholars.[56]The bank brought its practices in compliance with sharī'ah by avoiding *ribā* as defined by all classical and modern Muslim scholars, by sharing in the potential profit and loss through properly and fairly managed risk [*gharar*], and by engaging in a lawful business scheme—a not-in-kind for-profit partnership [*muḍārabah*]. On the face of it, then, this is a legitimate transaction that meets all the guidelines established in the primary sources of Islamic law as well as the rules established by Muslim legal scholars.

Does this transaction address poverty, the condition that caused the prohibition of *ribā* in the first place? To answer that and understand the difference between need borrowing and business lending and their role in creating wealth and preserving poverty, let's consider some other examples.

Scenario B. Ali is a laborer who is supporting his family from paycheck to paycheck. He has been living in a very small apartment, paying a significant sum of money for rent that the landlord keeps increasing. He realizes that he cannot continue living in the apartment given his growing family and his fixed salary, which is not increasing to keep pace with inflation and the cost of living. He decides to build a home. He finds a decent plot of land that he buys using all his savings and then applies for a loan to build the house. The Islamic bank turns him down because he has no collateral that he can use to secure the loan. He decides to find ways to save some money, difficult as that is, and begin building his future home one stone at a time, one wall at a time, one room at a time, one floor at a time, taking him and his family generations before the structure can be considered complete. One can see evidence of these practices all over the cities in Muslim countries, especially the poor ones: unfinished homes as far as the eye can see, perpetual construction in homes where people already live. In contrast, the apartment building where Ali had lived was built in months by an owner who was able to secure an investment loan for an income-generating building, for which the bank was happy to provide the capital.

Scenario C. The last scenario represents a common practice of most banks in the Muslim world. Mahmoud is a laborer and head of a household who needs a car. He approaches an Islamic bank for a loan to buy the car. The bank runs a credit history check and finds out that he qualifies for the loan. The bank asks him to find the car he wants. It then buys the car from the third party for $10,000.

Immediately thereafter, the bank *sells* the same car to Mahmoud for $12,000. Mahmoud pays the bank in equal installments of $200 every month for 60 months. Again, this transaction is valid in the view of most Muslim scholars because it qualifies, technically, as a trade [*bay`*]. However, considered from another angle, it is not any different from any loan from any other bank that charges 20% interest over the $10,000 loan, except that most traditional banks will frontload the payback of interest charges, whereas this Islamic bank spreads it equally throughout the 60-month period.

These hypothetical schemes underscore the problems facing Islamic financial institutions in living up to their obligation to fight poverty and follow a socially conscious business model. First, they are very selective about the projects in which they invest. Second, they tend to invest only in safe enterprises.[57] Thirdly, they accrue high upfront costs on feasibility studies and other administrative costs. All these measures are implemented for the purpose of avoiding losing money, since they are supposed to share in profit and loss.

Profitable investment projects face no difficulties securing capital whether from Islamic or non-Islamic financial institutions. Persons needing loans to meet basic needs like building a residential home, paying for food, college, health services, and other necessities are the ones who face difficulties securing loans. In the United States, for example, this challenge is met through government intervention or non-profit organizations. The same happens in some Muslim countries.[58] However, given the limited capital available in countries like Tunisia, Turkey, Morocco, Egypt, Jordan, Bangladesh, Pakistan, and most other Muslim countries whose economies are not enriched through oil production,the demand for need lending is alarmingly unmet. This problem impacts other areas of public life beyond alleviating poverty and managing the gap between the rich and poor in society. The failure to find solutions for financing endeavors that help alleviate poverty has an impact on economic development, city planning, architecture, arts, diversity, freedoms and rights, aesthetics, public health, zoning, education, and public services.

Importantly, from the point of view of religious compliance, there is no limit on profit, should a business actually become profitable, as long the terms are stipulated and agreed upon in a contract. A paradigm like this does little to address the problems of poverty and need and a lot in terms of guaranteeing and preserving the rights of the wealthy to augment their wealth from capital on the backs of the needy. In the end, the distinction between modern Western finance and trade practices and Islamic practices becomes academic, as neither seriously addresses social justice issues, wealth disparity, and fairness in lending.

Conclusion

When decidingwhether a product or service is in conformity with the general principles of Islamic law, regulators, consumers, and religious authorities essentially try to answer a simple question: What distinguishes Islamic finance and exchange laws from their counterparts in other legal traditions?

For a Muslim jurist, the answer is seemingly simple: finance and exchange laws must be sharīʽah-compliant. In other words, financial services and products must live up to the ethical and legal codes described in the primary sources of Islamic law—the Qur'an and the Sunnah. This broad statement is reduced in practice to one condition: to be sharīʽah-compliant, a financial service or product must be *ribā*-free. Moreover, *ribā* is more or less defined as the taking of a fixed interest on deposited or borrowed money or goods regardless of the purpose of the loan or trade.[59]

As we have seen, the Islamic prohibition on *ribā* is merely a qualified modification of the same rule that exists in Jewish tradition. Jewish scriptural sources also prohibit charging interest on loans to the poor, although rabbinic scholars have interpreted that prohibition to exclude Gentiles. That is to say, a Jew shall not charge interest to another Jew, be she rich or poor, but profiting from non-Jews by charging them interest is acceptable. Muslim scholars on the other hand extend the prohibition on *ribā* to all: one cannot profit from interest, cannot charge interest, and cannot be engaged in transactions that charge interest to anyone, Muslim or non-Muslim, under all circumstances.

But importantly, Muslim scholars generallyhave failed to address the cause of prohibition as stated in the primary sources—not taking advantage of the poor—as if, by prohibiting profiting from fixed interest ventures, the poor will no longer be impacted by the negative aspects of *ribā*. The assumption is that, charging interest is bad when it is fixed, collected over time, and does not spread risk. Muslim scholarshave reasoned that by creating instruments that allow all parties to share risk and profit and by limiting monopolism, the problem with *ribā* is mitigated.

But this solution fails to address the fundamental cause behind the scriptural prohibition—mitigating need and poverty—and focuses on the wrong goal—devising instruments of profit and augmenting wealth.

The textual evidence, examples, and analysis I have provided lead to the conclusion that Islamic finance and exchange law is neither a system nor a subsystem that is radically different from other legal systems.Islamic law, in the end, recognizes the absolute right of persons to own property individually and collectively and to augment their wealth through a variety of practices. Despite the fact that Islamic scriptureexplicitly prohibits profiting from the poor and vulnerable members of society, the financial and exchange laws in Islam have become merely a scheme to get around some of the religious prohibitions and limitations on *ribā*, monopolism, debt, and risk. Examples have shown that Islamic banks can in fact continue to profit, sometimes more than traditional banks, from services and products needed by the poorest of people. The question, then, becomes: is there a way that preserves the rights of the rich to profit from their wealth and protects the poor at the same time?

The answer to this question could be the subject of an entire monograph. However, by way of opening this topic for discussion, I would suggest that balancing rights and protecting the vulnerable is indeed possible. For instance, regulators could require that all banks reserve one-fourth or one-third of their loan portfolio to provide loans to poor and vulnerable individuals in the form of *at-cost loans*. The rest of the portfolio can include products and services whose terms are decided by market forces. Such a solution could create uniformity among financial institutions around the world, something sorely needed in today's highly global community. After all, some of the schemes devised by Islamic banks to get around *ribā* limitations are, in the final analysis, not that different from the terms of loans provided by non-Islamic banks. The at-cost quota on loans ensures that the most vulnerable in society have access to affordable loans while allowing banks to profit in business dealings restricted only by market forces, conditions, and healthy competition.

Islamic services and products are made sharīʽah-compliant by simply avoiding interest charges, sharing in in profits and losses, and not investing in illegal businesses (like winery, gambling, pork, etc.). But again, this compliancefulfills only the letter of the law, not its spirit. After all, as illustrated in scenario C above, a poor person may not technically pay interest on a loan from an Islamic bank, but he nonetheless pays a markup price on resold goods that is much higher than the interest he would have paid to a non-Islamic bank. Similarly, although Islamic banks are said to share in the loss and profit when investing in a business, in reality, and as a consequence of the extensive studies conducted by banks to assess the success of the business, Islamic banks end up actually investing in businesses with potential for success only—hence rarely sharing in the loss. Lastly, the prohibition on investments in what can be seen as illegal ventures can have negative impacts on businesses that are discouraged religiously, such as some forms of arts, literature, sciences—impacting entire areas of human creativity and production.

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Endnotes

[1] Graciela L. Kaminsky and Carmen M. Reinhart (1999) "The Twin Crises: The Causes of Banking and Balance-Of-Payments Problems" The American Economic Review, Vol. 89, No. 3 (Jun., 1999), pp. 473-500; Viral Acharya, Thomas Philippon, Matthew Richardson, and NourielRoubini (2009) "The Financial Crisis of 2007-2009: Causes and Remedies" Financial Markets, Institutions & Instruments, Volume 18, Issue 2, pages 89–137; Chalmers Johnson, (1998) "Economic crisis in East Asia: the clash of capitalisms" Cambridge Journal of Economics, Volume 22, Issue 6, pp. 653-661; C.A.E. Goodhart, (2008) "The regulatory response to the financial crisis" Journal of Financial Stability, Volume 4, Issue 4, pp 351–358; and Andrew W. Lo (2009) "Regulatory reform in the wake of the financial crisis of 2007-2008" Journal of Financial Economic Policy, Vol. 1, Iss: 1, pp.4 – 43.

[2] Although poverty statistics must be analyzed in the proper context, it ought to be noted that according to the most recent UN and World Bank figures (2010), more than 50% of people around the world live on less than $2.50 a day; 80% live on less than $10 a day. Even those troubling numbers become meaningless when considering poverty in the developed world. For instance, many Americans live on just above the $10-a day-cutoff, but are still living in poverty. In fact, close to 40 million Americans are actually poor but live on more than $10 a day.

[3]Zulkifli Hasan, Sharī'ah Governance in Islamic Banks (Netherlands: Edinburgh University Press, 2012), 21.

[4] Since our inquiry goes all the way back to the formative period, when transactions and trade were done in kind or mediated by exchange of precious metals for goods, I must clarify that I use the terms "finance and exchange" in the broadest sense possible, referring to financial transactions through currency or trade in goods.
[5] Oversight in Islamic financial institutions mimics Western corporate structures in many ways. However, the governance controls within Islamic financial institutions include, in addition to their regular functions, determination of compliance with sharī'ah rules. "[C]orporate governance plays a role to reassure stakeholders that their activities are fully compliant with Sharī'ah principles. Second, the stakeholders also need to be assured that IFIs [Islamic financial institutions] aim to maintain improved growth." See Zulkifli Hasan, Sharī'ah Governance in Islamic Banks, 25. This double role creates a conflict of interest of some sort. Corporate governance is tasked with putting in place rules and regulations that would maximize value for stakeholders. What happens when the rules intended to increase value or return conflicts with the principles of Islamic law is understandably unknown, hence the need for the creation of separate agencies, given the difference in functions and aims.
[6] Daniel Klein (1995) "The Islamic and Jewish Laws of Usury: A Bridge to Commercial Growth and Peace in the Middle East" Denver Journal of International Law & Policy, Vol. 23:3, pp. 536.
[7] Daniel Klein, 541.
[8] Daniel Klein, 543.
[9] Daniel Klein, 544.
[10] Daniel Klein, 538.
[11] Mohammad Omar Farooq (2007) "Partnership, Equity-Financing and Islamic Finance: Whither Profit-Loss Sharing?" Review of Islamic Economics, Vol. 11, Special Issue, pp. 67.
[12] While Sunni and Ibāḍī legal scholars recognized the important function of ijtihād and applied it, especially during the formative period of Islamic law, Shi`ite scholars did not fully embrace ijtihād, albeit under a different word-- `aql, until after Occultation. It must be noted also that, for Sunnis, *ijtihād* during the first three Islamic centuries was not the same as ijtihād thereafter. Ijtihād during the former period was not bound by the limits imposed by emerging schools of jurisprudence, whereas ijtihād during the latter period was limited by the rules governing the school of jurisprudence within the broader tendency known as Sunnism.
[13] Muslim jurists did not agree on a single definition of ijmā'. Ali al-Mishkini, *Isṭilāḥāt al-uṣūl* (Qom: Hadi Press, 1985), 23.
[14] Some schools of jurisprudence put strict guidelines and restrictions on the person once a choice is made, however.
[15] Ahmed E. Souaiaia, *Anatomy of Dissent in Islamic Societies: Ibadism, Rebellion, and Legitimacy* (New York: Palgrave, 2013)
[16] Popular opinion suggests that Shiism was the first sect in early Islamic society. I have argued in another work (Anatomy of Dissent in Islamic Societies) that that position is not tenable. Ibadism is the first organized schism in Islam since Ali's followers were at least "mainstreamed" when Ali became caliph. Ibadis on the other hand, continued to represent a distinct organization that broke off its ties with Ali on legal and religious grounds. Shiism only became a coherent movement with distinct ideological and theological principles only after the death of Ali's son, Hussain.
[17] [Q2:V276-8].
[18]Mudawwanat Abī Ghānim al-Khurāsānī, (Oman: Maktabat al-Jil al-Wa`id, 2006), 623-24.
[19] The exegete, al-Huwwārah, suggests that the use of the word "*ya'kulūn*" refers to the profiting from usury the same way people would profit from trade. See his commentary on [Q2:V275] in his Tafsīr kitāballāh al-`azīz.
[20] See Kitāb al-ribā in Yahya Ibn Abdullah al-Nabhani and Ibrahim Ibn Muhammad al-Asakir, Mudawwanat Abī Ghānim al-Khurāsānī, 624.
[21] Muhammad Ayub, Understanding Islamic Finance (New York: John Wiley & Sons, 2009), M. SiddieqNoorzoy (1982) "Islamic Laws on Riba (Interest) and Their Economic Implications" International Journal of Middle East Studies, Volume 14, Issue 01, pp 3-17; J. Michael Taylor (2008) "Islamic Banking - The Feasibility of Establishing an Islamic Bank In The United States" American Business Law Journal. Volume 40, Issue 2, pp. 385–414; and Farhad F. Ghannadian, GautamGoswami (2004) "Developing economy banking: the case of Islamic banks", International Journal of Social Economics, Vol. 31 Iss: 8, pp.740 – 752.
[22] Muhammad Fathi Muhammad al-Atrabi, *Fiqh al-masarif al-islamiyyah* (Egypt: Dar al-Mutbu`at al-jami`iyyah, 2012), 90.
[23]al-Atrabi, 91.
[24]al-Atrabi, 97.
[25] It ought to be noted that, for some Muslim scholars, the Qur'an and the Sunnah are both the primary source of Islamic law. In other words, the Sunnah is not, in the view of these scholars (mostly from the conservative schools of thought), a secondary source.
[26]al-Atrabi, 97.
[27]al-Atrabi, 108.
[28] In Islamic law, gold and silver are not the only form of currency; any tradable thing is considered "currency." The Prophet is said to have declared that "whoever dies defending his wealth (*mālahu*) is a martyr." al-Atrabi, 119.
[29] From [Q4:V11-12].
[30] From [Q9:V34].
[31] It is reported in *Ṣaḥīḥmuslim*, on the authority of Mu`ammar Ibn Abdullah who heard the Prophet Muhammad declare that only the wicked would engage in monopolism [*lāyaḥtakiruillākhāṭi'*].
[32] The link between ribā and monopolism has been made by Muslim scholars from the classical and well as the modern era. "With regard to discriminating monopoly which practices price discrimination, the position of Islam is unequivocal. The practice of price discrimination—selling the same goods at different prices to different customers—is considered equivalent to exploitation or ribā." See AbdusSamad, (2008) "Market Analysis from an Islamic perspective and the Contribution of Muslim Scholars" Journal of Islamic Economics, Banking and Finance, 2008, pp. 55-68.
[33] Muḥammad Ibn AḥmadSarakhsī, al-Mabṣūṭ (Lebanon: Dār al-Kutub al-'Ilmīyah, 2001), 15: 177.
[34]Aḥmad ibn Idrīsal-Qarāfī, al-Dhakhīrah (Cairo: Maṭba'atKullīyatal-Sharī'ah, 1961), 4:355.
[35]al-Mubdi`; 3:362.
[36]MohdMa`sumBillah, Applied Islamic Law of Trade and Finance (Malaysia: Sweet and Maxwell Asia, 2007), 25.

[37]Stambovsky v. Ackley, 169 A.D.2d 254 (N.Y. App. Div. 1991)
[38]Billah, 24.
[39]Billah, 33.
[40]Billah, 41.
[41] Specifically, accruing debt with the knowledge that it can't be repaid and not needing the loaned object is illegal [*muḥarramma`afaqd al-qudrah `alaqaḍā'ih wa-`adamal-ḍarūrahilayh*]. The preference is to seek help from the collectors (or donors) of alms (zakāh) but if unable to secure the need through alms, then accruing debt will be acceptable over begging [*ṭalab bi-'l-kaff*]. A. Salah al- Halabi, al-Kāfī fī-'l-fiqh (Isfahan: Emam Ali Library, 1979), 331.
[42] Tradition reported on the authority of Imam Ja`far al-Ṣādiq. See Fiqh al-imam Ja`far al-Ṣādiq, 4:6.
[43] See Fiqh al-imam Ja`far al-Ṣādiq, 4:6.
[44] [Q2:282]
[45] See Fiqh al-imāmJa`far al-Ṣādiq, 4:11.
[46] "Almsgivings are for the poor, the destitute, the tax collectors, the friends of the community, wound murder victims, debtors (*ghārimīn*), the causes of God, and travelers; these are divinely ordered sanctions and God knows best." [Q9:60]
[47] See Fiqh al-imāmJa`far al-Ṣādiq, 4:4.
[48] Functionally, in modern Islamic law, *rahn* is also referred to as *ḍamān* (collateral). Some scholars consider the absence of collateral to be a cause for voiding certain financial transactions, such as a loan or an investment deal. See WaelArabiyyat, al-Maṣārif al-islāmiyyah wa-'l-muassasātal-iqtiṣādiyyah (Amman: Dar al-Thaqafah, 2006), 32.
[49] [Q2:V283].
[50] See Fiqh al-imāmJa`far al-Ṣādiq, 4:23.
[51] Generally, the mortgaged security cannot be modified or benefited from except in accordance with an agreement between the two parties established before the effective date. However, if the mortgaged security is an animal requiring constant care, benefiting from the services that can be provided by such an animal—like riding a mortgaged horse or using the wool of a mortgaged ram—is allowed. See al-Kāfī fī-'l-fiqh, 334.
[52] Securing a loan in classical Islamic law can take many forms, which creates confusion in the terminology. For instance, a loan can be secured by placing a property as collateral, which is generally referred to as rahn. However, one can also secure a loan by providing assurances either by naming another business as collateral, having a third party cosign on the loan, signing a promissory note, or simply staking the reputation of some prominent community leader. This kind of security is sometimes called ḍāmin or kafīl. See Abdullāh al-Bahlawī al-`Umānī, Kitāb al-jāmi` (Oman: Wizarat al-Turath wa-'l-Thaqafah, 2007), 2:411-12.
[53] Although this scheme is a form of partnership, only the investor [*rabb al-māl*] may risk losing the capital. Ibāḍī jurists void this kind of scheme if it includes a stipulation requiring the laborer to guarantee success or pay back all or part of the invested capital. See al-`Umānī, Kitāb al-jāmi`, 2:368.
[54] This scheme is the foundation for investment lending in modern times whereby one of the two parties can be a bank. The bank provides the capital but becomes a partner (not lender). The agreement will involve a formula that will allow the bank to recuperate its original capital and share in the profit, but be prepared to sell its stake either to the "partner" or a new one. See WaelArabiyyat, 36.
[55] Shiite jurists, for instance, insist that partnership [sharikah] is valid only when the partners pool together "money" of the same kind [*amwālmutajānisah*]. Partners may contribute equal or unequal amounts, but the profit will be proportional to the amount of their initial investment or else it will be voided by usury rules. In what appears to be a divergence from the general rule, jurists allow for a partner to join in by offering his labor instead of the money, for example, on the condition that his labor investment must be converted into money (or whatever currency used to create the partnership) based on fair wages rate, which makes his labor an investment in kind. al-Halabi, al-Kāfī fī-'l-fiqh, 343.
[56] In Islam, "the lender who advances money for trade and production can contract to receive a share of the profit, because he becomes part-owner of capital and shares in the risk of the enterprise." Abbas Mirakhor and Zubair Iqbal, Islamic Banking (International Monetary Fund, 1987), 2.
[57] Modern Islamic banks "will not enter into a partnership unless it is assured that the venture will be profitable." WaelArabiyyat, al-Maṣārif al-islāmiyyah, 37.
[58] Ironically, micro financing schemes, which are designed to help the poor in countries like Bangladesh, are the ones that help the needy yet charge interest to remain sustainable, a practice that, on the face of it, could be a violation of posited Islamic law.
[59] Of course, financing a business that deals in services or products explicitly prohibited by Islamic law is also prohibited. For this reason, some Muslim scholars prohibit trading stocks because they see it as a form of gambling. Others consider trading stocks of legitimate companies legal because it amounts to investing in a business and sharing in the risk and loss, as opposed to holding an interest-bearing savings account, which guarantees profit.