“Islamic” banking between literalism and rationalism

Mahmoud A. El-Gamal
Rice University

Literalists and Rationalists through the centuries

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<th>Rationalist analysis of Texts</th>
<th>Anti-rationalist jurisprudence</th>
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<td>Ibn Al-Muqaffa` (720-56)</td>
<td>Al-Shafi`I (d.820)</td>
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<td>Abu Yusuf (731-98)</td>
<td>‘ibn Hanbal (d.855)</td>
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<td>Al-Farabi (870-950)</td>
<td>Al-Ghazali (1058-1111)</td>
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<td>‘ibn Sina (980-1037)</td>
<td>‘ibn Taymiyya (1263-1328)</td>
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<td>‘ibn Rushd (1126-1198)</td>
<td>(Most jurists …)</td>
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<td>‘ibn Khaldun (1332-1406)</td>
<td>Al-Mawdudi, …</td>
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<td>Al-Afghani, ’Abduh, …</td>
<td><strong>Exclusive, rejecting non-Muslim thought, rejecting innovations, …</strong></td>
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Inclusive, intellectual cross-fertilization, embracing 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-Fadl, 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 Kayyīsan:
    - 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**