

# **A Critique of Islamic Banking and Finance: Harmonization of *Fatawa* (Islamic Opinions) and the Nature of Modern Economic Life**

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## **ABSTRACT**

*From dawn of Islamic civilization, fuqaha (Islamic jurists) served the Islamic society as the middlemen making inquiry into Qura'n and the tradition of the prophet (PBUH) to find out the solutions for the growing queries of the everyday life. The queries of the early Muslims in the primitive Islamic societies would have been aroused from the expediencies of the era they lived in. The economic life that they were realizing was an agrarian economy, the concept of wealth in their mind was real assets, and the circulating money ought to serve the economy as a mere means of exchange. In these circumstances, the fatwas of the preceding Islamic jurists was quite consistent with the time span they lived through. Today, however, the state of affairs has vividly altered. A huge nominal sector alongside with vital institutional changes affects the modern economic life. A person may be wealthy today without holding any kind of the real assets. Instead, a personal wealth inventory includes paper assets. The lending process in the modern time is not informally carried out between two individuals in an uncontrolled environment. Instead, it is being performed formally under the new institutions protecting both borrowers and lenders in nearly competitive markets. Nevertheless, the fatwas of the Islamic jurists are yet as the same as they were in the agricultural era. This implies a slight change in Muslim scholars' attitudes towards the underpinnings of the modern era.*

## 1. Introduction

The compliance with the rulings of *Shari'ah*, is the main basis for the Islamic banking and finance evolution. It is the duty of *fuqaha* (Islamic scholars/jurists) to recognize whether a mode of finance or any other features of financial system, are within the limits imposed by the *Shari'ah*, or not. By issuing *fatawa* (Islamic formal opinions), *fuqaha* declare their views on the different aspects of human life, based on the sources and attributes of the Islamic values and principles. *Fatwas* are the result of *ijtihad* (expertized investigation in Islamic sources) to obtain the legal rules from *Qura'n* and *Hadith* (the tradition of the Prophet of Islam (PBUH)). According to Islamic ideology, while *Qura'n* and *Hadith* are revealed and can not be considered as human intellect, *fatawa* are the product of independent reasoning by qualified scholars to conduct life within the *Shari'ah* outlines.

*Fatawa* must be subject to critical scrutiny to provide appropriate infrastructure institutions on which a sound socioeconomic system could be built. The most ideal possibility for *fatawa* regarding the Islamic financial sector is not only to be competently compliant with the *Shari'ah* principles but also to be adequately in harmony with the inherent nature of the modern economic life.

A large literature contends the *Shari'ah* related foundations of Islamic finance. Some authors have discussed the adaptability of Islamic law to changed conditions of the contemporary financial system from a legal perspective (Ahmed 2006). Yet, the adaptability of *fatawa* to the emerging new conditions of the modern world has not been thoroughly discussed from an economic point of view. This research is intended to fill this void.

This paper investigates some doubts which may arise due to applicability of outdated definitions of *Riba* to the conditions prevailing in the modern world. The reasons for the obsolescence of the existing definition of *Riba* as well as the need for revising it are the main themes of the paper. The possible amendments in the foundations, on which Islamic banking and finance are operating, paves the way for more innovations and growth in the new emerging Islamic modes of finance.

The paper approaches the above matters with a critical review of Muslim jurists' methodology in order to examine its merits and pitfalls in confrontation with the intricate socioeconomic phenomena of the modern world. Then, a brief discussion of the foundations on which the modern economic life is based will be surveyed upon. This will distinct the discrepancies between the *fatwas* and today economic life. Eventually the need for revising the methodological framework of *fatwas* will be recommended while emphasizing on reconciliation between theory and practice.

## 2. Islamic law

Islamic law started with the advent of Islam. The primary sources of Islamic law are *Qura'n* (cited revelation) and *Hadith* (non-cited revelation which stems from the tradition of the Prophet of Islam (PBUH)). According to Islamic ideology, *Qura'n* and *Hadith* are revealed and can not be deemed as human intellectual achievements. The second source of knowledge in Islamic law, however, is what derived from human intellect through *ijtihad* (exertion). *Ijtihad* is the process of independent reasoning by

qualified scholars to obtain legal rules from the primary sources using other (secondary and tertiary) sources of Islamic knowledge which comprise the methodological discipline of Islamic legal system or *u sul al fiqh*.<sup>1</sup> The inferred knowledge resulting from *ijtihad* is referred to as *fiqh* which comes up with the *fatawa* (formal and legal opinion) of jurists. (Hassan 1992)

The introduction of *fiqh* took place when Islam began to expand throughout the world. At the outset, the diversity of opinions among Muslim jurists as to the methodology of law led to the evolution of different *fiqhi* schools. One of the factors that distinguish these schools is the emphasis that each puts on making use of rational methods to elaborate the legal system of Islam. On this ground, the schools are ranged from pure traditionalists who consider *Qura'n* and *Hadith* as the only basis of laws, to the rationalists who believe that the primary sources need to be complemented with rational principles to develop laws.<sup>2</sup>

The evolution of Islamic jurisprudence did not continue in the course of time. After a period of flourishing and versatility, a long period of *taqlid* (imitation) ensued in which the teachings of the respective schools were strictly followed. During a long period, the doors of *ijtihad* were closed and this led to the stagnation of the evolution of Islamic jurisprudence (Ahmed 2006).

A resurrection is occurring in the contemporary times. From the middle of 20<sup>th</sup> century as Muslim countries realized that adopting Western laws and legal system defensively may retard their progress, Muslim scholars and thinkers began to seek solutions for various aspects of human life from Islam. This eager urge to revive Islamic legal system manifested plainly in the evolution of Islamic banking and finance.

Nevertheless, it seems that various *fatawas* underpinning the rules and regulations of Islamic banking and finance is strictly bound to the old methodology of *fiqh*. Moreover, Today's *fatawa* of contemporary jurists are highly dependent on the preceding jurists' percepts of the economic system envisaged in the time span they lived.

## 2.1. Current Definition of *Riba*

From Islamic perspective, prohibition of *riba* is the most eminent feature of a sound financial system. Yet surprisingly enough, its meanings are vague and based on the views of early jurists who had experienced a different economic system which is no longer in vogue.

Regarding the prevailing definition of *riba*, the mainstream percept can be viewed more or less as such manifested by the Federal Shariat Court Pakistan 1999 as follows:

- i. Any amount, big or small, over the principal, in a contract of loan or debt is *riba* prohibited by *Qura'n*.
- ii. A transaction of money for money of the same denomination where the quantity on both sides is not equal, either in a spot transaction or in a transaction based on deferred payment.

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<sup>1</sup> For a discussion on the sources of knowledge in Islam see Kharoufa (2000) and Rayner (1991).

<sup>2</sup> For a discussion on the evolution of *fiqhi* schools in Islam see Owsia (1994) and Phillips (2002).

- iii. A barter transaction between two weighable or measurable commodities of the same kind, where the quantity on both sides is not equal, or where the delivery from any one side is deferred.
- iv. A barter transaction between two different weighable or measurable commodities where delivery from one side is deferred.

This categorization of *riba* is followed by the remarks that out of these four types of *riba*, the first is dominant in the day-to-day conventional banking operations, the second can be extended to the stocks trading in modern finance, and the last two appear only in barter system that has become a rare phenomenon in modern trade.

A brief history of *riba* since the inception of Islam till the current disputes concerning Islamic banking and finance can illuminate the idea to be explained in this paper.

## **2.2. Riba in Qura'n**

The verses of *riba* were revealed to the prophet (PBUH) on four different occasions.

First, it finds mention in the verse 39 of *Surah Al-Room*. This verse does not issue an explicit injunction against *riba*, though it decries it by saying that “whatever *riba* you obtain as if your wealth may increase at the cost of others, in the sight of Allah, it is not increasing.”

The second verse is that of 161 *Surah Al-Nisaa* where the term *riba* is used in the context of heinous sins committed by Jews. It blames them “for their devouring of *riba* even though it was forbidden for them.” This verse can not be taken as a direct prohibition of *riba* for Muslims. It simply implies that other religions have prohibited *riba*, though it contemplates *riba* as a sinful act for Muslims as well.

The third verse of *riba*, verse 130 of *Surah A'l-i-Imran*, was laid down in the following words: “O believers! Do not charge *riba* on top of *riba* and fear God so that you may prosper.” According to this verse which is estimated to have been revealed sometime in the 2<sup>nd</sup> year after Hijra (the migration of Prophet from Mecca to Medina), the practice of *riba* is forbidden for Muslims in express terms.

Finally, the fourth set of verses is contained in *Surah Al-Baqarah*, verses 275-281, where the severity of the prohibition of *riba* is elaborated in details. These verses state that in order to justify *riba* some people may be reasoning that “Trading is but like *riba*.” But they are warned off that “Allah has permitted trading and prohibited *riba*.” Those who may have been engaged in *riba*, are being rebuked to give up the unjust excess they have earned from *riba*; “O believers! Fear Allah and give up what still remains of *riba* if you are true believers. But if you do not, then listen to the declaration of war from Allah and His Messenger. And if you repent, then you can claim your principal. Neither should you inflict harm to others, nor others should do harm to you.”

As it seems from examining the above verses, *Qura'n* does not bear a crystal clear definition of *riba*. But it codifies some coherent codes which can serve us as general principles to provide guidance for interpreting the meaning of *riba*, taking into account the changed and changing circumstances of the time span we are living in. This can be accomplished by complementing these codes through improving our understanding of the functions of the institutions affecting our economic life.

Before bringing up the main theme of this paper, it is worthy to investigate shortly the endeavors carried on by the early commentators of *Qura'n* to envisage a proper exposition of *riba*.

### 2.3. Riba in the early jurists' outlook

The word '*riba*' literally means "excess or addition". But it is not the lexical meaning to which *Qura'n* refers. To find up the true meaning of *riba*, the exegetes of *Qura'n* have sought it within the context in which the word used to be perceived and applied by Arabs in the days of the revelation of *Qura'n*. There are also terminological explanations propelled by the sayings of the Prophet (PBUH) in *Hadith* referring to some special kinds of transactions which would have not been known previously as *riba* by Arabs.

The Islamic scholars today, following the exact line of reasoning as their precedents, argue that *Qura'n* did not give any definition of *riba* for that the meaning was quite well known to its immediate audience. Not only Arabs but all the previous societies used to practice it and nobody had any confusion about its exact sense. The concept of *riba*, therefore, has a long historical life, throughout most of which it has been understood to be referred to as the practice of charging any amount by the creditor over and above the principal advanced by him to the debtor.<sup>3</sup> This kind of *riba* has been termed as the *Qura'nic riba* or the *riba* of *Jahiliyya* or the vivid *riba*.

The second exposition of *riba* in *Qura'n* has been authenticated to be within the ambits of *riba* by the authorization of *Hadith* and hence, it is called *riba-al-sunnah*. The Holy Prophet (PBUH), given the commercial atmosphere of fourteen centuries ago, prohibited some barter transactions under the title of *riba* which would have not been known as *riba* by that time. In an authentic saying, the Prophet (PBUH) issued the edict that in a barter exchange of "gold for gold, silver for silver, wheat for wheat, barley for barley, date for date, and salt for salt, (the exchange must be) like for like, equal for equal and hand to hand. If the commodities differ, you may sell as you wish, provided that the exchange is hand to hand" (Muslim, Al-Jami, *al-Sahih, Kitab al- Musaqat, bab al-sarf va bay`al-dhahab bi'l-waraq naqdan*).<sup>4</sup>

These two main primary perceptions of *riba*, along with narrations from the companions of the Prophet (PBUH) stating that the Holy Prophet passed away before giving any specific explanation of *riba* in detail (Usmani 2000), caused some debates amid the the jurists which came up with a broader definition of *riba*.

Regarding the *Qura'nic riba*, the most common form of *riba* practiced by the Arabs would be the creditor's claim to compensation in the case of a culpable neglect on the part of the debtor to fulfill his contract obligations<sup>5</sup>. Anyway, as the first extension to the meaning of *riba*, all early commentators and jurists unanimously contended that a

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<sup>3</sup> It does not make any difference whether the debt was originally liable due to a loan or a deferred sale but it seems that the latter would have been more prevalent at the time of the revelation of *Qura'n*.

<sup>4</sup> Some contemporary scholars have ascribed this decree to the characteristics of the mentioned commodities as a medium of exchange like money which will be further examined in this passage (see Usmani 1999 and Siddiqi 2004).

<sup>5</sup> It is supported by the saying of the non-believers in the verse 275 of *surah Al-Baqarah* that *riba* bears a resemblance to sale.

loan given against any stipulated increase over the principal makes sense of the prohibited *riba* in *Qura'n*.

The second extension in the meaning of *riba* is concerned with the *riba-al-sunnah*. The narrations of the statement that the Holy Prophet (PBUH) passed away before explaining *riba* in full terms are attributed to this kind of *riba* (Usmani 2000). The barter trades banned by the Holy Prophet (PBUH) were only embracing six special commodities. Afterwards, by modification (*tanqih'l-manat*), the purview of this type of *riba* was extended to other commodities, though jurists differ among themselves as to what those commodities should be. The attributes modified by jurists to distinguish groups of commodities which enter the sweep of *riba-al-sunnah*, include the characteristic of edibility, being salable by weight or measure, being storable necessities or, perhaps the most plausible, being used as a medium of exchange (Chapra 1984, p.7).

#### **2.4. Controversies over *Riba* in Current Age**

The primary juristic works as to the meanings and the senses of *riba* followed by a long period of stagnation during which only the rulings of the preceding jurists duplicated. As the modern banking institutions entered the world of Islam in the nineteenth century, the situation started changing. Muslims scholars faced with questions regarding dealing with banks. This brought back the Islamic thought into the scene.

Two different juristic opinions (*fatwa*) have been issued regarding the modern banking operations. The first, compared to the old views, entails the narrowest definition of *riba*. It confines *riba* to the practice of the Arabs in the past and thus, legitimizes the current banking operations. This view has been criticized by recent thinkers for giving no proof of the case and just focusing on the banking needs of Muslims (Siddiqi 2004).

As the Muslim countries came out of the foreign rule around the middle of the twentieth century, Muslim jurists, now finding the political and fiscal supports of governments, pronounced the same *fatawa* of the preceding Islamic jurists and ended up with the proclamation that declares the conventional bank interest as the current organized practice of prohibited *riba*. The advent of Islamic banks as an alternative for the Western banks and its rapid spread convinced Muslim thinkers that they can build economic institutions on the basis of the rulings of Islam.

As noted by Ahmed (2006), the expansion of Islamic modes of banking and finance has taken place in three different ways. First, traditional concepts\contracts came in to replace the contemporary concepts\transactions. For example, the traditional sale of debt (*bay-al-dayn*) is replaced for overdraft operation in the banking system of Iran. Second, a combination of traditional contracts is designated to create a new contract. As an example, *sukuk* is a composite of multiple transactions\contracts. Finally, the third method of creating new financial instruments is to adopt and adapt conventional products\contracts that meet the *Shari'ah* criteria. For example, investments in stocks are permitted as far as it does not violate the principles of *Shari'ah*.

Notwithstanding the large literature illuminating the characteristic of Islamic banking opinions, it seems that the true grounds of recent *fatawa* which may turn out to have economic characters repugnant to the nature of modern economic system, have not yet profoundly examined. The Islamic modes of finance, based on *fatawa* which are inconsistent with the essence of economic action, would be at the most a hybrid deemed as misleadingly to be void of *riba*.

## 2.5. A Critique of Today's Process of Ijtihad

Recent achievements in Islamic banking do not indicate an advance in the jurists' interpretation of *riba*. For more than a millennium, any development there was consisted in nothing more than the adoption of the old views in wider circles, the repetition of them in more or less skilful variations, and adapting the argument to the fashion of the time.

Writings on *riba* have been extensively concerned with the expositions of *riba*, but with disquisitions about *riba*. Thought about *riba*, and any other *Qura'nic* penetrative codes, must be a story of movements in outlook and ever-changing ideas, and developments taking place in contemporary social sciences. Its province is destined by God, may he be exalted, in a way to be determined and re-determined in the course of time by drawing insights from different branches of human science. The subject of *riba*, and other divine codes in *Qura'n* regarding dealings and transactions<sup>6</sup>, is such that no cohesive delineation of the scope can be regarded as final.

Some of needless difficulties that have arisen in a proper interpretation of *riba* are of linguistic origin. The jurist's business is with words. Words are not only tools of thought, but also control it. Accordingly, to think profitably about *riba* will be assisted by a sharpened awareness of possibilities of language, not only to lead thought but also to mislead it. This paves the ground on which the Islamic jurists' adherence to their predecessors' grasp of *riba* is questioned.

This should not be deemed a denial of the rich legacy handed down from the predecessors. A modern society cannot but build upon the foundations laid in the past. However, this must be carried out with due diligence. A deliberate attention must be paid to social and economic context in which the interpretation of a text in the past was formed.

The Companions of the Holy Prophet (PBUH) as well as the early commentators and jurists coming thereafter experienced a different historical horizon. They grasped the meaning of *riba* by relating it to the given socioeconomic underpinnings from which it was originating. They shared a perception resting on similar premises of socioeconomic system. It resulted in concerted interpretations within the consensual domain of the meaning of *riba*. It was generally accepted that *riba* has indisputable settled applications of the same substance as the word usury in other religions. Thus, the same envisage of the predominant political economy gave rise to a common sense about a wicked phenomenon, and a conviction of its illegitimacy not only amid Muslims, but also throughout the world.

The immutable divine rulings of *Qura'n* are not bound up with times and places. However, perception of the holy text is bound up with the socioeconomic settings of the time. It will be pointless that everyone in different times and places is the addressee of the Holy *Qura'n* if we fix its perception on what the preceding commentators and jurists perceived in the past time horizon.

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<sup>6</sup> The *Shari'ah* principle regarding devotional matters (*'ibadah*) is that anything not validated by *Shari'ah* is prohibited. The case might be different about the subject matter of dealings and transactions (Mallat 1993).

### 3. Modern Socioeconomic Settings

Interpreting *riba* gives a strong inducement to make an inquiry into the nature of modern economic system though it is very difficult to show the full extent of the subject. To this end, we shall first of all make a rapid survey of the matters which will occupy our attention. This can be most easily done by abstracting the main features of the economic system of our times. We shall then see at a glance how this can contribute to our central vexed problem.

#### 3.1. Capital and Interest

Since the Renaissance and the Industrial Revolution, capital had gradually become a power. Machinery had appeared on the scene and won its great triumphs; and helped to extend business on a great scale, and to give production more and more of a capitalistic character. In this capitalistic world, if one postpones its very enjoyment of resources with a hope to get more satisfaction in the future, this function is referred to as investing or, in other words, transforming the present resources to capital.

Capital is merely the means to the end called income. In the modern world, it can be very broadly defined to include the different varieties of human resources, tangible and intangible physical resources and the most recent types of resources called as financial assets<sup>7</sup>. A laborer<sup>8</sup> while undertaking a task is carrying out a deal through which his or her immediate resources (i.e. time) of any quality that could have been spent on the present satisfactions (i.e. present income), is exchanged for more future pleasures (i.e. future income). Much the same is true with factory owners<sup>9</sup>.

For any one who owns capital, it is generally possible to obtain from it a permanent *net income*, called *interest*.<sup>10</sup> As a matter of fact, it can be imagined that on a pure theoretical ground of economic theory, interest differentiates itself on different kinds of income like light in the prism. "It includes what is called rent and profits and even wages..." (Fisher 1930, pp. 332). Distinctions of income in the objective reality,

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<sup>7</sup> Fisher defines capital as follows: "Capital, in the sense of capital value, is simply future income discounted or, in other words capitalized. The value of any property, or rights to wealth, is its value as a *source of income* and is found by discounting that expected income....The ownership may be divided or parceled out among different individuals in the form of partnership rights, shares of stock, bonds mortgages, and other forms of property rights. In whatever ways the ownership be distributed or symbolized in documents, the entire group of property rights are merely means to an end – income. Income is the alpha and omega of economics." (Fisher 1930, p.12-13)

<sup>8</sup> In modern capitalistic world, based on the advantages of the division of labor, workers have lost their status as crafts men (of peasants). Today's typical workers do not earn their income by selling commodities they personally have produced; rather they sell their labor to firms and receive money wages. They have increasingly become cogs in a machine that they do not fully understand or control (Lipsey 1984). This is due to highly monetization of the economy.

<sup>9</sup> In modern cooperative organization of production, fostered by the process of monetization of the economy, factory owners are distinguished as shareholders.

<sup>10</sup> Fisher points out that interest can not be accounted as absolute income, he explicitly states that "...interest itself, as it accrues, is capital gain; and is neither negative income (cost) nor positive income. The fallacious idea that it is a cost is simply the other side of the fallacious idea ... that it is income. There are two kinds of economic gain, capital gain and income gain, the former being the anticipation or discounted value of the latter..."(Fisher 1930, pp.57-58).



however, spring from legal expediciencies to differentiate among the varieties of income people earn.

Accordingly, we may define the rate of interest as *the percent of premium* on present goods (wheat or any other sort of good) in terms of the same goods to be in hand one year later. To elucidate the case, suppose that a bushel of wheat be exchanged for two bushels of barely in spot market and for one and half a bushel if it is destined to be received one year hence. At the absence of any sort of uncertainty (i.e. no inflation and guaranteed delivery of amount sold), one and half a bushel of barley today is exchanged for two bushels of barley to be in hand one years later. The premium paid on barley at present date in terms of barley coming a year afterwards, is a half bushel of barley and this, as a percentage of the present income discarded today (i.e. one and half a bushel of barley), or the rate of interest, is nearly 33 percent<sup>11</sup>. This price is nothing but “the influence of time on human valuation of goods” (Bohm-Bawerk 1970). Therefore, interest rate in this sense is quite a legitimate price by which future resources (i.e. future income) are evaluated down to the present; a process sometimes referred to as *capitalization*.

This rather simple study demonstrates that the rate of interest is indispensable in economic life, and that its vitality has been boosted significantly as capital became the thews and sinews of the modern economy. It is, in essence, a sort of price that links one point of time with another point of time in the markets of the world. It concerns every branch of economic theory in which the time element enters, and as Fisher illustrates it is “the most pervasive price in the whole price system” (Fisher 1930, pp. 33).

### **3.2. The Emergence of Nominal Sector**

Another feature of modern economy that makes it distinguishable from agrarian economy, whose institutional arrangements was set by early thinkers and jurists in an elaborative harmony with the social structure, is the intensive expansion of nominal sector.

The agrarian economy which our predecessors attempted to regulate was sparsely monetized, land was the chief source of production, and the whole economic activity centered around the relationship between the landowner and the worker on the land, the landlords and the real users of the land, and the lenders and borrowers of money<sup>12</sup>. The rights and obligations in these relationships were customary and *the system was based on personal relationships*. The landlords and money lenders enjoyed power and prestige and often oppressed the poor cultivators who lived an impoverished existence.

The concept of wealth in the agricultural era was narrowly confined to tangible wealth consisting of a nation’s natural resources and its stocks of goods. Market transactions involved mostly trading of tangible goods in exchange for goods (barter) or money by simple mutual agreements among the two sides of the transaction. The property rights were determined by customs; and the property to which people customarily claimed their ownership referred to land, cattle, agricultural implements and other tangible material objects. As a result, legal settings, based on divine revelation and

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<sup>11</sup> Practically, in a highly monetized economy, money is substituted for barley in above statement.

<sup>12</sup> The intrinsic properties of money as to pack considerable value into non-perishable and convenient portable denominations, soon, designated money as the most proper means of lending.

human intellects, were institutionalized in a way congruous with this kind of economy. Almost all Islamic contracts in the old legal body of Islam, corresponding to the economic circumstances of the time, were originally designated to control barter or money transactions of tangible objects in *real sector of the economy*.

In the modern age, however, there are many intangible forms of the wealth, like ideas, authorship of books, artistic production, musical notes and other intellectual innovations that the juristic system ought to take the responsibility of providing protection to people in all these matters. There are still some components of intangible wealth of nations, notably the skill, knowledge and character of its population and the framework of law, convention and social interaction which are not appropriable; they can not be owned by governments, or privately by individuals or other legal entities.

The most prominent characteristics of the modern economic system is concealed in the fact that a person today may be wealthy without owning any of the assets counted in appropriable national wealth. Instead a personal wealth inventory would list paper currency and coin, bank deposits, bonds, stocks, mutual funds, cash values of insurance policies and pension rights. These are paper assets evidencing claims of various kinds against other individuals, companies, institutions or governments. In reckoning personal *net worth*, each person would deduct from the value of his total assets the claims of others against him. If the net worth of all economic units of the nation added up, paper claims and obligations cancel each other. All that remains, if valuations are consistent and the census is complete, is the value of the national wealth (Tobin 1992). Thus, the appropriable national wealth, mostly tangible assets, is owned, and transferred, by economic units not directly but through the intermediation of a complex net work of paper debts and claim.

At this very advanced stage of industrial economy, even money, in the traditional sense<sup>13</sup>, has become a secondary means of exchange. Most of business in a higher level is transacted on credit. The economy is so advanced and transactions have become so huge and complex that no amount of hard money would be able to meet the demand<sup>14</sup>. Moreover, the exchange on the basis of credit is very convenient, quick and safe.

Traditional *fiqh* is devoid of appropriate rulings that can be adaptable to these nominal transactions because the traditional contracts nominated to be applied to this new emerged nominal sector of the economy, either directly or in a composite form as elaborated by Ahmed (2006), has its genesis in a quite different economic system. Throughout the whole contemporary nominal sector of the economy, dealings only include paper securitized assets in both sides. In other words, it is only money in broad definition, or more appropriately *finance*, which is traded as between present and future. Such circumstances used to be inconceivable in an agrarian economy. If *riba*, as in the mainstream view, is conceived to ban the market in which present and future money is traded, the sanction must encompass all the modern financial system.

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<sup>13</sup> The concept of money, in a broad definition, can be stretched to include all types of paper assets because of the high degree of liquidation they possess in modern financial markets. In this sense, the process of improving economic relations through the intermediation of the paper assets may be regarded as the enhanced degree of monetization.

<sup>14</sup> Countries differ over the degree of intermediation of paper assets. Among less developed countries, the financial interrelations ratio has increased substantially, though it generally is less below the level reached by the developed countries (see Goldsmith 1985).

The problem of a proper interpretation of *riba* which is legally applicable is prior to attempts at the adaptability of Islamic law to contemporary financial system. Otherwise, the adaptability process would at most be mere legal stratagems to apply traditional customs to modern objects in the face of opposing impressions and prejudices. But just as certain is it that, after an immense expenditure of ingenuity, at bottom the problem of *riba* is not solved.

### **3.3. Bank Interest and the Problem of *Riba***

As mentioned previously, the mainstream *fatawa* regard bank loans as the salient practice of *riba* in modern world. This is the direct result of the analogy between the bank loan and the early jurists' opinion that any excess charged over the principal in case of a loan is *riba*. To make this argument the chief subject of critical examination, it is necessary to discuss shortly about the financial intermediation role of banks.

This analogy is false because bank loan is really part of a system entirely different from the one that was contemplated by early jurists (Faridi 1964). Seddiqi (2004) asserts that this argument is a partial truth. But it does not prove that it is totally different.

The fact is that the above analogy is not complete as Siddiqi blandly affirms. In contemporary *fatawa*, the progressive role of technology and the inhibitive role of institutions have been ignored. Firstly, it should be noted that unlike the traditional loan system that the relationship between the lender and borrower was very personal and informal, the relationship in modern banking industry is formal and impersonal so that the competition will be relatively pure, and both sides enjoy market protection.

Secondly, banks as financial intermediaries can render services on both sides, lenders and borrower, which could have not been established in their absence. To begin with, economies of scale and specialization in financial transactions enable banks to tailor assets and liabilities to the needs and preferences of lenders and borrowers. This service is especially valuable on both sides whose needs vary in amount continuously; they like deposit accounts and credit lines whose use they can vary at will on their own initiative. Modern banks can also specialize in the appraisal of risk with expertise in the gathering and interpretation of information costly or unavailable to individual savers. By pooling the funds of its creditors, banks can diversify away risks to an extent that the individual creditors cannot. Moreover, banks screen potential innovators and advance purchasing power to the most promising. In practice, the cachet of a banker often enables his customer also to obtain credit from other sources or to float papers in open markets. Similarly, banks typically reconcile differences among borrowers and lenders in timing of payments, and transform illiquid assets into liquid liabilities (Tobin 1992).

Thirdly, banks are legal personalities, and the loan relationship through banking system takes place between legal and real personalities, or two legal personalities. This can be used to bring banks in the condition of being legally responsible only to the extent of the nominal value of its shares. The same can be imagined when a legal personality approaches banks as a borrower.

Finally, in modern financial system, the government has obligation to regulate banking system. The government's role is carried out through reserve requirements, last-resort lending, deposit insurance, balance sheet supervision, interest ceilings and controlling entry, branching and merging.

Those who took the trouble to go deeply into the technicalities of modern financial institutions influencing the banking industry must have realized that the practice of *riba* as perceived by the predecessors might hardly match the current banking operations. Hence, the true meaning of *riba* is still ambiguous, and it seems that the problem has its roots in the imitation of legal rulings belonging to another type of economic system.

#### 4. Conclusion

While Islamic banking and finance has its genesis in the prohibition of *riba*, this paper suggests that an important, if not essential, prelude to knowing *riba* in the contemporary times should be some thought about the underpinning foundations of the modern political economy. There is still need of earnest effort to make clearer and more consistent the fundamental concepts. These are the tools which aid Islamic jurists to think fairly on economic objects. A flaw in these concepts, not only impedes the theoretical progress in Islamic banking and finance, but affects adversely the popular judgment on the most practical achievements.

A rightful understanding of the circumstances and special social and economic problems helped the former jurists in centuries ago to bring up a grouping of harmonized ideas under a consensual term, named *riba*. Although the circumstances have profoundly altered, the concept of *riba* at which the contemporary jurists grasp, has remained firmly unchanged. It is the business of the economists, sociologists as well as jurists to measure, mark and correct concepts, to make the parts consistent with each other and the whole fitted to the needs of social life.

The paper also suggests that as far as the rate of interest in the capitalistic age, and even beforehand, is the most pervasive price in all markets, it could not be taken equal to the concept of *riba*, and as far as the modern financial system does but converts the outside wealth of the economy into different paper assets, the exchange of paper assets against outside money might not be deemed to lay inside the ambit of *riba*. Even more astonishing, bank interest as far as it is affected by various kinds of banking technologies and the newly-established institutions it might not sound a practice of *riba*. These lead to the conclusion that a better definition of *riba* is the most urgent appeal of the abstracter branch of Islamic banking and finance.

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