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A Theoretical Recapitulation of the Ethical Nature of Islamic Finance and Banking Law

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Abstract

The rule of Islam is simple: if you advance a loan, you are entitled to receive your capital only and nothing more. If you wish to secure profit you should enter into a partnership and become a shareholder. Prohibitions against interest are not peculiar to Islam. If we were to trace back through history, a number of examples of such prohibitions can be found in the early Greek, Roman and Rabinnical thought. With the decline of the influence of the Catholic Church interest transactions become legal and stimulated giant Western corporations which forged capitalist imperialism. The practice of charging interest (usury) now dominated Western law and ethics for over a millennium. But, the Western or capitalist economic system has proven a failure in its quest for economic justice, which serves to benefit all in society, both the rich and the poor. In particular, capitalism is currently causing a terrifying scenario of making the rich richer and the poor poorer due to interest charges. An alternative banking model, called Islamic finance and banking, is evoked in this study in order to depress financial exploitation by banking institutions.

Keywords: Theoretical Recapitulation, Islamic Finance and Banking Law, Ethical Nature of Islam, Prohibitions in Greek, Roman and Rabinnical Thought.

1. Introduction

The ethical appeal of Islamic banking actuates a distinction between usury (*riba*) and interest. Usury is regarded in this study as the taking of more than the principal. Pro-banking scholars and some Muslims assert that interest is moderate and may therefore not be viewed as usury (*riba*). They equate this notion with bank interest. Another group of scholars exert that usury (*riba*) covers all forms of interest and not only "excessive" interest. As far as Islamic finance and banking is concern, there is no technical difference between interest and usury. Both is to be prohibited. If the western banking system has paid heed to this call, we would not have the financial crisis we living though now. But, western banks have lent excessively to augment their profits. They are assured of their repayment with interest. This has led to an unhealthy expansion of credit, to excessive leverage and to subprime debt and living beyond means. This leads to financial fragility and debt crisis. The financial crisis has subsequently led to a precipitous decline in property and stock value and a rise in bank failure. This created an uneasy feeling that there is something basically wrong with the western interest-bearing banking system.

As the current economic crisis unfolded, it became evident that the international financial architecture is in need of reform.

2. Literature Review

2.1. Objectives of this Research

The research attempts to get to the core of the meaning of *riba* from religious and economic perspectives. It strives to attain a wider consensus on the meaning of *riba* among scholars and policymakers.

The research discusses the pertinent issues of *riba* that many blame for the global financial turmoil. It postulates an alternative to a capitalist or *riba*-based economy.

Finally, it purports to achieve a point where people can have the choice of a life without *riba*.

2.2. Methodology

The paper opted for a theoretical research. The author generates his research from a clear database which he draws on. The data is based on a thin and impressionistic account of an event. The research draws on, demonstrate knowledge of the latest research-based literature on the topic and the writings are universal. This paper present thus a strong and relevant theoretical framework within which the inquiry is located.

This study achieves its objectives by engage solely on a theoretical model. The data is acquired from literary sources and books with both an Islamic and Western inclination. The Western component entails literary sources from Greek, Roman and Jewish tradition. These sources are complemented or contrasted by Islamic sources. These two models, the Islamic and Western model, are placed against each other in order to establish their respective pro and cons. It is also the aim of this study to pose the weak and strong points of both systems and let it complements each other where necessary. The study in no way wants to pose that one model is better than the other. The objective of the research is to emphasize that the two models can learn from each other, adopt each other's good features and tries to make it part of itself.

2.3. Review of Literature

The literature review is stradled between antiquarian sources as far back as Aristotle, Philo and Plato and Scholastici such as the encyclicals of the Popes.

This study adumbrates that the practice of interest is maintained still to this day, although it was renounced by mainstream religious institutions. As legalization of interest is invoked especially by prominent financial institutions, the justification of interest became easy and acceptable. Forms for justification of interest taking can be couched under the following principles: *poena dentenori* or *mora*, *in fraudem usurum*, *damnum emergens*, *lucrum cessans*, *venditio sub dubio* and *contractus trinus*). The practice of interest became rife and knows no borders. A spill-over appear and interest taking amounts to double charging (*in duplum*) of the capital amount and even more.

The emergence of interest in the West was triggered by the Rabinnical permission of allowing the taking of interest in the West. Lending in Judaism caused the dilemma of usury (riba).

This study also touches upon the renditions of modern pro-banking and Muslim scholars. In between we find the religious perspectives of the three dominant denominations, as well as the account of Muslims.

In a synopsis, the strength of this research lies in the fact that it proposes a holistic view of the concept of usury (interest). On the one hand, the research poses the natures of interest and usury and hypothesize that there is a difference between these two principles. Other scholars, especially Muslims believe the contrary and is of the opinion that these principles are basically the same. Their views will be aired in this research.

This study accounts for the reason for the financial crisis and furnish us with possible solutions.

2.4. Hypotesis

The capitalist economic system has proven its failure to ensure economic justice that serves to benefit all in society, both the rich and the poor. Capitalism is causing a scenario whereby the rich is getting richer and the poor poorer.

The paper asserts that interest is moderate and *riba* exorbitant and oppressive. The prohibition of usury is understood as relating to the exploitation of the economically disadvantaged in the community by the relatively affluent. On the strength hereof, usury-based financial instruments are forbidden in Islam. And as such, Islamic banking must evolve alternate instruments of financing like *mudaraba* (profit-sharing) and *musharaka* (partnership).

As far as Islamic banking is concern excessive interest is equal to usury. Islam therefore may embrace profit which is a minimal positive nominal return on savings. On the premise of this contention, an Islamic economic system would achieve a greater degree of economic justice than existing capitalist systems.

3. Core of the Meaning of Usury (*riba*) from Religious and Economic Perspectives Religious Perspectives

3.1.1. In Greek Thought

This study has achieved its aim in solving the riba conundrum. There is now consensus among scholars that the term usury (riba) covers all forms of interest - and not only "excessive" interest. If the global economy has to bear this economic theory in mind, we would not be seeing the kind of finance crisis, we are living through now. The research also asserts that interest is a hindrance to the moral and material growth of a society in which the individual is exploited. This notion is taboo in Islam as it morally condemns the taking of interest. In so doing, Islam reforms the character of a people so that an inclination to usurious businesses are suppressed and replaced by a spirit of sympathy and generous co-operation in human society.

Riba (usury), the original name for modern interest or a fixed return on investment was present in the early Greek, Roman and Rabbinical thought. *Riba* is the practice of taking interest on interest, which was easily manipulated by adding the unpaid interest to the unpaid capital and using the sum as the base for the next interest payment (Aristophanes, *Nubes* 1286 ff). This taking of *riba* (any interest or fixed return) was treated as an offence against morals (Anwar, 1987, p. 2).

In Greece, taking interest was a fact of life, while the legitimacy of interest taking was recognized throughout Greek history, opposition to it did exist. Until the 6th century BC, insolvent debtors were obliged to place their bodies at the disposal of their creditors to work as slaves, to be sold in captivity, or even to be killed (Maloney, 1971, p. 84).

Plato and Aristotle condemned the practice of *riba*. The former saw money as barren and therefore outlawed profit on loans (Plato, *Leges* 5.742; In Maloney, 1971, p. 86). The latter saw money as a necessary art, but he is of the opinion, that if it becomes the end of life, if it knows no bounds, and if it turns to unnatural practices to satisfy its excessive desires, then it is contrary to man's true good. Aristotle exerted that money was intended to be used in exchange, and not to increase at interest (Aristotle, *Politica* 1.101258a-b; In Maloney, 1971, p. 87).

The usurer, because of greed, attempts to make a profit from what is naturally sterile and purely a medium of exchange (Maloney, 1971, p. 95).

3.1.2. Romans

In his *Corpus Juris*, Justinian (483-565 BC) forbade interest to rise higher than capital (Maloney 1971: 95). Theodosius has decreed in 386 BC that usurers should pay a penalty of fourfold the amount of illegal interest that they had taken (Maloney, 1971, p. 94).

In 347 BC, in Rome, a law reduced the interest rate: "… the rate of interest was cut in half (*semiunciarum tantum ex unciario fenus factum*) (Maloney, 1971, p. 90). A similar law, the *Lex*

Fluminia minus solvendi (271 BC) allowed borrowers to pay off their debts with money of reduced value, and the *Lex Valeria* allowed bankrupt debtors to satisfy their creditors by repaying one fourth of what they owed (Stein, 1956, p. 141).
The Romans began to adopt the long-standing Greek practice of one percent per month (12 percent a year) as the rate of interest on loans. This became the legal maximum in Rome in 51 BC (Maloney, 1971, p. 92).

3.1.3. Rabinnical Thought

In Old Testament times, permission to take interest from Gentiles remained. Some even saw it as a command: "Unto a foreigner thou mayest lend upon interest, but unto thy brother thou shalt not lend upon interest" (Stein, 1956, p. 141). According to this understanding, Jewish people could extract usury from foreigners, but not from each other (fellow Jews) (Vessio, 2005, p. 9).
The prohibition against usury was one of those laws which concerned only members of the Jewish community. Rabbi Simeon ben Eleazar, was of the opinion that this prohibition should extent to foreigners as well. He praised the person who lends without interest and condemned those who refuse to do so. In the same vein, the *Tosephia to Baba Mezi'a* notes the promise of a reward to those who lend freely. Philo (c. 30 BC to 45 AD) forbade anyone to lend money on interest to a brother or sister (anyone of the same citizenship or nation). He reflects that a free gift is in a sense a loan that will be repaid by the recipient when times are better, without compulsion and with a willing heart. He wrote in his *De Virtutibus*: "For along with the capital, in place of interest which they determine not to accept, they receive a further bonus of the fairest and most precious things that human life has to give: mercy, neighbourliness, charity, magnanimity, a good report and good fame" (Philo, *De Virtutibus* 14 82-83; In Maloney, 1971, p. 98). Similarly, the *Mekiliha on Exodus* condemns everybody who takes part in usury (Maloney, 1971, p. 101).
Usury is at times made equivalent to denying God. The *Gemara of the Babylonian Talmud* quotes Rabbi Jose as saying: "Come and see the blindness of those who lend at interest […] So-and-so has denied the God of Israel. In almost the same words, the *Gemara of the Jerusalem Talmud* labels interest taking as a denial of *Yahweh*. (Maloney, 1971, p. 103).
In the text of the *Jerusalem Talmud*, usury is connected with idolatry, the most serious of sins (Stein 1956: 141). In the opinion of the rabbis, usury was also equivalent to the shedding of blood (Stein 1956: 141). The rabbis also equate usury to the selling of one's own daughter into

slavery. The *Gemara on Arakin* records: "[…] a man should rather sell his daughter than borrow on usury" (Maloney, 1971, p. 105). Considering usury (*riba*) equivalent to robbery, the rabbi's excluded the moneylender from being a witness or a judge (Maloney, 1971, p. 106).

4. Economic Perspectives

4.1. A Deviation from Religious Views

The practice of usury and interest reappeared notwithstanding the fact that charging of usury and interest was condemned by the three major religious denominations. These religious denominations give way for an economic dimension in which the charging of interest or usury come to be accept in contemporary money-lending transactions. For example, the parable of the talents told by Christ seems to consider interest generated by deposits in banks not only normal practice but even a commendable one (Holy Bible. Matthew 25: 14-80; Luke 19: 11-27).
As a consequence, laws were drafted for legalizing interest transactions. Scholastic treatises allowed exceptions to the ban on usury by which a lender in a *mutuum* may receive some payment beyond the principal (Munro, 2002, p. 511). If one lends money to a merchant or anyone else, who makes profit out of it, it is argued, it cannot be unjust to draw a profit from it yourself. Human laws were therefore promulgated to permit usury, and its aim was to avoid interference with the "useful" activities of many persons (Thomas Aquinas, *Summa Theologiae* 2-2, q. 78, a. 1). For example, the Holy Office, allowed in 1830 AD, for interest to be lawfully taken for money lent to merchants who were in profitable trade (Siddiqi, 1994, p. 5).
The creditors were allowed to receive compensation from defaulted debtors on two grounds: If a debtor failed to pay a loan on the stipulated day, the creditor might suffer loss. In that case, the just price of the loan must include some compensation for the loss. This additional payment was called "interest." Interest might also be claimed if the lender lost an opportunity for making profit, because the debtor did not return the loan in time. The creditor could lawfully draw usury in the name of interest (Anwar, 1987, p. 3). For example, the *poena detentori* or *mora* imposed a penalty for late payment – after the specified date of maturity of the loan. But it must bear in mind that a tacit agreement to make late payment was usurious. (*in fraudem usurarum*). The second title was *damnum emergens* – a compensation for damages or loss that the lender incurred after having made the loan: for example, from not having the money accessible in an emergency – a fire or storm that destroyed his barns or livestock. A third title, was the *lucrum cessans*, the lender's opportunity cost in the form of *interesse*, this was viewed as licit difference

between the principal and repayment of a loan. This title justifies the exaction of a return beyond the principal. The final title was the *venditio sub dubio* – a device where a loan was cloak in a sales contract which specified future payment. In the *venditio sub dubio* the amount of a loan was disguised by augmenting the stipulated principal to be repaid by the amount of the required interest payment (Munro, 2007, pp. 511-512). For example, the *venditio sub dubio*, is a credit sale, where goods are received on a particular day and paid for at a later date. The creditor received a higher payment at the later date because the value of the goods sold had increased by the time of payment. The difference between the prices of the goods on the day of reception and at a future date was effectively interest on the loan. Such contracts were open to abuse by the unscrupulous. In my view credit sales at much higher prices are to be considered usurious (Burke, 2009).

Another title, which shares the same sentiment of the above, was the theory of *contractus trinus* (triple contract), which made usury lawful in the name of interest (Fekete, 2004, lecture 4). The triple contract, *contractus trinus* contract was considered an admissible verse of credit which escaped proscription on grounds of the usury laws. The *contractus trinus* was a legal trick used by European merchants in the Middle Ages to allow borrowing at usury. It was a combination of three contracts, which together yielded a fixed rate of return from the outset. For example, person A might invest $100 with person B for one year. A would then sell back to B the right to any profit over and above say $30, for a fee of $15 to be paid by B. Finally, A would insure her or himself against any loss of wealth by means of a third contract agreed upon with B at a cost to A of $5. The result of these three simultaneously agreed upon contracts was an interest payment of $10 on a loan of $100 made by A to B (Diwany, 2000).

The justification for usury may run along the following lines: Money lending involves an element of risk and an element of time. For the time during which the lender has extended the loan, he/she is unable to invest his or her money in alternative endowment schemes. The risk factor means that the debtor may ultimately be unable to pay the loan and interest in time, or at all (Vessio, 2005: 9).

4.2. The Jews Question

As mentioned earlier a deduction can be derived from that fact that the emergence of interest in the West was probably triggered by the Rabinnical permission of allowing the taking of interest from Gentiles. Abarbanel, who represents the first known Jewish attempt at an economic theory towards capitalism in the 12th century says: “There is nothing unworthy about interest *per se*,

because it is proper that people should make profit out of their money, (wine and corn, and if someone wants money from someone else), why should the borrower not give the lender a certain amount of interest? Why should a farmer, for instance, who received so much wheat to sow his field, not give the lender 10 percent, if he is successful, as he usually would be? This is neither despicable nor contemptible. It is an ordinary business transaction and correct. Nobody is under obligation to gives his money away to somebody else, unless it be for the sake of charity […]"(Stein, 1956, p. 143). On the basis of this assertion, it would be appropriate to give some compensation to the owner of capital (Stein, 1956, pp. 153-154).

Even Canonists (who oppose the taking of interest) agreed that one may pay up to 5 percent for lending money. Pope Alexander VI gave permission to the rulers of the state to allow the Jews to charge interest (Stein, 1956, p. 157).

According to Calvin, interest is only forbidden in so far as it is opposed to equity and charity, otherwise *nous sommes fr res, voire sans aucune*. This formula became the new spirit of capitalism (Stein, 1956, p. 161).

This justification of the concept of usurious lending in Judaism caused the dilemma of usury (*riba*). Up to the 11th century, commercial traffic belonged to merchants from the Orient, principally the Jew. "Jews" were synonymous with "merchants" and were increasingly identified with "usurer." Due to the extremely large interest rates (between 43 and 86 percent), a large number of estates belonging to the nobility passed into the hands of Jewish usurers. This disposed nobility avenged themselves by organizing massacres of Jews. In 1189 AD, Jews were massacred in London, Lincoln and Stafford. A year later, the nobility, led by a certain Malebys, destroyed the *Scaccarium Judaeorum* (Exchequer of the Jews). The notes were burned and the Jews, besieged in the chateau, committed suicide. The entire Jewish population of England, almost 3000 people, was expelled and their property confiscated (http://www.marxists.org/subject/jewish/leon/ch3a.htm (page 8 of 17) accessed on 11/20/2009).

5. Consensus on the Meaning of Usury (*riba*) and Interest

Usury (riba) is identified in a general sense as the taking of more than was lent (McCall, 2008-2009, p. 559).

5.1. Definition of Usury

McLaughlin asserts that *usura* is derived from *ab usu aera, usu aeris, usuera, usueri, usurea* or *usu rei*. It means *pecunia* and usury therefore signifies not only money, but any kind of goods which man possesses (McLaughlin xii, xiii and xiv Century: 98). McLaughlin cited Innocent IV, who is of the opinion that usury is gain owed or exacted from a contract of loan: (*Usura est lucrum mutuo pacto debitum vel exactum)* (Innocent IV, *Commentaria*: x.v.19.c.1; McLaughlin: 98). A more comprehensive definition, forwarded by Hostiensis reads that usury is whatever is in excess of the capital for the use of the thing lent when either there is an agreement or this intention present or even that which without either agreement or intention is exacted from the borrower: (*Quodcumque solutioni rei mutuatae accredit ipsius rei usus gratia pactione interposita, vel hac intentione habita in contractu, vel exactione habita post facto)* (Hostiensis, Summa de usuries, n. 1, fol. 372; McLaughlin, xii-xiv century, p. 98).

5.2. Teaching of Usury in the Middle Ages

Gratian has composed his Decretum (*Decretum Gratianus*) after 1140, which embodied all the ancient laws of the Church. In Distinctions XLVI and XLVII V, of the *Decretum*, he forbids clerics to demand usury and stipulated that a perpetrator of this crime never be raised to orders. In the case where the perpetrator is already in orders, he then be deposed. Gratian formulates a synopsis of usury in his *Concordia Discordantium Canonum*: “To demand or receive or even to lend expecting to receive something above the capital is to be guilty of usury; usury may exist on money or anything else; one who receives usury is guilty of rapine and is just as culpable as a thief; the prohibition against usury holds for laymen as well as clerics but, when guilty, the latter will be more severely punished.” (*Quod autem praeter summam emolumenta sectari sit usuras; after c. 4: Ecce evidenter ostenditur quod quicquid ultra sortem exigitur usura est; before q. 4, c. 1: Quod vero nec clericis nec laicis liceat usuras exigere. Cf. also summaries of q. 3, c. 1: Qui plus quam dederit expetit, usuras accipit; c. 2: Quicquid supra datum exigitur usura est; c. 3: Quicquid sorti accidit usura est; c. 4: Quando amplius exigitur quam detur usura accipitur; q. 4, c. 8: Etiam laicis usura dampnabilis est)* (*Concordia discordantium Canonum* c.14, q. 3, c. 1).

Gratian inspires canonists and as a result they compiled a document, the *Corpus Juris Canonici*. This document dated from the twelfth to the fourteenth centuries and touches on the question of usury (McLaughlin xii-civ century: 81). At these periods, the Canonists were all concerned with the problems of usury, of banking, of contracts, and with all the aspects of the commercial life which has become an important fact of these times (McLaughlin xii-xiv century, p. 81).

According to McLaughlin, the Lateran Council of 1139, the avarice of usurers is detested by both divine and human laws. He alleges further that the Council of Vienne of 1311-1312, that the chief official in any community commit an offence against God, when he draw up or cause to draw up, statutes permitting usury to be charged (McLauglin, xii-xiv century, p. 84).

To lend for usury is a mortal sin as is theft: (*Audivi Dynum dicentem quod non quia usurae prohibitae sunt jure divino et jure canonico et civili et quia foenerare est mortale peccatum sicut rapere)* (McLauglin xii-xiv century cited Cinus on Cod. Iv.32.24).

McLaughlin says Baldus mentions that there are three kinds of usury, namely *quaedam sunt usurae punitoriae, quaedem recompensatoriae* and *quaedem lucratoriae*. The first kind is allowed by divine law and the canons allow it to be demanded as *interesse* on account of delayed payment. The second kind is also permitted up to a certain amount following the custom of the place which requires compensation by way of permutation rather than by way of penalty. This kind of usury is based on equity. Natural reason forbids one to enrich himself at the expense of another: (*Secundae usurae similiter sunt permissae usque ad congruum et honestum modum prout mos regionis expostulat quia potius recipiuntur loco permutationis quam loco poenae… Sunt enim hujusmodi usurae onerosae, non gratuitae, et fundantur in ratione naturali aequitate quae est quod quis non locupletur cum aliena jactura*) ((McLaughlin cited Cod. Iv.32.2). The third kind is forbidden by divine law (Cod. Iv.32.2). McLaughlin interprets these rules as to read that *interesse* is allowed on the loss which the creditor suffers and on the profit which the debtor has made: (*Interesse enim est licitum quocumque nomine nuncupatur, tam in damno quam in lucro)* (McLauglin cited Cod. Iv.32.2). On the question, why *interesse* is allowed and usury forbidden, Baldus answers that the intention is different. He alleges that in the case of usury, the creditor intends to be a usurer, to demand something on account of the loan. On the other hand, in the case of *interesse*, the creditor receives something on account of the loss suffered or the gain which the debtor has made: (*Sed quare poena est licita super interesse, secus in usura? Respondeo quia in usura constat de intentione quod intendat esse usurarius)* (McLaughlin cited Cod. iv.32.2).

McLauglin contends that both parties stand to lose or gain in a loan at usury. According to him, the creditor may lose the capital itself (McLaughlin, xii-xiv century, p. 94).

The *Decretum of Gratian* condemn usury as the receiving of more than the sum lent, not only of money but of anything in kind, wheat, wine or oil (C. 14q.3c.1; McLaughlin, xii-xiv century, p. 95). McLaughlin interprets, the phrase on usury "… more than the sum lent," as any excess demanded, though it be a small gift (McLaughlin, xii-xiv century, p. 95). He means whatever is

added to the capital, no matter by what name: (*Quodcumque sorti accidit, et quodcumque velis ei nomen imponas)* (C.14.q.3.c.1; McLaughlin, xii-xiv century, p. 95), and or whenever more is required that was given: (*Ubi amplius requiritur quam quod datur)* (C.14.q.3.c.1; McLaughlin, xii-xiv, p. 85), then McLaughlin alludes we have usury. The condemnation posed in the *Decretum of Gratian*, alludes also to usury, for example, those who buy with the intention of selling at a higher price, who engage in any business for gain or who in any contract receive more than they give (McLaughlin, xii-xiv century, p. 95). According to McLaughlin, the following contracts may be usurious: If I lend you ten pounds and a poor horse worth five pounds for six months and demand twenty pounds. This contract is made to avoid the name of usury unless the horse were really worth than what has been added to the sum loaned. Another example, if I sell goods worth twenty pounds for thirty pounds to be paid at a certain date, I am guilty of usury unless there is doubt as to the approximate value of the goods. Also if I buy and pay now for grain to be delivered at harvest time and the current price which I pay is much lower than that which will then be current, this contract may be usurious (McLaughlin, xii-xiv century, p. 97).
McLaughlin is also of the opinion that a penalty for the late payment of a loan may also results in usury transactions (McLaughlin, xii-xiv century, p. 97).

5.3. Consensus by Scholars

According to McLaughlin, Canon law condemns as usury the taking of more than the principal even though the lender assumes the risk (McLaughlin xii-xiv century: 103). The *Corpus Juris Canonici* states that if one expects to receive in return more than the amount of the loan, he is a usurer: (*Si feneraveris hominem, id est sit u mutuum dederis pecuniam tuam a quo plus quam dedisti expectes… fenerator es)* (C.14.q.3.c.1; McLaughlin, xii-xiv, p. 106). Urban III regards someone as a usurer, who would not lend money unless he knew that he would receive more than the capital. He also regards one who refuses to grant an extension of time to one who is under oath to repay a debt on a certain day, a usurer. Both of these are guilty of the crime of usury on account of their intention: (*Hujusmodi hominess pro intentione lucre quam habent… judicandi sunt male agree, et ad ea quae taliter sunt accepta restituenda, in animarum judicio efficaciter inducendi*) (X.v.19.c.10; McLaughlin, xii-xiv, p. 106).
Pro-banking scholars equate interest with *riba*. According to them, *riba* refers to the premium that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity. *Riba*, is therefore, the predetermined return on the use of money (Vadillo, 2006, p. 33).

They forward three caveats in favour of the differentiation between usury (*riba*) and interest:

(a) *Riba* means usury and as such interest, particularly bank interest, does not fall into the ambit of *riba*.

(b) *Riba* relates to loans contracted by the poor and the needy persons for consumption purposes, while interest constitutes reward on commercial, productive and profitable loans.

(c) Interest stands for reasonable rate of return, while *riba* represents an excessive, exorbitant and exploitative rate of interest.

These three features assert that interest is moderate, while *riba* exorbitant and oppressive. In view of this, nominal interest, like bank interest, may not be regarded as *riba* (usury). The term *riba* in Islam, covers therefore only "excessive" interest (Swartz, 2009, pp. 415-416).

There is, however, an ambivalence on the concept of *riba* (usury) and interest, among Muslim scholars. One group is of the opinion that not all forms of interest is riba (usury), whereas the other group, is of the opinion that usury (*riba*) covers all forms of interest and not only "excessive" interest (Swartz, 2009, p. 415). On the strength of the latter, Khurshid Ahmad submitted that the three premises are totally incorrect, theoretically inadmissible and empirically baseless. He reasons that there cannot be any economic or *Shari'ah* justification for confining *riba* to usury and excluding interest from its jurisdiction. He asserts that as far as economic analysis is concerned there is no technical difference between interest and usury. He further avers that when we look upon the phenomenon from the demand side of economic analysis or the supply side, the rationale develop in economic theory for interest and usury are the same. If it is a reward for waiting, there cannot be any differentiation between interest and usury. Khurshid Ahmad alleges, if the question is examined from the productivity approach, there cannot be any differentiation between the two. Whatever differentiation has been introduced in the literature comes on moral grounds stating that one is high and exorbitant (usury) and the other is low and as such reasonable and secondly that usury deals with loans to the poor for consumption purposes, while interest deals with profitable commercial advances. According to Khurshid Ahmad there is no economic substance in any of these excuses (Institute of Policy Studies 1998: 38). There is no difference between consumption loan or production loan or high rate or low rate or loan taken by a poor person or rich (Institute of Policy Studies, 1998).

As far as Islamic banking and finance is concern, there is no technical difference between interest and usury. There is now consensus among modernist scholars that the term covers all forms of interest and not only "excessive" interest (Vadillo, 2006, p. 34).

Since usury involves paying more than the value of money received, it offends against commutative justice in that it charges more than the value of the money lent, which is unjustified since money is barren and can produce nothing in and of itself. Usury, therefore affects wealth transfer from the poor to the rich and is harmful to individuals and society (McCall, 2008-2009, p. 569).

6. Usury (*riba*): Cause for the Global Financial Turmoil

6.1. Rationale for the Prohibition of Usury

The philosophical basis for the prohibition against usury dealt with the very nature of money itself. The Third Lateran Council, condemning usury in 1179, stated that many persons are deserting other occupations to become money lenders (McLaughlin, xii-xiv century, p. iii).

If the taking of usury was allowed many evils would follow. People would neglect the cultivation of their lands. This would cause famines and the poor would perish. Though they might have lands to till, they would not have the animals and implements necessary because they have not their own, and the rich would place their money out at usury where the profit is greater and more certain, rather than in agriculture where the gain is smaller and less certain. Food would be so expensive on account of its scarcity that the poor would be unable to purchase it (McLaughlin, xii-xiv century, p. iii).

The paying of usury perennially will reduce men to poverty and one who practices usury can hardly avoid falling into the sin of idolatry: "The heart of the avaricious is in his money." (McLaughlin, xii-xiv century, p. iii). For this reason, usury is against charity and piety since we are obliged to love our neighbor and succor him in need (McLaughlin, xii-xiv century, p. iii).

No one could for long pay usury without being reduced to poverty (McLaughlin, xii-xiv century, p. iii).

The diversion or aberration of "money" from its basic function as a medium of exchange is in my view the basis for the financial crisis. Money, is however, made as an object of trade, which transformed the whole economy into a balloon of debts over debts. This is what Imam Al-Ghazali had predicted 900 years ago when he insisted that money should not be taken as an object of trade. He remarked: "*Riba* (interest) is prohibited because it prevents people from undertaking real economic activities. This happens when somebody with money is allowed to

earn more on the basis of interest […] It becomes easy for him to earn more money on the basis of interest without exerting himself to real economic activities. This leads to hampering the real interest of humanity, because the interest of humanity cannot be safeguarded without real trade skills, industry and construction." (Usmani, 2010, pp. 19-20).

All this happened because money was allowed to be used as a machine producing more money on the basis of interest, and its function to act as a medium of exchange was left out of the equation. The aspect of interest has been criticized by many economists. For one, James Robertson writes; "The pervasive role of interest in the economic system results in the systematic transfer of money from those who have less to those who have more. Again, this transfer of resources from poor to rich has been made shockingly clear by Third World debt crisis: "[…] It is partly because those who have more money to lend, get more in interest than those who have less; it is partly because the cost of interest repayments now forms a substantial element in the cost of all goods and services, and the necessary goods and services looms much larger in the finances of the rich. When we look at the money system that way and when we begin to think about how it should be redesigned to carry out its functions fairly and efficiently as part of an enabling and conserving economy, the arguments for an interest-free monetary system for the 21st century seems to be very strong (Usmani, 2010, pp. 19-20).

6.2. The Banking Sector

Western banks lend excessively to augment their profits. They are assured of the repayment of their deposits with interest. This leads to an unhealthy expansion of credit, to excessive leverage, to even subprime debt and to living beyond means (Chapra, 2008, p. 4).

Two factors enable Western banks to assume that they will not suffer losses. The first is collateral. If there is no risk-sharing, the bank will not always undertake a careful evaluation of the collateral and they may extend financing for any purpose, including speculation. The second factor that provides protection to banks is the "too big to fail' concept, which assures them that the central bank will bail them out. Banks equipped with such safety nets have incentives to take greater risks than what they otherwise would (Chapra, 2008, p. 4).

The easy availability of credit makes it possible for the public sector to have high debt profiles and for the private sector to live beyond its means and to have high leverage. This leads to financial fragility and debt crisis. The easy availability of credit and the resultant steep rise in debt are the result of inadequate market discipline in the financial markets due to the absence of risk-sharing (Chapra, 2008, p. 5). The prevailing financial crisis, which started in 2007, caused

Western banks to have been bailed out of three to four trillion dollars by the US, UK, Europe and a number of other countries. The financial crisis has seized up money markets and has led to a precipitous decline in property and stock value, a rise in bank failure, and nervous anxiety about the fate of the global economy and the financial system. This created an uneasy feeling that there is something basically wrong with the Western interest-bearing banking system.

7. An Alternative to a Western Interest-Based Model: Islamic Financial Architecture

As the current economic crisis unfolded, it became evident that the international financial architecture is in need of reform. The crisis obliges us to re-plan our journey, to set ourselves new rules. This crisis becomes an opportunity for discernment in which to shape a new vision for the future. A system concerned only with interests, advantages and power calculations will not be able to create a world in which humanity is central. If global banking practices were based on Islamic principles, we would not be seeing the kind of crisis we are living through now. In its very nature, interest is a hindrance to the moral and material growth of the society. The money lenders who grab interest income appear to be motivated by greed, selfishness, narrow-mindedness, self-aggrandizement and malignancy. These negative qualities in society dilute the positive qualities related to charity (Ahmad, 1994, p. 48). In the *Quran*, Allah deprives usury (*riba*) of all blessings, but blesses charity (Holy Quran, Surah Al-Baqarah 2: 276). The reason why the *Quran* is so strict about the levying of interest, is that Islam is against all forms of exploitation. Islam condemns all forms of exploitation, particularly injustice in the form of a lender being guaranteed a positive return without sharing the risk with the borrower. The borrower spends labour and time and utilizes his or her skills, but there is no guarantee of profit. In contrast, the money lender simply lends funds and does not invest time or labour in the business, but is guaranteed a fixed rate of profit in the form of interest. Interest charged on loans and advances therefore amounts to exploitation as the borrower is in a weaker position (Siddiqi, 1994, p. 25). There arise instances where the debtor has paid the original amount of a loan in full, but due to the accumulation of interest, the amount outstanding is more than the principal amount advanced. In Islam, money is only a medium of exchange. It has no value in itself. It should therefore not be allowed to give rise to more money *via* interest payments. Money advanced to a business as a loan, is regarded as a debt of the business and not capital and is therefore not entitled to any return (interest). Usury charges render the full adjustment of loans almost impossible, and the poor person continues taking one loan after the other to get out of the vicious circle without any success. The poor person has already paid much more

than the original amount, but the outstanding amount continues to rise due to the application of usury (*riba*). This notion can be illustrated in the following story highlighted in the British media. David Taylor, a leukemia patient, had taken a loan from a major Western bank. The bank overdraft was growing at a frightening rate due to the bank's high interest rate. The poor and sick man was worried that the longer he lived, the more of his life assurance money would be taken by the bank, leaving little or nothing for his family. Every additional day of his life meant less money for his wife and children. He was, therefore, not interested in prolonging his life. This example explains the misery of the application of overcharging of loans. Islam thus determined that only the principal amount should be recovered on such loans provided the borrower is in a position to repay (Siddiqi, 1994, p. 16). It is on this moral and economic logic that Islam prohibits usury (*riba*) in all its forms and intent.

8. Life without Usury (*riba*)

The interest-based economic society is tottering on the brink of disaster. It is in times like these that the phenemenon of the resurgence of Islamic banking is started to make its impact. Islam is not merely a spiritual formula but as a complete code of life in itself envisaging the economic well-being of an individual as well as a society upon sound foundations and divine instructions.

Islam does not stop at the moral condemnation of usury. It also reforms the character of a people so that an inclination to usurious businesses are suppressed and replaced by a spirit of sympathy and generous co-operation in human society.

As mentioned in the paper, in an usurious (capitalist) society, the individual is exploited. As a consequence, the chances of developing trade and industry diminish and opportunities for capital formation become scarce. The rise in the capital holdings of a few individuals will cause a depression in the collective economy. In a capitalist system, one individual enhances accumulated wealth in a way that renders thousands incapable of earning anything, let alone saving.

In contrast to this, in a society in which the interest is zero, the state guarantees relief to every citizen in need, and stinginess and hoarding of wealth will vanish. The affluent citizens will spend freely and pass on enough purchasing power to the poor citizens. This will promote trade and industry, which will open up more employment opportunities. The majority of the people will save because of enhanced income. This saving will not arise out of stinginess, apprehension, or greed, but will be the product of an economic system in which the affluent will still be left with much surplus wealth as they will not find any needy person to whom it may be denoted. It is

evident that Islamic banking is based, on the one hand, on the avoidance of all forms of financial exploitation and, on the other hand, on the creation of wealth and the alleviation of poverty. Herein, the Islamic banking system could contribute to alleviating the global financial crisis which we face. The capitalist system has failed in achieving this social justice for which the Islamic system was tailored.

9. Conclusion

This study has achieved its aim in solving the *riba* conundrum. There is now consensus among scholars that the term usury (*riba*) covers all forms of interest - and not only "excessive" interest. If the global economy has to bear this economic theory in mind, we would not be seeing the kind of finance crisis, we are living through now. The research also asserts that interest is a hindrance to the moral and material growth of a society in which the individual is exploited. This notion is taboo in Islam as it morally condemns the taking of interest. In so doing, Islam reforms the character of a people so that an inclination to usurious businesses are suppressed and replaced by a spirit of sympathy and generous co-operation in human society.

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