“Islamic” banking between literalism and rationalism

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Literalists and Rationalists through the centuries

Rationalist analysis of Texts

- Ibn Al-Muqaffa` (720-56)
- Abu Yusuf (731-98)
- Al-Farabi (870-950)
- ‘ibn Sina (980-1037)
- ‘ibn Rushd (1126-1198)
- ‘ibn Khaldun (1332-1406)
- Al-Afghani, `Abduh, …

<u>In</u>clusive, intellectual cross-fertilization, embracing innovations, …

Anti-rationalist jurisprudence

- Al-Shafi`I (d.820)
- ‘ibn Hanbal (d.855)
- Al-Ghazali (1058-1111)
- ‘ibn Taymiyya (1263-1328)
- (Most jurists …)
- Al-Mawdudi, …

<u>Ex</u>clusive, rejecting non-Muslim thought, rejecting innovations, …

How do we define the forbidden Riba? How do we avoid it?

- Islamic economics and Islamic finance are a by-product of the literalist form of fundamentalism
- Contemporary jurists are excessively certain about what is forbidden and how to avoid it
  - Contrast with our ancient scholars
- Islamic Law is too important to be left to jurists!

Ribā is neither "interest" nor "usury"

- There is *Ribā* without interest (*Al-Faḏl, Al-Nasā'*) and interest without *Ribā* (credit sales)
  - The Hadith ➔ "hand to hand, and in equal amounts"
  - The percentage does not matter.
- The prohibition is not about "exploitation"
  - The misunderstanding has led to both types of error
  - Al-Subkī debunks the opinion of Ibn Kayyisan:
    - how about credit sales with exorbitant "interest"?
    - Non-*Ribawī* goods.

It is not an issue of risk, or time value

- Jurists recognized time value of money:
  - "The price may be increased with deferment"
  - "Time has a share in the price"
  - "What is worth 5 in cash is worth 6 deferred"
- Money is "fertile" (eligible for *Ribā* and *Zakāh*)
- Credit sales include the same type of risk as loans with interest: credit risk
  - "No return without risk" is a tautology
  - There is no Textual basis for the claim that "profit and loss sharing" is preferable in Islam

Jurists' solutions are harmful to Muslims

- Example 1: Lease to purchase conditions
  - Islamic bank holding title – why not a lien?
  - Bank responsible for maintenance – moral hazard and adverse selection problems
- Example 2: Islamic mutual fund screens
  - Qualitative screens cause poor sectoral distribution
  - Quantitative screens cause increased volatility, pro-cyclicality, and loss-trading

Is it time for a rationalist approach?

- The jurists' conception of Riba contradicts the texts that they use and the practices they allow
- The jurists' solutions are poor imitations of conventional financial practices
- Do we need to reinvent the wheel, or simply to build upon the accomplishments of others?

How to avoid Riba (usury)?

Literalist jurist approach:

Focus on contract name:
Murabaha or *Ijara*

• **Form over function**:
Implicit rate of return can be LIBOR + markup

• **Enforce outdated conventions**:
Contract conditions stipulated in jurisprudence books, based on □□□

A rationalist approach:

What is the essence of Riba *in secured-loan financing*?
Agree with Calvin and U.S. regulators: charging excessive interest rates

• **Function over form:**
Marking rate to market rental rather than LIBOR+

• **Luther's "Christian" cobbler makes a *good* shoe**