

RIBA, EFFICIENCY, AND PRUDENTIAL REGULATION: PRELIMINARY THOUGHTS

MOHAMMAD H. FADEL*

I. INTRODUCTION

The last decade has witnessed the birth and remarkable expansion of a specialized-niche within the world of global finance known as “Islamic finance.” While no precise figures exist with respect to the aggregate size of this sector, it has grown sufficiently to attract the attention of conventional commercial and investment banking institutions, many of which have set up Islamic finance divisions within their firms.¹ The ostensible justification for the existence of this niche is that Muslims—because of religious proscriptions set forth in the *shari’a* (Islamic law)—are unable to use conventional financial products, and accordingly, Islamic finance responds to this need by creating products that are claimed to comply with the requirements of Islamic law.² The most important rule of Islamic law that is said to justify the existence of Islamic finance is the prohibition against paying or receiving *riba*, which is often, although inaccurately, translated as interest.³ The irony, of course, is that Islamic finance largely consists of designing instruments that can be deemed to comply with the formal requirements of Islamic law while, at the same time, bearing all the economic attributes of the

* Canada Research Chair in Law and Economics of Islamic Law; University of Toronto Faculty of Law. Unless otherwise noted, the author provided the translations in this article.

¹ See, e.g., Will McSheehy & Shanthi Nambiar, *Islamic Bond Fatwas Surge on Million-Dollar Scholars*, BLOOMBERG, May 1, 2007, <http://www.bloomberg.com/apps/news?pid=20601109&sid=a.DsH16oTM6U&refer=home> (suggesting that amount of wealth managed according to Islamic law is approximately \$1 trillion and projecting it to reach \$2.8 trillion by 2015).

² MAHMOUD A. EL-GAMAL, *ISLAMIC FINANCE* 11-12 (2006).

³ *Id.* at 2 (describing how “Islamic” products mimic the features of conventional ones, with one series of “Islamic” bonds claiming to pay “4 percent annual profit” rather than “interest”). Given the breadth of the doctrine of *riba*, a more accurate translation of *riba* might be “unjust enrichment.” See FRANK E. VOGEL & SAMUEL L. HAYES, III, *ISLAMIC LAW AND FINANCE* 84 (1998) (suggesting that unjust enrichment is one theory underlying the doctrine of *riba*). Cf. NABIL A. SALEH, *UNLAWFUL GAIN AND LEGITIMATE PROFIT IN ISLAMIC LAW: RIBA, GHARAR AND ISLAMIC BANKING* 13 (1986) (defining *riba* as “unlawful advantage by way of excess or deferment”).

conventional financial instruments, including bearing interest, that are criticized for being inconsistent with Islamic law.⁴

Many scholars have attacked the schizophrenic relationship of Islamic finance vis-à-vis conventional finance as little more than crass exploitation of religious sentiment. One leading scholar coined the term “*shari’a* arbitrage” to describe Islamic finance as little more than the extraction of fees simply for transforming a conventional product into one that seems to comply with the formal requirements of Islamic law, while retaining all the economic features of that conventional product.⁵ This paper has nothing to say directly regarding the social desirability of the rise of or the continued existence of Islamic finance; instead, its goal is to address, from the perspective of Islamic law, the jurisprudential puzzle that allows for *shari’a* arbitrage to exist in the first place. It is now generally recognized, at least among scholars, that Islamic law permits numerous transactions which at the very least incorporate implicit interest in their structure.⁶ At the same time, Islamic law also prohibits several transactions on grounds that they contain *riba*, even though the transactions in question, because they are consummated in the spot market, lack an element of economic interest. To further complicate the meaning of this term, *riba* literally means “increase,” but there is universal agreement that not all increases resulting from trade are subject

⁴ See EL-GAMAL, *supra* note 2, at 2. Whether a specific instrument is deemed to be sufficiently in compliance with the norms of Islamic law so as to permit a Muslim in good-faith to avail herself of the product is generally determined by the opinion of one or more Islamic law experts. These experts work closely with bankers in structuring the terms of instruments (on an instrument-by-instrument basis) in order to permit them to give an affirmative opinion regarding the permissibility of an investment from an Islamic perspective in the instrument in question. See McSheehy & Nambiar, *supra* note 1.

⁵ Haider Ala Hamoudi, *Jurisprudential Schizophrenia: On Form and Function in Islamic Finance* 7 CHI. J. INT’L L. 605, 606 (2007) (claiming that “something akin to schizophrenia [exists] in the Islamic financial community, where formalist means have led to formalist ends, which proponents describe as functional”); EL-GAMAL, *supra* note 2, at 1 (comparing the practice of Shari’a experts giving opinions on the compliance of particular financial instruments with the Shari’a to the pre-Reformation practice of selling indulgences by the Catholic Church). To the extent Islamic financial products merely replicate already existing financial instruments, the costs generated by Islamic finance are simply dead-weight losses from a social perspective. To the extent that Muslim investors or end-users of financial products are unwilling to avail themselves of conventional financial products, however, the existence of an Islamic financial sector could nevertheless be socially efficient, even if suboptimal. For this to be true, one would have to assume that social gains in the form of increased savings and investment arising out of the existence of Islamic investment and credit alternatives exceed the dead-weight losses arising out of *Shari’a* arbitrage.

⁶ EL-GAMAL, *supra* note 2, at 51-52 (explaining that *riba* is not synonymous with “interest,” and that “even the most conservative contemporary [Muslim] jurists do not consider all forms of what economists and regulators call interest to be forbidden *riba*”).

to the restrictions of *riba*. This paper argues that the rules of *riba* should be analyzed as consisting of ex-ante and ex-post restrictions on contractual freedom. When viewed from this perspective, the historical doctrine of *riba* might be understood as part of a prudential scheme of regulation adopted to reinforce a wider system of rationing basic commodities under general conditions of scarcity; therefore, the rules at issue sacrificed individual efficiency gains in order to serve socially desirable distributive goals. This paper takes no position, however, as to whether the doctrine of *riba*, even if it prohibited some *Pareto* superior trades, may have nevertheless been Kaldor-Hicks efficient.

This paper will consist of four parts. Part II is an overview of the historical rules associated with the prohibition against *riba*. Part III is a jurisprudential digression into whether it is legitimate, from the internal perspective of Islamic law, to consider the welfare-effects of the rules of Islamic law. Part IV provides an overview of historical and contemporary justifications of Muslim jurists for the historical doctrines of *riba*, including as applied to the permissibility of conventional banking practices, as well as revisionist accounts providing alternative justifications for these doctrines. Part IV also attempts to place the historical doctrine of *riba* within a wider context of prudential and categorical regulations in Islamic law concerned with maintaining an equitable distribution of basic commodities. This paper concludes with the argument that *riba* restrictions are best understood as a type of price-setting regime designed to reinforce a public guarantee of a minimum distribution of basic goods.

II. OVERVIEW OF THE HISTORICAL DOCTRINE OF *RIBA*

The proscriptions against *riba* can be broadly broken down into two types of contractual restrictions, ex-ante and ex-post.⁷ I will begin with a description of ex-post restrictions and then proceed to discuss ex-ante restrictions. Ex-ante restrictions, in turn, can be further broken down into restrictions on contracts in the spot market and restrictions on contracts in credit transactions.

⁷ SALEH, *supra* note 3, at 13 (describing three basic kinds of *riba*).

A. EX-POST *RIBA*-BASED RESTRICTIONS ON CONTRACTS IN ISLAMIC LAW

Ex-post restrictions on the settlement of obligations represent the core of the doctrine of *riba* as this prohibition was set forth expressly in the Qur'an.⁸ According to early jurists and exegetes of the Qur'an, the transaction referenced in the Qur'an occurred in connection with a debtor's failure to pay a debt upon its maturity date.⁹ In this case, the creditor would agree with the debtor to defer the debt's maturity date in exchange for an increase in the amount owed.¹⁰ Although the pre-Islamic practice of the settlement of debts in this fashion was defended as being similar to the ex-ante mark-ups customarily charged by merchants at the time of the original sale—the legitimacy of which the Qur'an did not contest¹¹—the Qur'an categorically condemned the ex-post agreement as constituting *riba*, threatening creditors with damnation¹²

⁸ See *al-Baqara* 2:275-76, 2:278; *Al 'Imran* 3:130; *al-Nisa'* 4:161; *al-Rum* 30:39; 1 WAHBAH AL-ZUHAYLI, FINANCIAL TRANSACTIONS IN ISLAMIC JURISPRUDENCE 311 (Mahmoud A. El-Gamal trans., Dar al-fikr, 2003).

⁹ See 3 MUHAMMAD AL-ZURQANI, SHARH AL-ZURQANI 'ALA MUWATTA' AL-IMAM MALIK 324 (Dar al-ma'rifa 1987) (17th Century)

In the days before Islam, *riba* would occur in cases where one man owed another a debt maturing in the future, and when that debt matured, the creditor would ask his debtor 'Shall you pay or shall you increase?' If the debtor paid, he would take [his debt], but if the debtor did not pay, he would defer the maturity date and increase the debt.

3 MUHAMMAD B. JARIR AL-TABARI, JAMI' AL-BAYAN 'AN TA'WIL AY AL-QUR'AN 101 (Maktabat mustafa al-babi al-halabi, 3rd ed. 1968) (9th Century) (quoting an early authority as saying that, "[t]he *riba* of the people before Islam would occur when a seller sold on credit, with the debt maturing on a specific date in the future. When the debt matured, but the debtor had no means to discharge the debt, the creditor would defer payment and increase the debt."); 1 ABU BAKR MUHAMMAD B. 'ABDALLAH IBN AL-'ARABI, AHKAM AL-QUR'AN 241 (Ali Muhammad al-Bijawi ed., Dar al-Ma'rifa n.d.) ("*Riba* was known to them [and consisted of] one selling to another [with payment due] in the future, and when the debt matured, [the seller] would say 'Shall you pay or shall you increase?' meaning 'Shall you increase the amount you owe me and I wait an additional term?'").

¹⁰ See *supra* note 9 and accompanying text.

¹¹ See AL-TABARI, *supra* note 9, at 103-04 (stating that the mark-up charged by the seller at the origin of a contract is licit profit, in contrast to the increase charged in exchange for a deferral of the maturity date); IBN AL-'ARABI, *supra* note 9, at 242

[The people before Islam] would say that "selling is like *riba*," meaning that the increase [agreed to] at the time of the debt's maturity [in exchange for] a subsequent maturity date is like the original price [agreed to] at the time of the [original] contract, but God, may He be glorified, rejected their statement.

AL-ZUHAYLI, *supra* note 8, at 310 n.3.

¹² *al-Baqara* 2:275

and a “war from God and His messenger”¹³ if they did not desist from this practice. Instead, the Qur’an counseled creditors of bankrupt debtors to defer their debts gratis until the debtor’s solvency, or to forgive such debts altogether.¹⁴ Because of this transaction’s association with the period in Arab history prior to Islam, the jurists called it *riba al-jahiliyya*, the *riba* of the pre-Islamic days.¹⁵ It was also referred to as *riba al-qur’an*, the *riba* of the Qur’an, since it was expressly prohibited by the Qur’an,¹⁶ in contrast to other transactions that were also prohibited on the grounds of *riba*, but whose prohibitions lacked a basis in the Qur’an’s text.¹⁷ Although the Qur’anic prohibition is closely associated with the treatment of bankrupt debtors, and many early authorities expressly associated this transaction as one involving insolvent debtors, the rule eventually formulated by Muslim jurists simply prohibited settlement of one debt with a future debt on terms different than that of the original debt, without regard to whether the debtor was insolvent.¹⁸

In addition to the prohibition of pre-Islamic *riba*, the majority of Muslim jurists also prohibited agreements between a creditor and his debtor which purported to settle the debt by allowing the debtor to pre-pay his obligation in exchange for a discount on the amount owed.¹⁹ According to Ibn Rushd the Grandson, known to the West as Averroes, this latter rule was derived analogically from the prohibition of the pre-

Those who devour *riba* walk not save as one possessed by the devil: that is because they say “Indeed, is not trade the equivalent of *riba*?” But God has made trade lawful and forbidden *riba*. So whosoever desists, having received admonition from his Lord, may retain what he has previously taken [as *riba*] and his affair shall be [settled by] God. But whosoever resumes [taking *riba*], they are the denizens of Hell wherein they shall dwell forever.

¹³ *al-Baqara* 2:279 (“If you desist not [from taking *riba*], then take notice of a war from God and His Messenger. But if you repent, you are entitled to your capital amounts, neither being treated unfairly nor treating [others] unfairly.”).

¹⁴ *al-Baqara* 2:280 (“and if [the debtor] is insolvent, then [grant him] a deferral until [such time as he is] solvent and to [forgive the debt] as an act of charity would be better for you”). See IBN AL-‘ARABI, *supra* note 9, at 242 (“God made clear that, if the debt matures, and the debtor does not have the means to pay the debt, he should be given a deferral until he is solvent in order to lighten [his burden.]”).

¹⁵ See, e.g., 3 AHMAD IBN MUHAMMAD AL-DARDIR, AL-SHARH AL-SAGHIR 96 (Mustafa Kamal Wasfi, ed., Dar al-Ma’arif 1972).

¹⁶ MUHAMMAD ABU ZAHRA, BUHUTH FI AL-RIBA 33 (Dar al-Buhuth al-‘ilmiyya 1970).

¹⁷ *Id.* at 78-79.

¹⁸ AL-DARDIR, *supra* note 15, at 96.

¹⁹ See, e.g., *id.* at 69 (not allowing a creditor to accept as repayment a quantity of food less than the contractually specified amount prior to the maturity of the debt).

Islamic *riba*.²⁰ According to this analysis, the only benefit the creditor receives from pre-payment is time, just as the only benefit the debtor receives in the case of pre-Islamic *riba* deferral, is time.²¹

B. EX-ANTE *RIBA*-BASED RESTRICTIONS ON CONTRACTS IN ISLAMIC LAW

In addition to restricting the freedom of contracting parties in connection with the settlement of existing debts, Islamic law also placed restrictions in the name of *riba* on the formation of contracts. These restrictions existed for contracts involving both spot transactions and credit transactions, and were not based on the Qur'an; they instead derived from a set of statements attributed to the Prophet Muhammad.²²

Unlike the rules that restricted ex-post agreements on the settlement of debts, this category of rules proved to be much more controversial among Muslim jurists; while all Muslim jurists accepted the legitimacy of at least some of these restrictions, they disagreed on the reasons for these restrictions.²³ As a result, some schools of jurisprudence—principally the *Zahiris*²⁴—refused to extend the application of these restrictions to transactions other than those specified in the relevant statements of the Prophet.²⁵ The three schools of Sunni jurisprudence that have been historically dominant, however, agreed that the transactions prohibited by the Prophet were only examples of a

²⁰ 4 ABU AL-WALID MUHAMMAD B. AHMAD IBN RUSHD THE GRANDSON (*known as AVERROES*), *BIDAYAT AL-MUJTAHID WA NIHAYAT AL-MUQTASID* 525 ('Ali Muhammad Mu'awwad & 'Adil Ahmad 'Abd al-Mawjud, eds., Dar al-Kutub al-'ilmiyya 1996) (12th century).

²¹ *Id.*; AL-ZUHAYLI, *supra* note 8, at 329 ("a reduction of liability based on prepayment is very similar to increasing it based on deferment").

²² ABU ZAHRA, *supra* note 16, at 78-79. Muslims generally accord the statements of the Prophet Muhammad normative weight in determining the content of Islamic law to the extent such statements can be attributed to him with reasonable likelihood.

²³ See IBN RUSHD, *supra* note 20, at 497-506 (describing various theories justifying *riba*-based prohibitions); SALEH, *supra* note 3, at 14-18.

²⁴ The *Zahiris* were a school of Islamic jurisprudence that rejected the use of analogy for the derivation of law in favor of strict adherence to the plain meaning of revelation. SALEH, *supra* note 3, at 15.

²⁵ IBN RUSHD, *supra* note 20, at 503; SALEH, *supra* note 3, at 15 (mentioning the limited scope of *riba* according to the *Zahiris*). Some prominent Sunni jurists also expressed skepticism toward the historical doctrines of *riba*. See, e.g., I 'IZZ AL-DIN B. 'ABD AL-SALAM, *QAWA'ID AL-AHKAM FI MASALIH AL-ANAM* 164-65 (Dar al-Ma'rifa n.d.) (13th century) (discerning no purpose justifying the rules of *riba*).

broader class of prohibited transactions, not a conclusive enumeration of the restricted transactions.²⁶

In the next section, the restrictions on spot transactions will be analyzed first, followed by a description of the restrictions on credit transactions.

1. THE PROHIBITION AGAINST THE *RIBA* OF “EXCESS”

The basic prohibition against the *riba* of “excess,” known as *riba al-fadl*, derives from a statement attributed to the Prophet Muhammad in which he:

prohibit[ed] the sale of gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, unless it is the same [quantity] for the same [quantity] or the thing [itself] for the thing [itself], and that whosoever gives an increase or receives an increase, has committed *riba* [of excess].²⁷

Each of the three Sunni schools of law offered different explanations for identifying which commodities should be subject to the regime of the *riba* of excess, sometimes with dramatic differences for the scope of the prohibition. The Hanafi approach was the broadest, holding that any item sold by weight or volume was subject to the rules of the *riba* of excess.²⁸ The Shafi‘is, while they did not apply this prohibition to metals other than gold or silver, concluded that it applied to all kinds of food.²⁹ The Malikis put forth the narrowest interpretation of the *riba* of excess; like the Shafi‘is, they excluded all metals other than gold or silver from its scope.³⁰ With respect to food, the Malikis limited the prohibition to non-perishable staple foods.³¹ The rules prohibiting

²⁶ It is common to refer to four schools of Sunni jurisprudence: the Hanafis, the Malikis, the Shafi‘is, and the Hanbalis. The Hanbalis, however, were generally of minor historical importance prior to the twentieth century. Their prominence in the modern era is the result of two factors: (1) the Kingdom of Saudi Arabia follows the Hanbalis school; and (2) oil was discovered in Saudi Arabia during the twentieth century. Accordingly, this paper will focus generally on the theories of the three historically dominant schools of Islamic law.

²⁷ IBN RUSHD, *supra* note 20, at 497-98.

²⁸ SALEH, *supra* note 3, at 19; IBN RUSHD, *supra* note 20, at 500.

²⁹ SALEH, *supra* note 3, at 21; IBN RUSHD, *supra* note 20, at 500. The Shafi‘is defined *riba* as “a contract for a specified consideration (i) whose equivalence is not known according to the [relevant] legal measure at the time of the contract or (ii) with a deferral [in the delivery] of one or both of the considerations.” 2 MUHAMMAD B. MUHAMMAD AL-KHATIB AL-SHIRBINI, MUGHNI AL-MUHTAJ ILA MA‘RIFAT MA‘ANI ALFAZ AL-MINHAJ 363 (‘Ali Muhammad Mu‘awwad & ‘Adil Ahmad ‘Abd al-Mawjud, eds., Dar al-Kutub al-‘ilmiyya 1994).

³⁰ SALEH, *supra* note 3, at 16.

³¹ *Id.* at 24; IBN RUSHD, *supra* note 20, at 499.

trading in genera which are subject to the rules of the *riba* of excess, however, contained a significant loophole: if the counter-values in a proposed trade involved different genera, all jurists agreed that the contracting parties could make the trade on whatever terms they desired, on the condition that the trade was immediately settled.³²

Thus, the combination of the prohibition against trades within a genus, with permission to trade goods of different genera, permits a trader to exchange one measure of high-quality dates for one hundred measures of wheat, or one measure of gold for fifty measures of silver, even if both rates are well in excess of the going market price; however, it prohibits trading one measure of high-quality dates for two measures of low-quality dates, even if that is the market value of the high-quality dates relative to low-quality dates. In this case, where someone holding high-quality dates wishes to exchange them for lower-quality dates, she will be forced to enter into two trades. First, she must exchange her high-quality dates for goods from another genus, for example, barley; and second, she must trade the barley she obtained in exchange for her high-quality dates for the lower-quality dates she desires. Muslim jurists, far from being disturbed by this transaction as a circumvention of the prohibition against the *riba* of excess, expressly encouraged traders to enter into such back-to-back trades.³³ They also seemed unconcerned that traders might enter into such trades at a price that was far in excess of the prevailing market rate.³⁴ Therefore, in effect, the rules of the *riba* of excess are a prohibition against trading within a genus of goods based on differences in quality. Moreover, because the restrictions against the *riba* of excess apply only to spot transactions, the purported prohibition of interest is irrelevant to understanding this category of trading restrictions.³⁵

³² In some versions of the aforementioned statement of the Prophet, there is additional language that states, "you may sell gold for silver as you wish so long as delivery is mutual and immediate, and wheat for barley as you wish so long as delivery is mutual and immediate." IBN RUSHD, *supra* note 20, at 498-99.

³³ The legitimacy of back-to-back sales is attested to in a statement attributed to the Prophet Muhammad in which he counseled his followers to sell their low-quality dates and use the proceeds from the sale to purchase the higher quality dates which they desired, instead of trading two measures of low-quality dates for one measure of high-quality dates. *Id.*, at 504, hadith no. 954; *see also* EL-GAMAL, *supra* note 2, at 53; SALEH, *supra* note 3, at 19.

³⁴ AL-DARDIR, *supra* note 15, at 48. Ahmad al-Sawi expressly notes that mispriced exchanges of gold and silver are nevertheless binding. AHMAD B. AL-SAWI, BULGHAT AL-SALIK, *printed on the margin of* 3 AHMAD IBN MUHAMMAD AL-DARDIR, AL-SHARH AL-SAGHIR 48 (Mustafa Kamal Wasfi, ed., Dar al-Ma'arif 1972) (stating that off-market spot trades of gold for silver are binding).

³⁵ *See* EL-GAMAL, *supra* note 2, at 52.

2. THE PROHIBITION AGAINST THE *RIBA* OF “DELAY”

Just as Islamic law established commodity-specific restrictions on spot transactions, it also placed limitations on the terms on which certain commodities could be traded on a deferred basis. This set of prohibitions is also based on a statement attributed to the Prophet Muhammad in which he is reported to have said:

[Trading] gold for gold is *riba* unless [delivery is] hand-to-hand;
 [trading] wheat for wheat is *riba* unless [delivery is] hand-to-hand;
 [trading] dates for dates is *riba* unless [delivery is] hand-to-hand;
 [trading] barley for barley is *riba* unless [delivery is] hand-to-hand.³⁶

Accordingly, although the restrictions of the *riba* of excess did not prohibit trades involving the specified commodities of the same genus so long as the counter-values were equal and delivery was immediate, the doctrine of the *riba* of delay prohibited trading these commodities on a deferred basis, even if the counter-values were equivalent.³⁷ While Hanafi, Maliki, and Shafi‘i jurists agreed that this prohibition applied to the six commodities enumerated in the report establishing the doctrine of the *riba* of excess—gold, silver, barley, wheat, dates, and salt—and agreed that the prohibition extended to other deferred trades as well, they differed as to the scope of the prohibition against deferred trades.³⁸ For the Malikis, the reason for the prohibition against the deferred trade of wheat, barley, dates, and salt was simply their quality of being food, and accordingly, all deferred trades involving counter-values which were both food, were prohibited by the doctrine of the *riba* of delay.³⁹ In such cases it did not matter whether the counter-value was a staple or capable of being stored, whether the genera of the counter-values differed, or whether they were being traded in like quantities—the deferred trade of foodstuffs was categorically prohibited.⁴⁰ The Shafi‘is applied the same theory as the Malikis with respect to the deferred trade of food.⁴¹ The Shafi‘is and the Malikis both agreed that gold and silver were subject to the rules of the *riba* of excess

³⁶ IBN RUSHD, *supra* note 20, at 498. The prohibition against deferred trades in specified commodities is also supported by the additional phrase included in some of the versions of the Prophet’s statement prohibiting trading within the same genus of certain commodities. *See supra* note 32.

³⁷ SALEH, *supra* note 3, at 19-21, 25.

³⁸ *Id.*

³⁹ *Id.* at 25.

⁴⁰ IBN RUSHD, *supra* note 20, at 499-500; SALEH, *supra* note 3, at 25.

⁴¹ IBN RUSHD, *supra* note 20, at 500; SALEH, *supra* note 3, at 21.

and delay because they served as prices for private contracting (*al-thamaniyya*) and for the compensation of injuries to persons and property.⁴²

With respect to commodities that were not subject to the rules of *riba* of excess and were not food (e.g., cloth), the Malikis permitted deferred trades in these commodities unless (1) the counter-values were of the same genus,⁴³ and (2) the counter-values were not equivalent.⁴⁴ The Shafi'is, however, permitted all deferred trades so long as the counter-values were not food and the proposed trade would otherwise be permitted under the rules of the *riba* of excess, with the exception of deferred exchanges of gold and silver, which were categorically prohibited.⁴⁵ For the Hanafis, all trades involving commodities sold by weight or volume could not be settled on a deferred basis unless one of the counter-values was gold, silver, or copper coins, or a good not sold by weight or volume (e.g., cloth).⁴⁶ In addition, deferred trades involving the same commodity, even if such commodity was not sold on the basis of weight or volume and thus not subject to the rules of the *riba* of excess, were also prohibited, even if the counter-values were equivalent.⁴⁷

⁴² IBN RUSHD, *supra* note 20, at 500. Gold and silver are unique in serving this pricing function according to the Malikis and the Shafi'is and for that reason, the prohibitions applying to trading in gold and silver do not extend to anything else. *Id.* at 499. Thus, the Shafi'is do not apply the rules of *riba* to the exchange of copper coins. AL-SHIRBINI, *supra* note 29, at 369

[T]he reason gold and silver are subject to the rules of *riba* is they are the usual method of pricing and this quality is absent from copper coins and other goods . . . and the reference to 'usual' is necessary to exclude copper coins that are in general circulation, for *riba* does not apply to them.

⁴³ "Genus" for this purpose was defined loosely—accordingly, a sheep which is traded to be slaughtered for its meat is considered "different" than a sheep which is traded for its potential to produce milk. IBN RUSHD, *supra* note 20, at 508.

⁴⁴ *Id.* at 507; *see also* SALEH, *supra* note 3, at 25-26 (summarizing the Maliki prohibitions with respect to spot and deferred trades).

⁴⁵ SALEH, *supra* note 3, at 21-22 (summarizing the Shafi'i prohibitions with respect to spot and deferred trades).

⁴⁶ *Id.* at 20-21.

⁴⁷ *Id.* at 20 (summarizing the Hanafi prohibitions with respect to spot and deferred trades) The Hanafis defined *riba* as "the [uncompensated] excess to which one of the contracting parties is entitled by a contractual stipulation in a trade." 7 MUHAMMAD B. 'ABD AL-WAHID (*known as* IBN AL-HUMAM), SHARH FATH AL-QADIR 8 (Maktabat wa matba'at Mustafa al-Babi al-Halabi 1970), *reprinted in* Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech. 2004. For purposes of applying this definition, receiving a good immediately against a future delivery obligation constitutes a preference that results in an uncompensated excess, thereby explaining the requirement of simultaneous delivery in the case of the trade of goods of the same genus. MUHAMMAD B. MAHMUD AL-BABARTI, SHARH AL-'INAYA 'ALA AL-HIDAYA, *printed on the margin of* 7 IBN AL-

Accordingly, the Shafi'is took the narrowest view of the *riba* of delay: so long as the counter-values were not subject to the rules of the *riba* of excess, the rules regarding the *riba* of delay simply were inapplicable to the trade.⁴⁸ The Hanafis gave the broadest scope to the doctrine, with the Malikis taking a position in between these two extremes. Thus, the Shafi'is unconditionally permitted the trade of one sheep in exchange for two sheep to be delivered in the future, while the Malikis would permit this trade only if the exchanged sheep had different use values, e.g., one was for meat, and the other two sheep for milk. The Hanafis, however, prohibited the deferred trade of one sheep for one sheep, or one sheep for two sheep, even if the uses of the sheep in the two trades were different.⁴⁹

All three schools of law, however, permitted deferred trades if one of the two counter-values was gold or silver, or even copper coins, and the other counter-value was food or any other commodity.⁵⁰ Likewise, they all permitted the deferred trade of food or other fungibles for non-fungibles (e.g., the trade of wheat for cloth).⁵¹ In any case, so long as the trade in question did not violate the formal rules of the *riba* of delay (or for that matter the rules of the *riba* of excess), the jurists were largely unconcerned with the pricing terms agreed to by the parties.⁵²

HUMAM, SHARH FATH AL-QADIR 7, reprinted in Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech. 2004. See also, IBN RUSHD, *supra* note 20, at 507. Ibn Rushd also reports that the Malikis, as a result of their prohibition of self-interested loans (*salaf jarra naf'an*), would also prohibit deferred trades of goods from the same genus. *Id.* at 508. There is a dispute within the Maliki school as to whether the prohibition against self-interested loans is a self-standing principle of law (*asl*) or is merely a prophylactic measure (*sadd al-dhari'a*). *Id.* at 510-11.

⁴⁸ SALEH, *supra* note 3, at 21.

⁴⁹ IBN RUSHD, *supra* note 20, at 508.

⁵⁰ SALEH, *supra* note 3, at 19-22, 25-26.

⁵¹ *Id.*

⁵² As a general rule, if the price was determined by arm's length bargaining (*mukayasa*), the fact that the contract price was off-market (*ghabn fahish*) would not invalidate the contract. See 4 MUHAMMAD B. MUHAMMAD B. 'ABD AL-RAHMAN AL-HATTAB, MAWAHIB AL-JALIL LI-SHARH MUKHTASAR KHALIL 468 (Dar al-fikr 1992) (16th century). Al-Hattab quotes Ibn Rushd the Grandfather as saying that mispricing, even if material, does not give the purchaser an option to rescind the sale, as long as the sale was an arm's length transaction and the purchaser had full contractual capacity. *Id.* at 469. Indeed, Ibn Rushd the Grandfather cites the ruling of an early Maliki jurist, who concluded that the contract of a merchant who sold a good valued at 150 dinars for 1000 dinars on credit, and took a pledge from the purchaser as security for that obligation was binding, as evidence for the general rule that pricing errors do not effect the validity of a contract negotiated at arm's length. *Id.*; cf. AL-'ARABI, *supra* note 9, at 242 (mentioning a minority opinion within the Maliki school that would permit a trader to rescind up to a third of a contract whose terms are substantially off-market).

a. Excursus on Riba and Loans

As described above, the doctrine of *riba* was primarily concerned with the terms of sales and the settlement of debts. In addition, the label *riba* was also sometimes attached to any increase (or even more broadly, any benefit, whether or not monetary) that was obtained in connection with a loan, the legal term for which is *qard*.⁵³ (Because its definition among Muslim jurists is different from contemporary usage, I will refer to it using its Arabic name.) The most important feature of a *qard* was its charitable nature (*tabarru*).⁵⁴ Accordingly, the person extending the *qard* had to have the legal capacity to engage in charity (*ahliyyat al-tabarru*).⁵⁵ Consistent with its charitable nature, no date for repayment was required for the *qard* to be valid according to the Malikis,⁵⁶ and neither the Hanafis nor the Shafi'is would enforce a stipulated date for repayment.⁵⁷ Because of its charitable nature, if a condition was stipulated in the contract that gave a benefit to the person making the *qard*, the transaction was invalid.⁵⁸ Because of the deferred repayment obligation involved in a *qard*, it might appear to be prohibited by the rules of the *riba* of delay; however,

⁵³ See, e.g., AL-SHIRBINI, *supra* note 29, at 363 (identifying one type of *riba* as the “*riba* of a *qard* in which a benefit is stipulated”). A loan could also be referred to using the term *salaf*.

⁵⁴ 3 MUHAMMAD B. MUHAMMAD AL-KHATIB AL-SHIRBINI, MUGHNI AL-MUHTAJ ILA MA'RIFAT MA'ANI ALFAZ AL-MINHAJ 31 ('Ali Muhammad Mu'awwad & 'Adil Ahmad 'Abd al-Mawjud, eds., Dar al-Kutub al-'ilmiyya 1994) (16th century); 10 ABU BAKR B. MAS'UD AL-KASANI, BADA'I' AL-SANA'I' FI TARTIB AL-SHARA'I' 4981 (Matba'at al-imam n.d.) (12th century); AL-DARDIR, *supra* note 15, at 292 (stating that a *qard* is a morally meritorious (*mandub*) act because it is a form of “cooperation in piety and kindness”).

⁵⁵ 4 ABU ZAKARIYYA YAHYA B. SHARAF AL-NAWAWI, RAWDAT AL-TALIBIN 32 (al-Maktab al-Islami li-l-tiba'a wa-l-nashr n.d.) (13th century); AL-KASANI, *supra* note 54, at 4981. For that reason, guardians of minors could not use their property to make a *qard* according to the Shafi'is. See, e.g., AL-SHIRBINI, *supra* note 54, at 31. Hanafis held guardians personally liable to their wards in the event they used the wards' property for a *qard* which was not repaid. IBN AL-HUMAM, *supra* note 47.

⁵⁶ The Malikis would enforce a repayment term if it was specified in the contract. AL-DARDIR, *supra* note 15, at 295-96.

⁵⁷ AL-KASANI, *supra* note 54, at 4983 (stating that a repayment date for a *qard*, unlike other debts, is not binding, whether or not stipulated at the time of the contract or subsequently); AL-NAWAWI, *supra* note 55, at 34 (stating that the stipulation of a repayment date in connection with a *qard* is neither permissible nor enforceable).

⁵⁸ AL-SHIRBINI, *supra* note 54, at 34 (“the purpose of this contract is to provide relief [*irfaq*], so if [the creditor] stipulates a condition that gives him a right, it is no longer consistent with that purpose, so it becomes invalid”); AL-NAWAWI, *supra* note 55, at 34; AL-KASANI, *supra* note 54, at 4983; AL-DARDIR, *supra* note 15, at 295. Al-Dardir's definition of *qard* made clear that it had to be for the exclusive benefit of its recipient. *Id.* at 291 (“[A] *qard* is the giving of property against a similar consideration payable in the future solely for the recipient's benefit . . .”).

it is excluded from the prohibitions of the *riba* of delay because of the exchange's explicitly charitable nature.⁵⁹

C. ECONOMIC OBJECTIONS TO THE DOCTRINE OF *RIBA*

The primary economic objection to the doctrines of *riba*, in all their various forms, is that by restricting contractual freedom, they prohibit what otherwise would appear to be *Pareto* superior trades, and accordingly appear to be inefficient.⁶⁰ Despite the fact that the doctrines of *riba* may appear to be either paternalistic or inefficient insofar as they reduce parties ex-ante and ex-post contractual freedom (and thus by hypothesis, the individual welfare of traders), economists recognize that in some circumstances, particularly where welfare is maximized only through mutual cooperation, restrictions on the "freedom" of individuals to "defect" (e.g., prohibitions on their ability to enter into side agreements) are often necessary to achieve the *Pareto* optimal result.⁶¹ El-Gamal suggests that the doctrines of *riba* can be understood as a type of divine command, i.e., a moral injunction, not to defect from a scheme of social cooperation that has the potential to increase the welfare of all, but only if all (or substantially all) are committed to its rules.⁶²

Based on this interpretation, the doctrines of *riba* would, at least in certain circumstances, be efficiency enhancing. More importantly, if this interpretation of the historical doctrines is correct, it suggests that the doctrines themselves are simply pre-commitment devices necessary to secure the level of cooperation necessary to achieve social efficiency in certain states of the world; accordingly, these rules ought to be subject to revision in light of overall systematic considerations of efficiency.⁶³ Some may question whether considerations of efficiency, however, are

⁵⁹ EL-GAMAL, *supra* note 2, at 57 (citing a medieval jurist for the proposition that *qard* "is exempted from the rules of *riba* because of its charitable nature"); ABU ZAHRA, *supra* note 16, at 89 (stating that some jurists described a loan contract as "an act that originates as charity and concludes as compensatory").

⁶⁰ See EL-GAMAL, *supra* note 2, at 8-9 (noting that law and economics scholars describe limits on contractual freedom, including laws against interest-based lending and borrowing, as inefficient and paternalistic).

⁶¹ *Id.* at 10 (describing two person prisoners' dilemma in which if both parties pursued their own interests they would each be worse off than if they agreed to adopt a cooperative strategy).

⁶² *Id.*

⁶³ *Id.* at 11 (noting that attempts to apply the doctrines of *riba* in connection with the rise of "Islamic finance" has resulted in dead-weight losses relative to conventional financial products). This contrasts with earlier periods of Islamic history when the prohibitions of *riba*, according to El-Gamal, were more likely to have been consistent with social welfare.

even relevant. Islamic law is said to be a “religious” law, so consideration of the welfare effects of legal rules may simply be illegitimate, or even if welfare concerns are a historically plausible explanation for the origins of the rules, Islamic jurisprudence may simply render such analysis irrelevant to the prospective articulation of its rules. Whether efficiency is a relevant factor in Islamic jurisprudence and contract law will be taken up in the next part.

III. THE RELATIONSHIP OF WELFARE TO ISLAMIC LAW

Noel Coulson, a leading twentieth-century English scholar of Islamic law, notes that, “[i]t is a trite assertion that Islamic law is a God-given and religious legal system as opposed to the secular man-made legal systems of the West.”⁶⁴ Because of this religious orientation, Professor Coulson argues, “equitable considerations of the individual conscience in matters of profit and loss override the technicalities of commercial dealings,”⁶⁵ in contrast to “[c]ommercial law . . . in the West [which] is oriented towards the intrinsic needs of sound economics, such as stability of obligation and certitude of promised performance.”⁶⁶ Whether the sharp differences Professor Coulson suggests exist between “Western” commercial law and Islamic law are as profound as he claims, or even assuming that such differences exist, whether those differences can reasonably be attributed to the “religious” nature of Islamic law in contrast to the “secular” nature of Western law is questionable.⁶⁷

Rather than debating the proper characterization of Islamic law as “religious” or “secular,” it is sufficient for the purposes of this paper to ask whether Muslim jurists, in the course of formulating their various legal doctrines, exhibited concern for and sensitivity to the economic impact of their rules.⁶⁸ Viewed from this perspective, it is hardly

⁶⁴ SALEH, *supra* note 3, at xi-xii.

⁶⁵ *Id.* at xii.

⁶⁶ *Id.*

⁶⁷ See, e.g., OUSSAMA ARABI, “*Al-Sanhuri’s Reconstruction of the Islamic Law of Contract Defects: Error and Real Intent*,” in *STUDIES IN MODERN ISLAMIC LAW AND JURISPRUDENCE* 63 (2001) (noting that Islamic law’s doctrines of error in contracts concerned with protecting the stability of market transactions and respect for the real intent of contracting parties).

⁶⁸ But note that the Muslim jurisprudence explicitly recognized the Prophet Muhammad to have acted in the dual capacities of a prophet and a secular lawgiver, with important consequences arising from this distinction. See Sherman A. Jackson, *From Prophetic Actions to Constitutional*

debatable that pre-nineteenth century Muslim jurists were concerned with the impact of their rules on the secular well-being of individuals, and that they largely—even if erroneously—assumed that the rules they formulated for the regulation of the economic realm were broadly consistent with society's need to preserve wealth and encourage its useful exploitation.

As a general matter, Muslim jurists understood Islamic law's rules to be made up of rules that could be rationally justified and those which were devotional; however, this latter category was largely limited to devotional acts (i.e., ritual law).⁶⁹ As for those rules of Islamic law that dealt with secular human existence, the conclusions reached by reason, in principle, should be consistent with the rules that are derived from revelation.⁷⁰ Indeed, the general congruence between the revealed law and the secular welfare of human beings had become the jurisprudential solution to the theological problem arising out of the simultaneous commitments to a revealed law and the use of reason in ordering human affairs.⁷¹ The notion that revealed law was consistent with reason led to the theory of the five "universals" which revelation aimed to protect: religion, life, reason, progeny, and property.⁷² The fact that Islamic jurisprudence recognized the protection of property as one of its universal ends, and that its rules should do so in a rationally cognizable manner, forecloses the possibility that Muslim jurists were, in

Theory 25, INT'L J. OF MIDDLE E. STUD. 71, 74 (1993) (discussing the important legal differences that arise as a consequence of whether the Prophet Muhammad was acting as a prophet or a secular ruler).

⁶⁹ 'ABD IBN 'AL-SALAM, *supra* note 25, at 4. Indeed, Ibn 'Abd al-Salam also states that while revelation is indispensable for knowledge of the hereafter, and the means by which one attains eternal happiness:

[T]he benefits and the harms of the profane world and the causes thereof are known via necessity, experience, custom and considered opinion, and if something is ambiguous, inquiry is made [using] its evidence [viz., necessity, experience, etc.]. And, whoever wishes to understand the substantive reasons [for revelatory rules regulating the profane world], the costs and benefits [of certain conduct], and the weightier of these considerations, he should present these [questions] to his mind, imagining that revelation was silent on these matters, and then he should derive rules. In this case, hardly will a rule [imposed by revelation] differ from the conclusions reached, save for such devotional rules as God has imposed upon His servants with respect to which He did not reveal to them either its benefit or its harm.

Id.

⁷⁰ *Id.*

⁷¹ Felicitas Opwis, *Maslaha in Contemporary Islamic Legal Theory*, 12 ISLAMIC L. & SOC'Y 182, 189-190 (2005).

⁷² *Id.* at 188.

principle, opposed to the substantive analysis of the economic consequences of their rules.

Muslim jurists also stated their belief that rules regulating trade were specifically intended to further human welfare; thus, al-Hattab, a sixteenth century Muslim jurist, explained that trade is permitted “for the purpose of easing the condition of people and [to assist them] in cooperating to obtain [the means of their] livelihood.”⁷³ Similarly, Ibn Farhun, a fifteenth century jurist, after explaining that God’s revealed law was based on substantive ends which were intended to secure the various needs of mankind, identified one class of such rules as those intended to provide for the necessities of human life: “the law of sales, lease, silent partnership, and partnership in cultivation of the earth, because of the need humans have for items possessed by others, and their need to use others to satisfy their own needs.”⁷⁴ Islamic law also recognized exceptions to the doctrine of *riba* where it was believed strict application of the rules would be harmful.⁷⁵ Likewise, muftis also recognized exceptions to the prohibitions against *riba*⁷⁶ and other restrictions⁷⁷ where doing so would further an individual’s welfare, thereby increasing the scope of permissible economic cooperation.

One particularly interesting example can be found in an opinion given by Abu Ishaq al-Shatibi, a Spanish Muslim jurist.⁷⁸ He was asked about partnerships for the manufacture of cheese in which individuals

⁷³ AL-HATTAB, *supra* note 52, at 227.

⁷⁴ 2 BURHAN AL-DIN IBRAHIM B. MUHAMMAD B. FARHUN (*known as* IBN FARHUN), TABSIRAT AL-HUKKAM FI USUL AL-AQDIYA WA MANAHIJ AL-AHKAM 105 (Dar al-kutub al-’ilmiyya 1995) (14th century).

⁷⁵ One such example is the *’ariyya* sale, pursuant to which the owner of a fruit tree could enter into a contract to purchase dried fruit immediately against his future obligation to deliver the same kind of fresh fruit at the time of harvest. The amount of the fruit to be sold was determined by the estimated amount that the seller’s tree would yield. AL-DARDIR, *supra* note 15 at 238.

⁷⁶ MUHAMMAD B. YUSUF AL-MAWWAQ, AL-TAJ WA AL-IKLIL LI-MUKHTASAR KHALIL, *printed on the margin of* 4 MUHAMMAD B. MUHAMMAD B. ‘ABD AL-RAHMAN AL-HATTAB, MAWAHIB AL-JALIL LI-SHARH MUKHTASAR KHALIL 317-18 (Dar al-fikr, 1992) (permitting individuals to press their olives jointly, with the oil being distributed proportionally to each person’s contribution of olives, even though different olives yield different amounts of oil, thus resulting in the unequal and the deferred exchange of olives for oil in violation of the rules of the *riba* of excess and delay because “people must have what benefits them”).

⁷⁷ Later jurists, for example, permitted the use of copper coins as the capital of a silent partnership (*commenda*) in lieu of gold or silver, on the grounds that gold and silver are not desired in themselves, but only for their potential to be invested profitably. AL-SAWI, *supra* note 35 at 684; *see also* ABRAHAM L. UDOVITCH, PARTNERSHIP AND PROFIT IN MEDIEVAL ISLAM 177-83 (1970) (explaining controversy and development of doctrine regarding what constituted permissible capital for a *commenda* partnership).

⁷⁸ 5 AHMAD B. YAHYA AL-WANSHARISI, AL-MI’YAR AL-MU’RIB 215 (Muhammad Hajji, ed. Dar al-gharb al-islami 1990).

would contribute milk and divide the cheese in proportion to their contributions of milk.⁷⁹ Although he noted that, strictly speaking, this arrangement was a violation of the rules of *riba* of delay and excess,⁸⁰ he believed that such partnerships were nevertheless permissible.⁸¹ First, al-Shatibi noted that humans engage in many cooperative ventures that are essentially not-for-profit (e.g., sharing food in the context of journeys or as part of neighborly relations).⁸² Because individuals lack a profit motive in these cases, such exchanges have been exempted from the rules of *riba*. Second, he noted that because most individuals only have small amounts of milk, it would be impracticable for them to produce cheese using solely their own milk.⁸³ Were the law to prohibit individuals from entering into these partnerships, it would create hardship.⁸⁴ The scope of hardship that would be imposed through the strict application of the rules of *riba* to partnerships for the manufacture of cheese also manifested itself in another Andalusian practice which al-Shatibi endorsed in this opinion.⁸⁵ Most shepherds oversee flocks consisting of livestock belonging to numerous individuals. Because the shepherds take these flocks to distant pastures, it would be impracticable for the shepherds to separate the milk of each person who contributed livestock to the flock, much less require the shepherd to manufacture cheese separately for each individual.⁸⁶ Significantly, the joint-venture between the shepherds and the owners of the livestock for the production of cheese is a profit-making venture, but al-Shatibi nevertheless resorts

⁷⁹ *Id.*

⁸⁰ See, e.g., AL-DARDIR, *supra* note 15, at 462 (stating that partnerships whose capital consisted of food are invalid).

⁸¹ *Id.* The partnerships at issue facially violated the restrictions against the *riba* of delay and the *riba* of excess for two reasons. First, because the partnership's capital consisted of milk, and its output was cheese, it was the equivalent of trading food for food on a deferred basis, thus running afoul of the prohibition against delay in trading food. Second, because the amount of cheese produced by a certain amount of milk varied depending on the quality of the milk, there was no guarantee that the partners, when they distributed the output, could do so consistently with the requirement that trades in milk, since it was subject to the rules of *riba* of excess according to the Malikis, be conducted on a basis of strict equivalence. Accordingly, if the partners distributed the output based on their pro rata contribution of milk to the enterprise, they would almost certainly violate the rule of equivalence which governs trades of milk for milk.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.* at 216.

⁸⁵ *Id.*

⁸⁶ *Id.*

to the principle of “removal of hardship (*raf‘ al-haraj*)” as a justification for the arrangement.⁸⁷

Accordingly, whether or not Islamic law is described as “religious,” it is clear that both at the level of Islamic jurisprudence and Islamic substantive law, Islamic law historically seemed to be concerned with justifying its rules in relation to secular outcomes, particularly in relation to the secular welfare of individuals. Likewise, modern authorities have denied that the prohibitions against *riba* are of a devotional character.⁸⁸ We will now turn our attention to the justifications Muslim jurists have given for the doctrines of *riba*.

IV. THEORIES IN SUPPORT OF THE HISTORICAL PROHIBITIONS OF *RIBA*

Given the jurisprudential assumption that the rules of Islamic law are rationally related to the secular welfare of human beings, it is not surprising that Muslim jurists offered theories in support of the prohibitions against *riba*. I will begin with a discussion of the pre-modern justifications offered by Muslim jurists, then proceed to justifications offered by modern Muslim jurists, and conclude with a discussion of revisionist justifications offered by non-jurists.

⁸⁷ *Id.*

The difficulty in this case facing shepherds and the owners of livestock exceeds the [hardship involved in the] previous example of the orphan’s property [where the orphan’s guardian was permitted to commingle his assets with that of the orphan provided he acted faithfully because of the difficulty of separating the orphan’s property from that of the guardian], and accordingly, this principle [i.e. removal of hardship] requires permitting partners to commingle milk for that purpose.

The legal principle of “removal of hardship” has its origins in various verses of the Qur’an which deny the notion that God imposes hardships as a part of religion. See, e.g., *al-Baqara* 2:220 (“Had God wished, He would have burdened you”); *al-Hajj* 22:78 (“He has made no hardship for you in religion”).

⁸⁸ ABU ZAHRA, *supra* note 16, at 81 (“There is no doubt that the majority of jurists do not consider a text prohibiting a type of sale to be devotional, because devotional rules, i.e. those rules whose legal causes are not sought, are limited to rituals, not to financial transactions that occur among people.”).

A. HISTORICAL JUSTIFICATIONS FOR THE PROHIBITION AGAINST *RIBA*

Ibn Rushd, in his discussion of the doctrine of *riba*, noted that the controversial nature of *riba* was due to the nature of the analogical enterprise itself as applied to the prohibitions found in Prophetic teachings.⁸⁹ Leaving aside the objections of the Zahiris, a school of Islamic law that for principled reasons rejected analogy as a valid method of interpreting revelation, Ibn Rushd noted that even some Muslim jurists who accepted analogy nevertheless rejected the doctrines of *riba* which were developed by the three principal Sunni schools of jurisprudence.⁹⁰ To such critics, the attempt to apply the doctrine of *riba* to transactions other than those specified in the texts was unconvincing since it was based on an analogy known as “the analogy of resemblance” (*qiyas al-shabah*). In contrast to an “analogy of principle” (*qiyas al-ma’na*), the “analogy of resemblance” was considered jurisprudentially weak by many jurists. Accordingly, these critics rejected the majority’s extension of these prohibitions.⁹¹ For Ibn Rushd, it was the problematic nature of the analogies used by the Sunni schools of law which created the substantially different interpretations of the scope of the *riba* prohibitions.⁹²

Despite Ibn Rushd’s apparent sympathies for those Muslim scholars who were skeptical of the reasoning that led to the expansion of the *riba* prohibitions, he argued for the Hanafi position as the most sensible interpretation of *riba*, although he, himself, was a Maliki.⁹³ Ibn Rushd believed that the Hanafi approach, which applied the prohibition to all commodities that were traded by weight or volume, to be sensible. To the extent that traders engaged in intra-generic trading of fungible goods, there was a high risk of mis-pricing (*ghabn*) due to the similarity of the counter-values.⁹⁴ This risk militated against the possibility that the terms of any agreement would be fair. In addition, because the utilities associated with each of the counter-values were substantially similar, such trades only made sense to the extent that they took advantage of differences in quality within goods of the same genus. Accordingly,

⁸⁹ See IBN RUSHD, *supra* note 20, at 525.

⁹⁰ *Id.* at 503.

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.* at 505 (describing the Hanafi theory of *riba* as the best explanation).

⁹⁴ *Id.*

such trades did not further any fundamental needs (*haja daruriyya*) of the traders, but rather only served to help them obtain advantages that Ibn Rushd dismissed as a type of “extravagance” (*saraf*).⁹⁵ In other words, Ibn Rushd believed that the purpose of the *riba* of excess prohibitions was to foreclose mis-priced trades in connection with the exchange of fungible goods, where the only rational benefit to be obtained from such a trade represented a kind of “extravagance,” rather than a genuine need. Accordingly, applying the rules of *riba* to all fungible goods would thus further the ultimate goal of establishing fair terms of exchange without sacrificing the fundamental interests of traders.⁹⁶

Ibn Rushd also reports other justifications of *riba* that he thinks plausible. He states that an early Muslim jurist limited *riba* to food that was sold by weight or volume, thus combining the Hanafis’ concern with fair pricing of similar products with the intuition of the Shafi’is and the Malikis that the law should be more concerned about fairness when it came to trades that dealt with the necessities of human life.⁹⁷ In addition, Ibn Rushd reports the opinion that limited the application of *riba* to those commodities that were also subject to *zakat*, a kind of tax levied on property which was intended for relief of the poor.⁹⁸ Finally, Ibn Rushd reports that an early Maliki authority, Ibn al-Majishun, proposed that the rules of *riba* should apply to all types of property because it was intended to protect property by preventing mis-pricing (*man’ al-ghabn*).⁹⁹

If the Hanafis are concerned about mis-pricing, one might wonder why they restricted the scope of *riba* to goods that are sold by weight or volume rather than applying the rules of *riba* to all goods, especially since they believe that implicit in the notion of trade is that each person receives something substantially equivalent to what she gives up.¹⁰⁰ Al-Babarti explains the limited scope of *riba*’s application on the grounds that only when goods of the same genus are traded does it become clear whether there is inequality in the terms of the trade;¹⁰¹

⁹⁵ *Id.* at 506.

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ IBN AL-HUMAM, *supra* note 47 (“[The hadith] imposed the obligation of equivalence as a condition in the sale . . . since it [i.e., “sale”] implies correspondence which is satisfied when [each of the exchanged considerations] is equivalent.”).

¹⁰¹ AL-BABARTI, *supra* note 47, at 7

[W]hen [a good] is exchanged for [another good] of its genus, all of its parts correspond to all of the parts [of the good for which it is exchanged]. So, if there is

accordingly the trade remains permitted in accordance with the basic rule of permission that governs contracts involving the trade of cross-generic goods subject to *riba*.¹⁰²

The other puzzle posed by the Hanafī doctrine is why, if equivalence is the touchstone of a lawful sale, are only quantity and genus taken into account, and not quality? Ibn al-Humam gives three possible explanations, two of which may be described as based in legal reasoning and one which is, for lack of a better term, “faith-based.” The faith-based reason is simply that the Prophet is reported to have said, in connection with trades involving goods of the same genus, that “high-quality [goods] and low-quality [goods] are equivalent.”¹⁰³ The legal reasons are either that: (1) traders do not customarily take into account quality differences; or (2) were the law to permit traders to take into account differences in quality, it would reduce the volume of trade.¹⁰⁴ His commentator al-Babarti, expressed skepticism regarding the claim that quality differences are irrelevant to traders, but found the second to be more plausible.¹⁰⁵ For Ibn Rushd, however, the whole point of the rules of the *riba* of excess was to prevent intra-genus trades, since the only conceivable reason for such trades was to exploit differences in quality, a goal which he had dismissed as “extravagance.”¹⁰⁶

The Hanafīs, in the course of refuting the Shafī‘i doctrines regarding *riba*, also report why the Shafī‘is limited *riba* to foodstuff and gold and silver. As reported by the Hanafīs, the Shafī‘is took a somewhat literal approach to the language of the Prophetic injunction, and concluded that trades in food and gold and silver are presumptively prohibited.¹⁰⁷ Accordingly, the requirement of equivalence and

an excess in one of the two [goods], that excess is a loss to its owner. In order to protect people from such losses, equivalence is an obligation [in the case of such trades], in contrast to an exchange of a good for [another good] not of its genus. In this case, it is impossible to ascertain non-equivalence and thus impossible to ascertain a loss.

¹⁰² *Id.* (“Permission is the legal presumption regarding the exchange of one good subject to the rules of *riba* for another good also subject to the rules of *riba*.”).

¹⁰³ AL-HUMAM, *supra* note 47, at 8.

¹⁰⁴ *Id.* (“Quality is not taken into account because it is not customarily considered [to result in] a difference or because taking it into account [results] in an obstacle to trade”).

¹⁰⁵ AL-BABARATI, *supra* note 47, at 8.

¹⁰⁶ IBN RUSHD, *supra* note 20, at 506 (“The prohibition of non-equivalence in these items necessitates the cessation of such trades since the utilities [of the counter-values] do not differ. The need to trade arises only when the utilities [of the exchanged counter-values] differ.”).

¹⁰⁷ See MAHMUD B. AHMAD AL-ZANJANI, TAKHRĪJ AL-FURU‘ ‘ALA AL-USUL 143 (Muhammad Adib al-Salih ed., Maktabat al-‘ubaykan 1999) (13th century).

simultaneous delivery is a condition to the permissibility of trades involving these commodities. The presumptive prohibition against intra-generic trades in food and gold and silver, which can only be overcome by the equivalence and mutual-delivery of the considerations, implies that the food and gold and silver involve matters of grave importance (*khatar*) and scarcity (*'izza*), and accordingly, any justification offered for the rules of *riba* must be consistent with this notion. Based on this analysis, the Shafi'is argue that it is appropriate (*munasib*) that the rules of *riba* be limited to food and gold and silver because food and gold and silver are, respectively, necessary for the preservation of human life and property; the latter only being preserved to the extent property is subject to a pricing mechanism.¹⁰⁸ The Hanafi response is that while the Shafi'is may be correct in identifying the necessity of food and gold and silver for human existence, they are mistaken in their inference from these facts of social life that God would make dealings in these necessities more difficult than other goods.¹⁰⁹ Indeed, to the contrary, "divine wisdom with respect to humanity has been to permit broadly all things for which [human] need is greater as is the case with water and pasture for livestock."¹¹⁰

B. MODERN JUSTIFICATIONS FOR THE PROHIBITION AGAINST *RIBA*

In this subsection, I will discuss two modern approaches to the traditional doctrines of *riba*. The first approach represents the dominant view which equates the modern practice of lending at interest with *riba* and forms the theoretical basis for the existence of Islamic finance. The second approach, which I call the dissenting view, takes the view that the modern practice of lending at interest may qualify as *riba* in a technical sense, but it does not constitute the *riba* condemned in the Qur'an, nor is it categorically prohibited by other proscriptions of Islamic law.

¹⁰⁸ AL-HUMAM, *supra* note 47, at 6; *see also* AL-BABARTI, *supra* note 47, at 6 (attributing to the Shafi'is the same position described by Ibn al-Humam but adding the Shafi'i criticism of the Hanafi justification of *riba* as failing to take into account the special importance of food and specie in the life of humans).

¹⁰⁹ AL-BABARTI, *supra* note 47, at 8 ("the path [of the divine law] in such [matters] is freedom [from restrictions] to the greatest extent because of the extreme need for [such things], not restricting [access] to [such things]").

¹¹⁰ *Id.*

1. THE DOMINANT VIEW

For modern Muslim jurists who believe that lending at interest is unlawful, the doctrines of *riba* are viewed as a means to achieve economic justice. For al-Zuhayli, the *riba* of excess “was prohibited to avoid injustice and financial losses.”¹¹¹ He adds that, “the general reason for the prohibition of [the *riba* of delay] is that it is conducive to exploitation of the poor by the rich, and putting undue financial pressures on the needy,”¹¹² and when the deferred trade involves food, it poses the risk of creating artificial shortages by merchants who would prefer to sell food on credit so as to increase their return.¹¹³ Al-Zuhayli points out, however, that despite Islamic law’s intent to prevent economic injustice, “*riba* is not restricted exploitative transactions,” suggesting that Islamic law is willing to tolerate efficiency losses in the form of over-broad rules in order to prevent exploitation.¹¹⁴

Abu Zahra blames lending at interest for a host of social and economic ills, and concludes that it is a “destructive convention rejection of which is obligatory,” regardless of its status under revelation.¹¹⁵

¹¹¹ AL-ZUHAYLI, *supra* note 8, at 317. He also asserts that permitting deferred trades in foodstuffs could result in shortages of food in the markets. *Id.* at 321.

¹¹² *Id.* at 321. Of course, the doctrine of the *riba* of delay does not categorically prohibit credit sales of food; only deferred trades where both countervalues and food are prohibited. See, e.g., *id.* at 320 n. 32 (stating that deferred barter of food are “suspected to be exploitative” but deferred payment of food for cash “is permitted since such deferred payments meet people’s needs”).

¹¹³ *Id.*

¹¹⁴ *Id.* at 317.

¹¹⁵ ABU ZAHRA, *supra* note 16, at 21. Among the social and economic ills he attributes to lending at interest are: excessive greed and sloth, *id.* at 21-22 (money-lenders are greedy insofar as their income comes solely from the effort of others without any equitable sharing of the risk of loss and results in slothfulness since they can earn returns without any personal effort); excessive risk-taking, *id.* at 22 (availability of credit leads merchants to take on too much risk that destroys their businesses when the economy subsequently contracts); excessive consumption and suboptimal savings (“the proliferation of lending at interest has encouraged many to become extravagant and neglect to save”); oppression of the working class by the moneyed-classes, *id.* at 19 (“the spread of lending at interest is nothing other than the severe tyranny of capital over labor and all other means of production”); and general economic instability, *id.* at 22-23:

It has been established that the crises that effect the world economy are caused by debts which are owed by companies. When they are unable to discharge those debts because of a recession, they are forced to sell their goods at reduced prices, if they are able to find anyone to buy at all. As a result, these [economic] crises are treated by reducing debts by various means, such as increasing the money supply in order to depreciate the value of the currency [in which the debt is denominated], thereby reducing the debt, as the United States did in 1934.

Indeed, he also claims that lending at interest leads to psychiatric disorders from the stress created by debt. *Id.* at 24 (“[I]n addition to the economic dislocation [lending at interest causes], it also produces constant anxiety for both parties” whose source is covetousness.).

Indeed, it was the *moral* criticism of lending at interest by religious scholars such as Abu Zahra that gave rise to the birth of Islamic finance in the latter-half of the twentieth century.¹¹⁶

Lending at interest, regardless of its impact on social welfare, was only marginally related to the pre-modern doctrines of *riba*. Instead of coming directly under the framework of *riba*, self-interested loans were simply prohibited as being contrary to the charitable nature of a *qard*.¹¹⁷ Indeed, one Hanafi authority expressly distinguished self-interested loans from *riba*, arguing that although such loans are not *riba*, they are prohibited because of their resemblance thereto.¹¹⁸ A Shafi'i authority argued that self-interested loans are simply an instance of the *riba* of excess,¹¹⁹ a doctrine that has generally been treated as simply prophylactic, even by modern authorities who are staunch opponents of lending at interest.¹²⁰ Likewise, although the Malikis also prohibited self-interested loans, it is not clear whether this is an independent principle or merely a prophylactic rule.¹²¹ More generally, however, authorities such as al-Zuhayli and Abu Zahra who condemn lending at interest have assimilated, without any discussion, the practice of commercial lending to the *riba* of the pre-Islamic days,¹²² even though

¹¹⁶ See generally Hamoudi, *supra* note 5, at 615-616 (noting the importance of social justice and fairness in the rhetoric of those who advocate an Islamic financial system).

¹¹⁷ See *supra* Part II.B.2.a.

¹¹⁸ AL-KASANI, *supra* note 54, at 4983 (“[A] contractually required increase [in a loan contract] resembles *riba* because [the stipulated increase] is an uncompensated benefit.”).

¹¹⁹ AL-SHIRBINI, *supra* note 29, at 363 (attributing to al-Zarkashi the view that self-interested loans are simply an instance of the *riba* of excess); see also AL-ZUHAYLI, *supra* note 8, at 315.

¹²⁰ See, e.g., AL-ZUHAYLI, *supra* note 8, at 342-43 (describing the rules of the *riba* of excess as a prophylactic measure to prevent circumvention of the law, but nevertheless condemning lending at interest as categorically forbidden).

¹²¹ See *supra* note 47 and accompanying text.

¹²² See, e.g., ABU ZAHRA, *supra* note 16, at 37 (“[T]he *riba* set forth in the Qur’an is precisely the *riba* that banks deal in, and the basis of the people’s commercial dealings. Accordingly, there is no doubt that it is prohibited.”); AL-ZUHAYLI, *supra* note 8, at 342:

There are two types of the forbidden *riba* in Islam. The first is *riba al-nasi’ah* [*sic*, i.e. the *riba* of the pre-Islamic days], which is effected through an increase in the debt amount in compensation for deferment of its maturity Commercial bank interest is a form of *riba al-nasi’ah*, whether it is simple or compounded.

At the same time, however, both authorities continue to describe the pre-Islamic transaction of *riba* (which the express language of the Qur’an condemns) as involving a pre-existing debt which is settled by a new debt whose principal amount is increased in exchange for a deferral of the term. See, e.g., ABU ZAHRA, *supra* note 16, at 34 (Quoting an early authority for the proposition that “the *riba* for which there is no doubt . . . occurs when a creditor asks his debtor ‘Shall you pay or shall you increase?’ If [the debtor] does not pay, [the debtor] increases the [principal] amount owed to the [creditor], and [the creditor] defers the maturity date.”); AL-ZUHAYLI, *supra* note 8, at 311 (“*Riba al-nasi’ah*, which is the only type known to pre-Islamic

the latter involved an ex-post agreement between debtors and creditors occurring after the original debt had matured,¹²³ and the former relates to an obligation that arises simultaneously with the ex-ante origination of the debt. Therefore, it would seem that if lending at interest is prohibited, it would be prohibited by the rules of the *riba* of delay, and not the prohibition of the *riba* of the pre-Islamic days.¹²⁴ Both of these authors also justify the prohibition against lending at interest on the grounds that permitting interest-bearing loans amounts to turning currency into an object of commerce, when it is intended only to be a measure of value of goods.¹²⁵

Arabia . . . is the *riba* collected in compensation for deferring a due debt to a new term of deferment.”).

¹²³ See *supra* Part I.A.

¹²⁴ AL-ZUHAYLI, *supra* note 8, at 343. Al-Zuhayli notes that the prohibition against self-interested loans is not based on strong textual evidence, but is instead based on the fact that a number of the Prophet Muhammad’s companions prohibited interest-bearing loans by analogy to the Prophet’s prohibition against the bundling of a loan with other transactions, such as a sale. *Id.* Were commercial loan transactions to be analyzed under the rules of the *riba* of delay, there is at least a facially valid (even if purely formal) argument that the Shafi’i and Maliki doctrines would permit such loans, at least so long as the loan involves fiat currency. See *id.* at 324-25. Al-Zuhayli, recognizing the potential force of this argument, attempts to pre-empt it by acknowledging that in this case, he departed “from the traditional Shafi’i position [in favor of the Hanafi position]” so that “all modern monies, including paper currency, [are subject to] *riba*.” *Id.* at 325. Al-Zuhayli also dismissed the views of those who would exempt transactions involving fiat currencies from the rules of *riba* by analogy to the pre-modern exclusion of copper coins because in prior periods, transactions involving copper currency represented only a de minimis amount of aggregate economic activity. See *id.* at 347. Shaykh ‘Ali Jumu’a, official mufti of the Arab Republic of Egypt, recently opined that bank interest was permissible, in part because Egyptian currency has no relationship to gold or silver and that banks and their depositors do not engage in lending as understood by Islamic law. *al-Qahira al-Yawm*, July 1, 2007 (NETWORK television broadcast July 1, 2007 (Egypt)), available at <http://www.youtube.com/watch?v=OIkRF4-Azg&mode=related&search=>, <http://www.youtube.com/watch?v=1FjGMURQgbA&NR=1>.

¹²⁵ See, e.g., ABU ZAHRA, *supra* note 16, at 40 (quoting Aristotle approvingly for the proposition that profit from lending at interest is contrary to nature because the presumption is that the value of money does not change as a result of time or place in contrast to other types of property); *id.* at 59 (Stating that selling a good at a markup is permissible because the prices of goods change with time, but “currencies are the means of valuation, so time by hypothesis does not effect them. They should always maintain the same value because they are not an article of commerce whose value increases and decreases.”); *id.* at 88 (stating that gold and silver are subject to the rules of *riba* so that they do not become commercial goods); AL-ZUHAYLI, *supra* note 8, at 321 (“[Permitting] “*riba al-nasi’ah* would lead to dire economic consequences, since the resulting commodification of money and trading it in different quantities, would cause an imbalance by preventing money from serving the role of stable numeraire.”).

2. THE DISSENTING VIEW

a. Rashid Rida

Perhaps the most important religious scholar who rejected the claim that an interest-bearing loan from its inception is forbidden is Rashid Rida, the early twentieth century Muslim legal reformer.¹²⁶ Responding to a series of questions presented to him regarding *riba* in 1907, Rida concluded that the rules of the *riba* of excess are entirely prophylactic,¹²⁷ and the only kind of *riba* that is morally condemned by the Qur'an is the *riba* of the pre-Islamic era.¹²⁸ Moreover, Rida makes clear that in his view, the initial increase in the principal amount of a debt at its origination is an instance of the *riba* of excess, even though the creditor insists on the increase as a result of accepting payment in the future.¹²⁹

It was the prophylactic nature of this prohibition, Rida argued, that led both the Hanafi and the Shafi'i jurists to authorize transactions that were designed to evade the technical doctrines of *riba*.¹³⁰ One such device that became well-known in the Ottoman Empire was the *mu'amala*, pursuant to which the creditor, after lending a sum of money (e.g., \$900) to the borrower, would then sell the borrower on credit a handkerchief (or any other low-priced good) at a price that was well in excess of its market value (e.g., \$100), thereby giving the creditor the desired return on the loan.¹³¹ According to Rida, the Hanafis and the Shafi'is permitted this evasion of the rules of *riba* in reliance on the statement attributed to the Prophet where he instructed his followers who wished to trade two measures of low-quality dates for one-measure of high-quality dates to sell the low-quality dates and use the proceeds to

¹²⁶ 2 FATAWA AL-IMAM MUHAMMAD RASHID RIDA, 603-09 (Salah al-din al-Munajjid & Yusuf Khuri eds., Dar al-kitab al-jadid 1970).

¹²⁷ *Id.* at 606 (“[T]he *riba* of excess was not prohibited for its own sake, but rather was prohibited to prevent a means to circumvent the law . . .”).

¹²⁸ *Id.* (“Accordingly, the *riba* which the Qur'an condemned is limited to the *riba* of delay as was customary in the days before Islam . . .”); *id.* at 608-09

The *riba* of delay that was customary [in the days prior to Islam] was the [*riba*] that occurred after the debt had matured as a result of a [second] delay [in repayment] and if that occurred repeatedly, it would result in a doubling [of the principal amount] as they used to do in the days before Islam.

¹²⁹ *Id.* at 608.

¹³⁰ *Id.* at 607.

¹³¹ *Id.*

purchase the high-quality dates.¹³² Because they rejected the use of such devices, Malikis instead accept the argument that prophylactic rules may be revised or abandoned where it would be beneficial to do so.¹³³

Rida argued that the only way to understand the prohibitions against the *riba* of excess was as a prophylactic device, “because there is no point in requiring that the exchange of currency or food for its like be simultaneous and in equivalent quantities for its own sake, because no rational person would ever do that, because [such a trade] lacks any benefit.”¹³⁴ The only reason people trade is to obtain “an increase, either in quantity or quality, and neither is prohibited for its own sake, since obtaining a gain is the very . . . goal of commerce.”¹³⁵ Since that is the case, the prohibitions of the *riba* of excess can be overridden whenever there is a legitimate need to do so. Among the examples that Rida gives as justifying a relaxation in the rules of *riba* are: (1) the need to invest the property of an orphan or a widow; or (2) a student, who would otherwise be unable to invest his property for income, with the undesirable result that he could not continue his studies.¹³⁶ Although lending at interest is justified by the need of either the creditor to invest her money or the debtor to borrow, the law must be careful not to allow such transactions to result in the “doubling”¹³⁷ of debts, something explicitly condemned by the Qur’an.¹³⁸ For that reason, Rida praised the Ottoman-era rule that placed a maximum interest rate on lending transactions as consistent with “the definitive [Qur’anic] rule prohibiting the doubling of debts . . . while at the same time taking into account the well-being [of people] or [necessity].”¹³⁹

b. ‘Abd al-Razzaq al-Sanhuri

‘Abd al-Razzaq al-Sanhuri, drafter of the Egyptian Civil Code as well as the civil codes of numerous other Arab countries, discussed the doctrines of *riba* at length in his work, *Masadir al-haqq fi al-fiqh al-*

¹³² See *supra* note 33 and accompanying text.

¹³³ FATAWA AL-IMAM MUHAMMAD RASHID RIDA, *supra* note 126, at 607-08.

¹³⁴ *Id.* at 608.

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.* at 609 (“If this results in a doubling of the debt owed by the borrower, it is contrary to the wisdom of the Lawgiver, and no one with any piety would deem it lawful.”); see also *supra* note 128 and accompanying text.

¹³⁸ Al ‘Imran, 3:130 (“O you who believe! Do not devour *riba*, doubled and doubled”).

¹³⁹ FATAWA AL-IMAM MUHAMMAD RASHID RIDA, *supra* note 126, at 608.

islami [The Sources of Obligation in Islamic Law].¹⁴⁰ Consistent with his training as a scholar of comparative law,¹⁴¹ Sanhuri, after giving a broad survey of the positions of Muslim jurists on the doctrine of *riba*,¹⁴² places Islamic legislation on this subject within a comparative perspective of the regulation of lending at interest.¹⁴³ For Sanhuri, Islamic law's approach to *riba* is characterized by two opposing trends. The first takes a broad view of *riba* and expands its scope until it covers broad areas of trade. The second attempts to narrow the application of *riba* to a more or less limited set of transactions, or in the alternative, permits parties to circumvent the prohibitions of *riba* by using legal fictions.¹⁴⁴ One such fiction was the back-to-back sale, pursuant to which the prospective debtor would agree to "sell" a commodity (e.g., ten bushels of grain) for the desired principal amount in cash (e.g., \$100); then agree to purchase from the first purchaser another commodity (e.g., ten bushes of grain) at a price equal to the original sale price plus a mark-up to be paid in the future (e.g., \$110 in one year). As a result of the two sales, the first seller/debtor receives one hundred dollars in cash against an obligation to pay one hundred and ten dollars in a year.¹⁴⁵ Another legal fiction involved a loan and a sale, as in the case where a person wishes to borrow one hundred dollars for a year, and the creditor wishes to receive one hundred and ten dollars a year later. In this case, a simple agreement to lend one hundred dollars against an obligation to repay one hundred and ten dollars would be unlawful because it involved a loan with a stipulated benefit. Here, the lender could sell the borrower an item of trivial value for a price equal to ten dollars due in a year (the interest component) and then lend him the

¹⁴⁰ See generally 'ABD AL-RAZZAQ AL-SANHURI, MASADIR AL-HAQQ FI AL-FIQH AL-ISLAMI (Dar al-Fikr 1953-1954) (3 volumes).

¹⁴¹ Several commentators have discussed the role of comparative law in Sanhuri's project to create a modernized Islamic law. See Enid Hill, *Al-Sanhuri and Islamic Law*, 3 ARAB L.Q. 33 (1988); 'Amr Shalakany, *Between Identity and Distribution: Sanhuri, Genealogy and the Will to Islamize*, 8 ISLAMIC L. & SOC'Y 201 (2001); 'Amr Shalakany, *Sanhuri, and the Historical Origins of Comparative Law in the Arab World*, in RETHINKING THE MASTERS OF COMPARATIVE LAW 152 (Annelise Riles ed., 2001).

¹⁴² 'ABD AL-RAZZAQ AL-SANHURI, 3 MASADIR AL-HAQQ FI AL-FIQH AL-ISLAMI 176-94 (Dar al-Fikr 1953-1954).

¹⁴³ *Id.* at 194-98 (discussing restrictions on lending at interest in ancient Egypt, the broader prohibitions in Judaism and Christianity, and the legalization of lending at interest in Europe as a consequence of the French Revolution and the introduction of the Napoleonic Code).

¹⁴⁴ *Id.* at 199 ("Originally, the scope of *riba* in [Islamic law] was quite broad . . . then it began to narrow as a result of economic pressures. This latter development was preceded by the recognition of numerous legal fictions which were used to legitimate otherwise illicit profits.").

¹⁴⁵ *Id.*

principal amount, resulting in a net obligation on the borrower to repay the lender the desired return.¹⁴⁶ Indeed, this latter fiction had become so entrenched in the Ottoman Empire that the state authorities placed a limit on the maximum interest which was permissible in such transactions.¹⁴⁷

In contrast to the legal trend which expanded the scope of *riba* (subsequently leading to the recognition of legal fictions to allow parties to circumvent those rules), al-Sanhuri identifies a minority of early jurists led by Ibn ‘Abbas, a religious scholar who was the Prophet Muhammad’s cousin, who attempted to restrict the application of *riba* only to the *riba* of the pre-Islamic days; however, their position was overwhelmed by the majority of jurists who favored the broad approach.¹⁴⁸ Finally, al-Sanhuri identifies a third group of Muslim jurists who put forth two intermediate positions regarding *riba*. The first of these two interpretations distinguishes the *riba* of excess, on the one hand, from the *riba* of delay, on the other hand, concluding that the former was a type of “subtle” *riba* that was not prohibited for its own sake, but only because it could lead to “obvious” *riba* (the *riba* of delay), which this group of jurists concluded had been prohibited for its own sake.¹⁴⁹ The second group of jurists identified *both* the *riba* of excess

¹⁴⁶ *Id.* In this case, if the sale precedes the loan, the Hanafis deemed the contract to be permissible (*ja’iz*), but if the loan preceded the sale, the transaction was deemed to be disfavored (*makruh*).
Id.

¹⁴⁷ *Id.* at 200 n.1 (reporting that the statutory maximum was 5 percent at one time and 15 percent at others); see also MUHAMMAD AMIN B. ‘UMAR (*known as* IBN ‘ABIDIN), RADD AL-MUHITAR ‘ALA AL-DURR AL-MUKHTAR, BAB AL-MURABAHA, (13th Century) *reprinted in* Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech. 2004 (discussing remedy in the event lender imposed an interest rate in excess of the legal maximum). The Shafi’is also permitted loans in which it was understood—but not expressly stipulated—that the debtor would voluntarily repay his creditor in excess of the principal amount. AL-SANHURI, *supra* note 142, at 239-40

[I]f it is known that a man, when he borrows, customarily repays an amount in excess of the principal, there are two positions [within the Shafi’i school regarding the permissibility] of lending to him. The first is that it is impermissible to make a loan to him unless it is stipulated that he will return only what is owed, because what is known by custom is akin to that which is contractually stipulated and, had the excess been expressly stipulated, it would not have been permissible, so the same [rule] should apply if [the impermissible stipulation] is established by custom. The second is that it is permissible, and that is the rule [that is followed] because it is [religiously] commendable to return an amount in excess [of that which was borrowed based on a saying of the Prophet that “the best of you is the most generous in the discharge of his obligations”], so it is impermissible to deny the validity of this contract based on that [consideration].

¹⁴⁸ AL-SANHURI, *supra* note 142, at 201.

¹⁴⁹ *Id.* at 202. According to Al-Sanhuri, the principal representative of this position is Ibn Qayyim al-Jawziyya, although Ibn Rushd comes close to Ibn al-Qayyim’s position. *Id.* at 203.

and the *riba* of delay as prophylactic prohibitions, i.e., they represented a “subtle” form of *riba*, with only the *riba* of the pre-Islamic era being categorically prohibited.¹⁵⁰ The legal implications of this middle position was that “subtle” *riba*, whether defined as the *riba* of excess or as both the *riba* of excess and the *riba* of delay, continued to apply, but only to the extent that a legitimate countervailing need could not justify an exception from the applications of these doctrines.¹⁵¹

Al-Sanhuri himself adopts the second of the two middle positions.¹⁵² He identifies three policy goals behind the doctrines of *riba* which presumably justify the continued application of the rules of the *riba* of excess and delay, even if only on a prudential grounds.¹⁵³ The

¹⁵⁰ *Id.* at 202. This second position differs from that of Ibn ‘Abbas to the extent that it continues to respect—at least presumptively—the prohibitions against the *riba* of excess and delay, whereas Ibn ‘Abbas did not recognize them at all. Al-Sanhuri, however, attributed the second position to Rashid Rida rather than to any pre-modern jurists. *Id.* at 219. At the same time, he criticized as arbitrary Ibn al-Qayyim’s implicit assimilation of the *riba* of delay into the “obvious” *riba*. *Id.* at 218-19. To the extent that neither the *riba* of delay nor the *riba* of excess is set forth in the Qur’an (unlike the condemnation of the *riba* of the pre-Islamic era), al-Sanhuri argued that they should receive similar treatment, i.e. each prohibition should be treated as prophylactic, not categorical. *Id.*

¹⁵¹ *Id.* at 206

There is an important consequence to distinguishing the *riba* of excess from the *riba* of delay and that is: because [in the view of Ibn al-Qayyim] the *riba* of delay is prohibited for itself while the *riba* of excess is prohibited only to the extent that it is a means to something illegal, [but is] not illegal in itself, the illegality of the *riba* of delay is more severe than the illegality of the *riba* of excess. Accordingly, no exceptions are allowed from the *riba* of delay unless a pressing legal necessity exists, such as that which would permit consumption of carrion or blood, whereas in the case of the *riba* of excess, exceptions may be recognized for a need. It is obvious that a need is less [demanding] than a necessity. Accordingly, whenever there is a need for a transaction that involves the *riba* of excess, it is permitted.

Al-Sanhuri cites numerous examples of such exceptions to the prohibition against the *riba* of excess. *See id.* at 209 (permitting the exchange of an estimated quantity of ripe dates prior to their harvest against a known quantity of dried dates); *id.* at 211-13 (excluding the sale of gold or silver jewelry for gold or silver from the scope of the *riba* of excess to take into account the value of the labor in the jewelry); *id.* at 214-15 (excluding the trade of any type of property which is ordinarily subject to the prohibition against the *riba* of excess from its scope where that property has been transformed by human art, e.g. bread for bread); *id.* at 215-17 (excluding the exchange of coins for bullion from the prohibition against the *riba* of excess where the difference is the implicit cost of the mint’s work and the need for cash is time-sensitive, e.g. a merchant who is departing on a trading venture).

¹⁵² *Id.* at 237 (concluding that while the *riba* of the pre-Islamic era is prohibited for its own sake—and thus exceptions to it can only be made in cases of pressing necessity—the prohibitions against the *riba* of increase and delay are only prophylactic and thus may be overridden whenever there is a legitimate need). Later, Al-Sanhuri notes that it is inconceivable that a legal excuse could ever exist that would permit a creditor to violate the prohibition against the *riba* of the pre-Islamic era. *Id.* at 242.

¹⁵³ *Id.* at 236.

first is to prevent the hoarding of food.¹⁵⁴ The second is to prevent manipulation of currency which could result in instability of prices as a consequence of currency becoming an object rather than measure of commerce.¹⁵⁵ The third is to prevent mis-pricing in the case of barter transactions involving goods of the same genus.¹⁵⁶ Finally, al-Sanhuri concludes that interest-bearing loans are not, properly speaking, subject to the doctrine of *riba* at all, but instead involve only *quasi-riba* and should be treated as a species of either the *riba* of excess or the *riba* of delay. Under this analysis, interest-bearing loans would presumptively be unlawful, subject to exceptions based on need.¹⁵⁷ Al-Sanhuri then concludes his discussion by addressing the question of whether a need exists for interest-bearing loans. Unsurprisingly, he concludes that the need of modern enterprises in a market economy for large amounts of capital in excess of what could be practicably raised via equity offerings represents precisely the kind of need under Islamic law that renders interest-bearing loans legitimate.¹⁵⁸

c. Mahmoud el-Gamal

Mahmoud el-Gamal has applied the methods of law and economics to the problem of *riba*. El-Gamal argues that the doctrines associated with *riba* should be understood functionally, i.e., as a species of benefits analysis, rather than as an exercise in formal adherence to

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.* at 241

Because interest in respect of a loan is not in reality *riba*, but only something that resembles *riba*, it must be deemed to be either a type of the *riba* of delay or the *riba* of excess, and although these kinds of *riba* are all prohibited, the prohibition is prophylactic, not for itself, and accordingly, the prohibition lapses when a need arises.

¹⁵⁸ *Id.* at 243-44. Consistent with his analysis of the types of *riba*, however, he condemns compound interest as constituting the *riba* of the pre-Islamic era, and consistent with his view that the rules regarding the *riba* of delay are intended to prevent the occurrence of the *riba* of the pre-Islamic era, he argues that the state should set maximum interest rates. *Id.* at 244. In fact, al-Sanhuri explains that the Egyptian civil code, which he largely drafted, included many provisions intended to protect debtors, and these provisions were inspired by Islamic law's prohibitions against *riba*. *Id.* at 244-46 (discussing provisions in Egypt's civil law including its prohibition against compound interest, its provision of a maximum interest rate, its prohibition against a creditor collecting interest in an amount in excess of the principal except in cases of long-term loans used for investment, and the right of debtors to pre-pay their debts after giving creditors six-month notice without any penalties other than payment of the principal and six-months' interest).

bright-line rules, the very structure of which invites easy circumvention.¹⁵⁹ In the case of the prohibitions involved in the *riba* of excess and the *riba* of delay, the primary benefit which is to be attained is trade on equitable terms by insuring the use of transparent market pricing mechanisms.¹⁶⁰ Because it would be impossible to enforce such a policy in all trades, the doctrine of *riba* was limited to those trades (intra-generic trades exploiting differences in quality) that raise particularly obvious problems in pricing, and have the effect of forcing the prospective traders, before they can complete their trade, to first sell their goods in the market and then buy, using the proceeds from that first trade, the ultimate goods they desire. According to El-Gamal, the rules of the *riba* of excess function:

[A]s a mechanism that pre-commits [individuals] to collection of information about market conditions, and marking terms of trade to market prices. This protects individuals against engaging in disadvantageous trades and enhances overall exchange efficiency. . . . Hence, justice and efficiency both dictate following this mark-to-market approach to establishing trading ratios.¹⁶¹

The same price discovery justification applies to the restrictions of the *riba* of delay by requiring that credit be extended in connection with the purchase of a specific asset, e.g., a deferred sale of a car—the prohibition against the *riba* of delay functions to force traders to establish the appropriate interest rate in light of the future value of the asset being financed. Presumably, this rule results in a more accurate interest rate than would have been the case if the transaction were simply a loan of money, with respect to which the creditor either was ignorant regarding how the debtor would use the proceeds, or could not satisfactorily bind the debtor to use the proceeds from the loan in a specified manner.¹⁶² By tying the price of credit to the specific asset that the debtor seeks to finance, the rules of the *riba* of delay contribute to the equitable pricing of credit, and may contribute to reducing the risks of asset bubbles in, for

¹⁵⁹ EL-GAMAL, *supra* note 2, at 30 (agreeing with the view of ‘Abd al-Wahhab Khallaf, a 20th century Islamic jurist from Egypt who argued that, in the context of financial transactions, “benefits analysis should be the final arbiter”).

¹⁶⁰ *Id.* at 53.

¹⁶¹ *Id.*

¹⁶² *Id.* at 53-54. This also suggests that an implicit interest rate in an otherwise formally compliant transaction that exceeds the market interest-rate should be considered to violate the spirit of the *riba* prohibitions. *Id.* at 54.

example, housing markets.¹⁶³ Accordingly, El-Gamal suggests that the prohibition of the *riba* of delay be understood as a prohibition of “the unbundled sale of credit, wherein it is difficult to mark the interest rate to market.”¹⁶⁴ Viewed from this perspective, the prohibition against the *riba* of delay is simply a special instance of *gharar*, a doctrine which invalidated contracts that included contingent pay-offs or other material uncertainties in the contract’s terms.¹⁶⁵ Moreover, El-Gamal is relatively optimistic that unsecured credit is not, for the most part, necessary for the functioning of even a modern economy, as “all the financial ends that can be served through commercial lending can be equally if not better served through other forms of commutative contracts (such as sales, leases, and the like).”¹⁶⁶ Finally, the paternalism inherent in the prohibitions against *riba* is justified, even in contemporary circumstances, for two reasons. The first is the documented human irrationality with respect to time preference which results in individuals taking on excessive debt and eventually, in some cases, leading to the bankruptcy of those individuals.¹⁶⁷ The second is that although the financial system is monitored by paternalistic regulators who impose restrictions to protect against excessive risk taking, they do so either from the perspective of protecting the health of the financial system in the aggregate, in the case of bank regulators, or the health of the bank, in the case of bank credit departments that oversee the extension of loans.¹⁶⁸

¹⁶³ *Id.* at 56-57 (suggesting that in structuring an Islamic lease to finance the purchase of a home, the purchaser/borrower would be able to compare the contractual rent against the prevailing market rent, and to the extent that the former exceeds the latter, she would be on notice that there is a high likelihood that the asset is overpriced).

¹⁶⁴ *Id.* at 57. This observation might be especially salient in a society that lacks developed credit markets but has established markets for the future delivery of commodities such as food or livestock.

¹⁶⁵ MAHMOUD A. EL-GAMAL, A SIMPLE *FIQH*-AND-ECONOMICS RATIONALE FOR MUTUALIZATION IN ISLAMIC FINANCIAL INTERMEDIATION 5 (2006), <http://www.ruf.rice.edu/~elgamal/files/mutualize.pdf>

If we accept those two economic definitions of *riba* and *gharar* [i.e. the unbundled sale of credit and risk, respectively], then we recognize that *riba* is also an extreme form of *gharar*: The sale or extension of unbundled credit (e.g. in an unsecured loan) is a counter purchase of credit risk (which is a negatively-priced bad, the risk of debtor default, the price of which would be one of the main components of the interest charged). Credit risk includes substantial uncertainty, because the probability of default may be difficult to estimate, and the resulting losses in case of default (esp. due to bankruptcy) can be quite substantial.

¹⁶⁶ EL-GAMAL, *supra* note 2, at 57.

¹⁶⁷ *Id.* at 55-56 (citing empirical evidence of “time preference anomalies” that lead to dynamic inconsistency in human patterns of savings, spending and borrowing).

¹⁶⁸ *Id.* at 55.

Neither set of regulators, however, is focused on the welfare of the bank's customers; thus, bank regulators may allow banks to engage in risky transactions without regard to individual customers' welfare, so long as the soundness of the banking system is not threatened thereby. Similarly, a bank's loan officers may permit the bank to extend credit to individuals who are otherwise not creditworthy if the loans are made to a large enough number of borrowers so that the profits made from the pool of loans exceed the losses incurred from defaulting credits. The paternalistic regulations set forth in the prohibitions against *riba* thus fill a regulatory gap, so to speak, by putting prudential limitations on individuals, just as there are already prudential limitations imposed on banks.¹⁶⁹

In substance then, El-Gamal agrees with Rida and al-Sanhuri that *riba* is primarily a prophylactic doctrine; however, he differs from them insofar as he adopts the Hanafi view that *riba* essentially applies to all trades in order to prevent mis-pricing. While he would not condemn transactions that are not formally in compliance with the requirements of Islamic law where there is little to no actual risk of mis-pricing, he condemns those who confer Islamic legitimacy to a trade simply on account of the transaction's formal adherence to the requirements of Islamic law without respecting the goal of promoting fair pricing, a practice he calls "*shari'a* arbitrage."¹⁷⁰

C. DIFFICULTIES WITH THE PROPOSED JUSTIFICATIONS OF THE RULES OF *RIBA*

Sunni jurists have long believed that Islamic transactional law, including the prohibitions associated with the various doctrines of *riba*, exist to further the secular welfare of human beings.¹⁷¹ Accordingly, it is not surprising that the juristic literature attempted to provide rational

¹⁶⁹ *Id.* ("Thus, restrictions imposed by regulators and financial professionals require supplementary protections for individuals against their own irrational behavior—a function that can be fulfilled by religious law."). It is not clear what the institutional implications of El-Gamal's analysis are, other than that religiously-motivated, paternalistic regulation might complement legal regulation of the financial sector by reducing the tendency of individuals to engage in irrational behavior that may be profitably exploited by the financial sector.

¹⁷⁰ *Id.* at 11 (noting that many secular legal constraints have substantially eliminated the ills addressed by the juristic doctrine of *riba* but that formal adherence to "Islamic" contractual forms sometimes not only add dead-weight costs in the form of higher transaction costs, but also fail to mitigate the underlying substantive risks that were the basis of the Islamic prohibition in the first place).

¹⁷¹ *See supra* note 88.

justifications for the doctrines of *riba*. Nevertheless, despite the various theories of *riba* that have been proposed throughout Islamic history, none of them seem to explain adequately the historical rules.¹⁷² Even if one is prepared to accept the notion that some *riba*-based prohibitions are in fact prudential and not categorical, it is often difficult to see what concerns gave rise to these “prudential” doctrines in the first place.¹⁷³ Consider the traditional Hanafī explanation of *riba*. In its generality, it purports to apply to every transaction in which there is a contractually-fixed but uncompensated consideration that accrues to one of the parties to the trade.¹⁷⁴ Leaving aside the question of what circumstances would lead rational traders to agree to such a one-sided trade, the Hanafī account of *riba* at least has the virtue of being related to a general problem of how to guarantee that private trades will occur on fair terms. Unfortunately, the concern for fair pricing, while it might explain the rules of *riba*, is completely contrary to the notion that the parties are bound to even bad bargains, so long as the law deemed the terms to have been set pursuant to arm’s length bargaining and the absence of fraud.¹⁷⁵ Indeed, one Maliki jurist stated that exploiting differences in subjective valuations of goods was deemed by early Maliki scholars to be part of the “art of commerce.”¹⁷⁶

More generally, however, given the doctrinal importance of the *riba* restrictions, why should the rules be so easy to evade simply by trading goods across genera rather than within the same genus? Likewise, why should one be able to trade goods of different genera which are subject to the *riba* restrictions in unequal quantities (e.g., one

¹⁷² VOGEL & HAYES, *supra* note 3 at 78-87 (reviewing various theories justifying the doctrines of *riba*, but concluding that “none of the . . . explanations is wholly satisfactory,” even if they “offer something towards comprehending [the] results”).

¹⁷³ Al-Zuhayli, for example, states that the *riba* of excess is prohibited in order “to prevent the means of circumventing the prohibition of” the *riba* of delay, but he does not explain the connection between the two. AL-ZUHAYLI, *supra* note 8 at 317. One could argue more convincingly perhaps that the trades prohibited by the doctrine of *riba* of excess were common means of evading the prohibition against the *riba* of the pre-Islamic era. A creditor of an insolvent debtor could “sell” his debtor one measure of dates for two measures, for example, resulting in a net transfer from the debtor to the creditor of one measure of dates. The two for one transaction, then, amounts to a fictitious sale that results in compensation to the creditor for deferring collection of his debt. This risk, however, would appear to be more efficiently policed by bankruptcy law, which denies a bankrupt debtor the capacity to enter into new contracts without adequate consideration. See AL-DARDIR, *supra* note 15 at 345 (“[A]n insolvent debtor, prior to the initiation of bankruptcy proceedings, is prohibited from dealing in his property except for [adequate] consideration, and [any such transactions] are not binding.”).

¹⁷⁴ See *supra* note 47 and accompanying text.

¹⁷⁵ See *supra* note 52 and accompanying text.

¹⁷⁶ IBN AL-‘ARABI, *supra* note 9 at 242.

measure of wheat for two measures of dates), but only if delivery of both counter-values is simultaneous? In other words, why would the *riba* of delay prohibit a trade on a deferred basis that the doctrine of *riba* of excess would permit on an immediate basis? Clearly, it could not be that the creditor is exploiting the debtor in this circumstance, because (assuming that the debtor has a positive discount rate) the debtor is receiving his consideration at a lower price in the credit transaction than he would have in the cash transaction. Perhaps then, it is the opposite—it is the debtor in the credit transaction who is exploiting the creditor by enjoying the immediate delivery of a good against an obligation to deliver a consideration in the future whose value, even assuming performance, may be substantially less than what the price on the delivery would have been.¹⁷⁷ This would suggest a general suspicion of credit transactions based on the notion that they are too amenable to mispricing. If that is the concern, however, why permit credit sales of food if the consideration paid is either cash or goods that are not food (e.g., cloth)? It seems difficult to make the case that whatever risk of mispricing exists in connection with credit sales, that risk is substantially mitigated (at least where food is the object of sale) by forcing the purchaser to pay in either money or goods that are not food.

Similarly, the classical rules pertaining to *qard* and how the doctrine of *riba* applies to it are equally confusing. Because a *qard* is meant to be charitable, if the lender stipulates a benefit for himself (or even another) it becomes invalid. In this case, however, it would appear that a self-interested loan is simply a sale, an analysis which is confirmed by the thirteenth century Egyptian jurist, Shihab al-din al-Qarafi.¹⁷⁸ If this is true, the legal treatment of the transaction should turn on whether it violates the restrictions of the *riba* of delay. Accordingly, while a self-interested *qard* granted in gold or silver would run afoul of the rules of the *riba* of delay, presumably a self-interested *qard* of copper coins or cloth would not (since neither commodity is subject to the rules of the *riba* of delay, at least according to the Shafi'is and the Malikis). There is evidence, however, that such a loan was deemed to include *riba* by at

¹⁷⁷ Indeed, the Hanafis justify the prohibition against the deferred trade of goods subject to *riba*, even in equal quantities, on the grounds that immediate delivery is more valuable than a deferred delivery, thus resulting in an uncompensated benefit for the debtor. See, e.g., AL-ZUHAYLI, *supra* note 8, at 336 (“(i) an identified object is better than one described as a liability and (ii) an immediately available object is preferred to the same object deferred.”).

¹⁷⁸ 4 SHIHAB AL-DIN AHMAD B. IDRIS AL-QARAFI, AL-FURUQ 2 (‘Alam al-kutub n.d.) (13th century).

least some authorities.¹⁷⁹ Moreover, although it was unlawful to bundle a sale and a *qard*, (e.g., conditioning the extension of the *qard* on using it to purchase a good), a merchant could simply sell the good to the purchaser on credit at a markup to the cash price, a transaction which was not deemed to be exceptional despite its inclusion of an implicit interest-bearing loan.¹⁸⁰

Modern authorities opposed to lending at interest claim to base their position on the grounds of traditional Islamic legal doctrine; however, more realistically, their condemnation of commercial banking is based on a combination of intuitions regarding social justice and social costs that arise from the sale of credit.¹⁸¹ Instead of interest-based financing, which they condemn as unfair because it guarantees a profit to the lender even as the entrepreneur bears the risk that the venture will lose money, they propose profit-loss sharing finance.¹⁸² Even if one ignores for a moment the fact that pre-modern Islamic law displays no aversion to fixed-price contracts, (so long as they are compliant with the rules of *riba*) and thus, there is no basis to conclude that Islamic law has a bias toward equity-financing rather than debt-financing, the preferred mode of financing put forth by modern religious scholars, *mudaraba* (also called *qirad* and known as *commenda* in Europe), is inconsistent with the very profit-loss sharing model they urge as being paradigmatically “Islamic.” In a *mudaraba*, the investor delivers capital to an entrepreneur who then invests it in return for a share of the venture’s profits. Significantly, the entrepreneur is not entitled to any

¹⁷⁹ See AL-NAWAWI, *supra* note 55, at 34; AL-DARDIR, *supra* note 18 at 291 (condemning self-interested *qard* as involving *riba* without conducting an analysis under the rules governing sales).

¹⁸⁰ See EL-GAMAL, *supra* note 2, at 50 (discussing the fact that jurists took for granted that the markup in credit sales relative to cash prices reflected the time-value of money).

¹⁸¹ See, e.g., AL-SANHURI, *supra* note 142, at 229 (quoting al-Darraz, a 20th century Egyptian religious scholar, for the proposition that lending at interest privileges capital at the expense of the working class and reinforces class differences); AL-ZUHAYLI, *supra* note 8, at 347 (arguing that the harms arising out of lending at interest—even if only to finance production and not consumption—exceed whatever benefits that may arise from such a practice and even suggesting that lending at interest “may produce bad distortionary effects, and may even force an inflationary spiral that harms all economic agents in the long run”).

¹⁸² AL-SANHURI, *supra* note 142, at 230 (quoting al-Darraz for the proposition that instead of interest-based lending, which is unfair, investments should be financed using partnership where losses and profits are divided equitably); ABU ZAHRA, *supra* note 16, at 74 (condemning interest-based lending for not sharing the risk of loss with the entrepreneur and proposing equity investments as an alternative means to finance investments); AL-ZUHAYLI, *supra* note 8, at 349-50 (describing Islamic banks as making their profits from partnerships with entrepreneurs and thus being exposed to the risk of loss arising from commercial ventures as well as the possibility of profit).

returns until all of the investor's capital has been returned. Accordingly, in the event of a loss of capital, the entrepreneur's labor is valued at zero. If a *mudaraba* was truly a partnership between the investor and the entrepreneur, the entrepreneur would be deemed to own a share of the firm's capital, in which case upon dissolution of the firm, so long as some equity remained, the entrepreneur would receive some of the firm's remaining value. In fact, Islamic partnership law (*sharika*) expressly provided that a partnership could not be formed where one partner contributed financial capital and the other partner contributed labor.¹⁸³ The refusal to permit capital and labor to co-exist as partners seems to be derived from the notion that labor works in exchange for a wage, which *must* be fixed as a condition for the validity of the labor contract.¹⁸⁴ Accordingly, traditional jurisprudence deemed *mudaraba* to be an exceptional contract (*rukhsa*), insofar as the compensation provided for the entrepreneur's labor is contingent, something that is ordinarily impermissible.¹⁸⁵ Therefore, the general rule of Islamic law is that labor *should* not be expected to bear business risk, a result that is consistent with the non-diversifiable (and therefore riskier) nature of human capital relative to financial capital.¹⁸⁶

1. RIBA AS PRICE-SETTING

It is perhaps too ambitious to aspire to a single, unified theory of *riba*, but I will nevertheless suggest that the various doctrines of *riba* are designed to prevent the occurrence of unjust enrichment. Accordingly,

¹⁸³ AL-DARDIR, *supra* note 15, at 455-456 (dividing partnerships into "commercial partnerships" to which each partner contributes financial capital and "labor partnerships" to which each partner contributes labor). The most important exception to this rule was a sharecropping contract (*muzara'a*), where the cultivator's labor was deemed to be part of the joint venture's capital. *See id.* at 492-500 (explaining rules of sharecropping).

¹⁸⁴ 4 AHMAD IBN MUHAMMAD AL-DARDIR, AL-SHARH AL-SAGHIR 81 (Mustafa Kamal Wasfi, ed., Dar al-Ma'arif 1972) (stating that among other requirements for validity, a wage must be fixed at the time of the contract with respect to its nature, amount, and time of payment).

¹⁸⁵ AL-SAWI, *supra* note 34, at 681 (noting the exceptional nature of the employment contract described by al-Dardir).

¹⁸⁶ *See generally* David Levhari & Yoram Weiss, *The Effect of Risk on the Investment in Human Capital*, 64 AM. ECON. REV. 950 (1974) (noting the especially risky nature of human capital relative to other forms of capital). Note, however, that Islamic law provides for a unilateral contract of hire that operates as an option in the favor of the laborer. Pursuant to this contract, a worker, upon acceptance of the offer, has the right, but not the obligation, to perform a specified task in consideration of payment that is earned only upon successful completion of that task. Upon acceptance of the offer by initiating performance, the offeror loses the right to withdraw the offer until the offeree ceases performance. *See* AL-DARDIR, *supra* note 184, at 79-85 (describing rules of unilateral hire contract).

riba occurs whenever one party to a trade receives a stipulated benefit for which she did not compensate her counterparty. What distinguishes the Islamic concept of *riba* from the common law concept of unjust enrichment is that certain transactions are conclusively, in the case of the *riba* of the pre-Islamic era, and presumptively, in the case of the *riba* of excess and delay, deemed by law to involve unjust enrichment regardless of the parties' consent, sophistication, or knowledge. In other words, a certain class of transactions is simply excluded from the universe of permissible market transactions, even though some traders view such trades favorably.¹⁸⁷

Another way of describing the rules of the *riba* of excess is that Islamic law sets the price of quality differences with respect to goods subject to the *riba* of excess at zero, *but only when such goods are traded intra-generically*. In the same vein, one can understand the rules of the *riba* of delay as simple prohibitions on the deferred trading of food for food, or gold or silver for gold or silver. Accordingly, the rules of the *riba* of excess and the *riba* of delay can be understood to be a type of self-executing price-setting regulation that applies whenever a market includes only limited types (perhaps even only one) of goods, something which presumably occurs only in circumstances of extreme scarcity.¹⁸⁸ That would be consistent with its primary effect, which is to prohibit certain trades from occurring despite the fact that certain traders would wish to make those trades; however, in circumstances where the market is well-supplied with numerous types of goods, such price-restraints become irrelevant because prices could be set freely through inter-

¹⁸⁷ IBN RUSHD, *supra* note 20, at 506 (observing that the rules of the *riba* of excess, insofar as they operate to “forbid the trade of unequal amounts in these items results in the absence of such trades on account of the fact that the benefits [of such items] do not differ but trade is necessary only where differing utilities are to be obtained”). Ibn al-‘Arabi makes a similar point when he argues that although *riba* is defined as “every increase received without a corresponding consideration (*kullu ziyada lam yuqabilha ‘iwad*),” the existence of *riba* can only be determined in respect of the considerations proposed in any particular trade. IBN AL-‘ARABI, *supra* note 9, at 242. Considerations that are offered in contracts, he argues, are divided into two classes: a class of considerations for which revelation has determined their values and a class of considerations whose values are determined not by the law, but by the contracting parties themselves. *Id.* With respect to this latter class, the only issue raised is whether the price terms of an agreement may be set aside if they are materially off-market. *Id.* Ibn al-‘Arabi concludes that even in this case, the contract should not be set aside—in the absence of fraud—because both parties presumably are or were in need of the considerations at the time they contracted, thus explaining why they entered into the trade. *Id.*

¹⁸⁸ 2 MUHAMMAD B. MUHAMMAD B. ‘ABD AL-RAHMAN AL-HATTAB, MAWAHIB AL-JALIL LI-SHARH MUKHTASAR KHALIL 368 (Dar al-Fikr 1992) (16th century) (quoting Malik for the proposition that the staple of the Medinese diet was largely dates).

generic trading. In that case, it is unlikely that traders would prefer to trade intra-generically based on quality differences when a differentiated product market, with its greater trading opportunities, exists.

The prohibition against the *riba* of the pre-Islamic era can also be understood as a type of price-setting, insofar as Islamic law sets the price of deferral of a debt's repayment at zero once the debtor's default has occurred, while at the same time permitting the contracting parties to determine the price of deferral on an ex-ante basis so long as the trade complies with the ex-ante restrictions of the *riba* of delay.¹⁸⁹ Accordingly, the parties could freely trade wheat for gold on a deferred basis with a price that implicitly accords a value to the delay in the debtor's delivery of his consideration, but they could not set a positive price for delay after the debtor defaulted.¹⁹⁰

If the rules of *riba* are a type of price-setting, several questions arise. For example, with respect to the rules of the *riba* of excess and delay, what are the justifications for this policy of price-setting in these specific commodities, especially in light of the strong legal norm of respecting parties' bargains and the ability of parties to escape the ex-ante prohibitions simply by engaging in two trades instead of one? Another important question that arises with respect to the ex-ante *riba* restrictions is the matter of compliance: is it plausible to believe that traders would have complied with the rules of *riba*, and if so, under what circumstances? In contrast to the prohibition against the *riba* of the pre-Islamic era, which is substantially similar to modern restrictions on

¹⁸⁹ See, e.g., IBN AL-'ARABI, *supra* note 9, at 242

[T]he people prior to Islam] would do this . . . by charging an increase for which no consideration was paid, and they would say "But selling is like *riba*," meaning that the increase charged upon the maturity of the debt ex post is like the original price [which implicitly included an increase] of the contract ex ante, but God rejected their claim and made what they believed to be lawful sinful to them and He made clear that upon the maturity date [of a debt,] if the debtor lacks the means to discharge [it], he is to be deferred until [the debtor] is again solvent, in order to lighten [the debtor's burden.]

¹⁹⁰ Although the Qur'an's treatment of *riba* appears only to require that free deferrals be granted to bankrupt debtors, Islamic law simply prohibited ex post mark ups of a debt in exchange for a deferral, without regard to the solvency of the debtor. It may be the case, however, that the overwhelming majority of such defaulting debtors were in fact bankrupt, even if the rule did not stipulate the debtor's insolvency as a condition for the invalidation of an ex post agreement to defer payment of a debt in consideration for increasing the principal amount owed. See, e.g., AL-WANSHARISI, *supra* note 78, at 229-30 (discussing the case of insolvent Bedouin whose creditor was not allowed to accept food from his debtor in lieu of a debt owed since it would have the effect of a deferred trade of food in violation of the prohibition against the *riba* of delay).

creditors' rights with respect to bankrupt debtors,¹⁹¹ the ex-ante riba restrictions remain puzzling. In the next section, I will address the questions arising out of the riba of excess and delay in light of broader pro-consumer regulation in Islamic law, with a special focus on their application to food.

2. RIBA IN THE BROADER CONTEXT OF ISLAMIC PRUDENTIAL REGULATION OF THE MARKET AND GUARANTEES OF MINIMUM ENTITLEMENTS

As has been explained above, Islamic law generally recognizes as binding the price terms that result from arm's length bargains, even in circumstances where it turns out that the contract price deviated materially from fair market value. The primary exceptions to this laissez-faire attitude toward trade are the rules of *riba* and *gharar*, respectively; however, in addition to those two doctrines, lesser-known doctrines exist which also limit the ability of certain parties to trade freely. Three examples of such doctrines are: (1) the rule against city-dwellers acting as selling agents on behalf of Bedouin producers,¹⁹² (2) the rule prohibiting city-based retail merchants from purchasing goods of a caravan prior to its arrival in the city's markets,¹⁹³ and (3) the rule permitting the government to set the prices at which retail merchants (but not producers or wholesale importers) sell staple foods.¹⁹⁴ Each one of these rules functions to increase the urban consumer's share of the surplus arising from trade. In the case of the first rule, the presumption is clearly that the Bedouin, being relatively ignorant of local prices, is willing to sell to the urban consumer at a price less than the equilibrium

¹⁹¹ The prohibition against the *riba* of the pre-Islamic era is substantially similar to the general rule that an unsecured creditor is not entitled to claim post-petition interest against the bankrupt debtor. See 11 U.S.C. § 502(b) (2006) (providing that interest ceases to accrue as of the date the bankruptcy petition is filed); *id.* § 506(b) (allowing post-petition interest in respect of a secured claim only to the extent that the value of the security interest exceeds the value of the claim). It is also consistent with the sharing norm of bankruptcy law which prohibits a debtor from favoring one creditor over another, which would be the result if a bankrupt were permitted to enter into an agreement with a creditor deferring his obligation in consideration for a markup in the principal amount owed to that creditor. Both Islamic law and contemporary Chapter 11 prohibit a bankrupt from entering into new contracts without the approval of the court.

¹⁹² See, e.g., 'ABDALLAH B. AHMAD AL-NASAFI, AL-BAHR AL-RA'IQ SHARH KANZ AL-DAQA'IQ, reprinted in, Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech. 2004; AL-HATTAB, *supra* note 52, at 378.

¹⁹³ AL-HATTAB, *supra* note 52, at 378-79.

¹⁹⁴ *Id.* at 227-28.

price prevailing in the town but for the intermediation of an urban agent.¹⁹⁵ The second rule is also intended to prevent a group of urban merchants from diverting to themselves the consumer surplus arising from the willingness of the caravan's merchants, due to their relative ignorance of local prices, to sell the caravan's goods at a price less than that prevailing in the city.¹⁹⁶ The third rule decreases retail merchants' share of consumer surplus generated by trade in food by not permitting them to sell above a government set maximum which by hypothesis is below the market-clearing rate.¹⁹⁷ Interestingly, Muslim jurists took each one of these rules as creating prudential standards of regulation, and accordingly they limited the application of the first two rules to situations where failure to apply the rule would harm the residents of the town.¹⁹⁸ In the case of the third rule, despite an express report attributed to the Prophet Muhammad in which he was purportedly asked to set prices and pointedly refused on the grounds that he was reticent to interfere in the prices that were set by the market,¹⁹⁹ they permitted governmental price-setting on the grounds that price-setting, despite the Prophetic injunction,

¹⁹⁵ *Id.* at 378 (“[This rule applies] when the urban agent takes charge of negotiating the contract or accompanies the good’s owner in order to discourage him from selling by telling him that the bid is less than its [market] price . . .”).

¹⁹⁶ AL-NASAFI, *supra* note 192 (stating that prohibition applies on its fact to cases where the urban merchants intend to purchase the goods from the caravan and then hope to re-sell it at an increase in the city on account of the need of the towns’ folk for the goods or where they buy it from the caravan at a discount to the prevailing price due to the caravan’s ignorance of the local price).

¹⁹⁷ *See, e.g.*, ‘UTHMAN B. ‘ALI AL-ZAYLA’I, TABYIN AL-HAQA’IQ SHARH KANZ AL-DAQA’IQ, *fasl fi al-bay’*, reprinted in Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech. 2004; SULAYMAN B. KHALAF AL-BAJI, AL-MUNTAQA SHARH AL-MUWATTA, reprinted in Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech.; AL-HATTAB, *supra* note 52, at 227-28.

¹⁹⁸ *See, e.g.*, AL-NASAFI, *supra* note 192 (stating that the prohibition against urban merchants purchasing from a caravan outside the city limits and the prohibition against a city dweller acting as a selling agent for a Bedouin both apply only where doing so causes harm to the town’s residents).

¹⁹⁹ AL-ZAYLA’I, *supra* note 197 (quoting the Prophet Muhammad as saying “do not set prices, for God sets prices; He constricts and grants provision, and He is the provider”); MUWAFFAQ AL-DIN ‘ABDALLAH B. AHMAD B. MUHAMMAD (*known as* IBN QUDAMA), AL-MUGHNI, *fasl fi al-tas’ir*, reprinted in Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech.

[P]rices had risen in Madina during the time of the Prophet Muhammad so [the people] said “O Messenger of God! Prices have risen, so set a price for us.” He replied “God sets prices; He constricts and grants provision, and He is the provider. Indeed, I earnestly hope to meet God with no claims brought against me involving blood or property . . .”

is permissible where necessary to prevent harm to the city's population that may occur as a result of "hoarding."²⁰⁰

Viewed from this perspective, it may very well be the case that the rules prohibiting the *riba* of excess and delay are related to the same general policy: maintaining an adequate minimum supply of food for all people in the community by setting prices in critical staples.²⁰¹ Economists generally look askance at price controls, arguing that they generally promote surpluses, if the price restraint is set at a minimum, or shortages, if the price restraint is set at a maximum, and as a result, only justify them as a short-term response to emergencies.²⁰² In addition to normative arguments against price-restraints, the history of price controls "appears to be one of unrelieved botchery and failure."²⁰³ This raises the question of whether, assuming the ex-ante rules of *riba* are akin to price

²⁰⁰ See, e.g., AL-ZAYLA'1, *supra* note 197 (permitting the government to set prices for food when they rise far above their normal price resulting in harm to the public); AL-BAJI, *supra* note 197 (permitting government to set prices for fungibles to protect public interest); AL-FATAWA AL-HINDIYYA, *fasl fi al-ihktikar*, reprinted in Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech. (permitting the government to force merchants to sell at a specific price where there is reason to fear for the well-being of the populace). *But see* IBN QUDAMA, *supra* note 199 (concluding that government price-setting is responsible for increases in prices because it causes goods to disappear from the market). See generally Keith Sharfman, *The Law and Economics of Hoarding*, 19 LOY. CONSUMER L. REV. 179 (2007) (conducting an economic analysis of anti-hoarding rules in the Talmud).

²⁰¹ For purposes of this article, I am assuming that the ex ante *riba* restrictions arise out of a concern related to the regulation of the money supply. Muslim jurists recognized the power of the state to regulate the value of currency by issuing new series of currencies, and in the case of copper currencies, by setting the exchange rate of the copper coin to either silver or gold. See, e.g., AHMAD B. MUHAMMAD IBN HAJAR AL-HAYTAMI, AL-FATAWA AL-FIQHIYYA AL-KUBRA, al-fasl al-thani fi ma yunqad fihi qada' al-qadi, reprinted in Encyclopedia of Islamic Jurisprudence CD-ROM, Kuwaiti Ministry of Endowments, the Islamic Development Bank & Harf Info. Tech. (describing rule applicable to contract denominated in copper when the exchange rate of that currency for silver is increased after the date of the contract). Alternatively, rules prohibiting deferred trades in gold and silver, but allowing deferred trades of gold and silver for food, might be consistent with the rationing/price-restraint scheme that I am speculating existed in the early Islamic state of Madina. On this theory, while a person with excess gold or silver was permitted to use it to import food or other goods to be delivered in the future, he could not attempt to profit from trading in these two commodities. Thus, a person with savings in gold and silver could either use them to purchase goods in the spot or the credit market, or he could lend them gratis. Such a policy would also be consistent with theoretical work explaining prohibitions against interest-bearing loans as a type of social insurance in societies with high and impermanent income equalities and with low growth rates, circumstances which certainly applied to seventh-century Madina. See Edward L. Glaeser & Jose Scheinkman, *Neither a Borrower nor a Lender Be: An Economic Analysis of Interest Restrictions and Usury Laws*, 41 J. LAW & ECON. 1 (1998).

²⁰² See, e.g., Hugh Rockoff, *Price Controls*, in THE CONCISE ENCYCLOPEDIA OF ECONOMICS, <http://www.econlib.org/LIBRARY/Enc/PriceControls.html> (last visited Feb. 14, 2008).

²⁰³ JOHN KENNETH GALBRAITH, A THEORY OF PRICE CONTROL 3 (1952).

restraints, they were in fact observed in times when it was impossible to trade around their restrictions due to an economic crisis, or whether these rules would have been systematically circumvented through the equivalent of “black-market” trading.

Before one can answer this question, one must consider the impact of the institution of *zakat*, a tax on agricultural produce²⁰⁴ in excess of a year’s provision whose proceeds are dedicated to the poor.²⁰⁵ This institution provided (or attempted to provide) a minimum amount of food for all. Moreover, there is considerable overlap between the commodities that are subject to *zakat* and those that were subject to the ex-ante rules of *riba*.²⁰⁶ In addition, the rules governing the sale of the *‘ariyya*, one of the contracts that was expressly permitted despite its being a violation of the rules of the *riba* of excess, limited it to amounts less than five *awsuq*, the quantity that was understood to represent the minimum amount of food necessary to feed one person for a year.²⁰⁷

The fact that Islamic law established that each person had a minimum entitlement to one year’s worth of food suggests that *zakat* was a type of rationing program. The existence of this rationing system, if successfully implemented, would have made the likelihood of compliance with the ex-ante *riba* restraints much higher, at least in theory.²⁰⁸ Moreover, to the extent that *zakat* is a rationing system, it appears that the ex-ante *riba* restraints are simply a means of enforcing that initial distribution against the risk that recipients will dissipate their ration through trade and be in need of an additional allowance

²⁰⁴ Savings held in gold and silver were also subject to this tax, but in contrast to the rules applicable to crops, the government could collect the tax from cultivators, whereas taxes on savings were subject to a self-reporting regime. Baber Johansen, *Amwal Zahira and Amwal Batina: Town and Countryside as Reflected in the Tax System of the Hanafite School*, in *STUDIA ARABICA ET ISLAMICA* 247, 252-53 (Wadad al-Qadi ed., 1981).

²⁰⁵ A person was defined as “poor,” and therefore entitled to receive *zakat* if she owned less than a year’s worth of food.

²⁰⁶ Indeed, Ibn Rushd mentions the view of one early authority who attempted to make the connection between *zakat* and *riba* by arguing that only those commodities which were subject to the *zakat* obligation were subject to the restraints of *riba*. See *supra* note 98 and accompanying text.

²⁰⁷ AL-DARDIR, *supra* note 15, at 239.

²⁰⁸ See generally GALBRAITH, *supra* note 203, at 10

There has never been any doubt, in theory, of the ability of a price control authority to maintain a fixed price in a particular market if the price-fixing is supplemented by rationing. Rationing, if properly administered, has the well-understood effect of limiting demand to what is available at the fixed price and thus establishing a special market equilibrium that is wholly stable.

subsequently.²⁰⁹ This explanation of the function of the ex-ante *riba*-restraints also casts in a more favorable light Ibn Rushd's criticism of intra-generic trading as a kind of "extravagance"—his moral criticism is based on the intuition that whatever private gains in utility accrue to the trader are offset by the social costs of that trade. It also explains why such trades could be viewed as a type of unjust enrichment—whatever gains are obtained by the parties from intra-generic trading come at the expense of undermining the publicly supported distributive outcome established by *zakat*. Finally, the fact that the ex-ante *riba*-based restraints reinforce the distribution of minimum-entitlements guaranteed by *zakat* also casts light on verses in the Qur'an which portray *riba* as the opposite of charity.²¹⁰

The persuasiveness of this interpretation of *riba* largely depends on whether the assumptions it makes regarding the economic conditions prevailing in western Arabia in the seventh century are consistent with what we know about early Islamic social and economic history. While little can be said regarding this period with certainty, it is fairly uncontroversial to describe the people of western Arabia as being quite poor.²¹¹ The town of Madina, the first capital of the Islamic state following the immigration of the Prophet and his followers there, was an agricultural oasis, but was unlikely to have been producing a large enough agricultural surplus to sustain a population that would have been expanding dramatically as a result of the growth in the number of Muslims.²¹² Moreover, until the eighth year after his migration to Madina, when the Prophet returned triumphantly to Makka, his home town, it was his conscious policy to encourage new converts to

²⁰⁹ Consider the case of a person who receives a food ration, but, unsatisfied with the quality of the food, desires to "trade up" for higher quality food by exchanging two measures of her lower quality food for one measure of higher quality food. If that trade were allowed, she would increase her own short-term welfare, but at the risk that the public will have to make up the shortfall later. Cf. Eric Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom of Contract*, 24 J. LEGAL STUD. 283 (1995) (arguing that the existence of a welfare state creates perverse incentives for individuals to take excessive risks).

²¹⁰ See, e.g., *al-Rum*, 30:39; *al-Baqara*, 2:278.

²¹¹ Cf. Glaeser & Scheinkman, *supra* note 201, at 19-21 (noting the chronic poverty in Hebrew society as the background of the Old Testament's prohibition of lending at interest).

²¹² In the years between the Prophet's migration to Madina and his return to Makka in year 8, new Muslims were strongly encouraged to immigrate to Madina, and often did. "*Hidjra*," in THE ENCYCLOPAEDIA OF ISLAM 366, 366-67 (B. Lewis, V. L. Menage, Ch. Pellat, & J. Schacht eds., 1971).

immigrate to Madina.²¹³ Accordingly, it is plausible to believe that even as Islam was winning new adherents, the economic strains on Madina would have been growing. This intuition is supported by express language of the Qur'an which praises the residents of Madina for "loving those who immigrated to them, not harboring any grudges on account of what was given to the [immigrants], and preferring them [to themselves with respect to the resources of the city] although they themselves are needy."²¹⁴ Accordingly, it seems reasonable that the Prophet Muhammad would have been very concerned to maintain an equitable distribution of food in light of the general poverty of his followers and the fact that the increasing number of Muslims in Madina would have strained the ability of Madina to feed everyone.

V. CONCLUSION

The doctrines of *riba* are a fundamental part of Islamic contract law that have received new attention in light of the rise of Islamic finance. Although often reduced to a prohibition of interest, the doctrines of *riba* apply even to spot transactions in which no interest is involved. At the same time, the doctrines of *riba* do not apply to numerous credit transactions despite the inclusion of an implicit interest rate in their terms. The core of the prohibition consists of protecting bankrupt debtors against creditors who seek to increase the principal amount owed by the debtor subsequent to default in exchange for deferring the time of repayment. While this rule is largely consistent with modern bankruptcy policies, ex-ante restrictions on contracts involving the sale of specified goods, largely staple foods and gold and silver, were also referred to using the term *riba*.

I have argued in this paper that Islamic law has generally been unable to offer a convincing account for the basis of these rules as evidenced by the numerous differences of opinions among Muslim jurists, both historically and in the last one hundred and fifty years,

²¹³ See generally CARL W. ERNST, FOLLOWING MUHAMMAD: RETHINKING ISLAM IN THE CONTEMPORARY WORLD 88-91 (2003). The Prophet Muhammad was also reported to have announced, after his return to Makka, that "There is no migration after the conquest [of Makka]." 6 AHMAD B. 'ALI (known as IBN HAJAR AL-'ASQALANI), FATH AL-BARI SHARH SAHIH AL-BUKHARI 48 ('Abd al-'aziz b. Baz & Muhammad 'Abd al-baqi eds., Dar al-kutub al-'ilmiyya 1989) (9th Century) (explaining that until the defeat of Makka, persons who converted to Islam were under a religious obligation to immigrate to Madina).

²¹⁴ *Al-Hashr* 59:9.

regarding the nature and application of these rules. I argue instead that the ex-ante *riba* restrictions are best understood as a type of price restraint designed to protect the distribution of entitlements guaranteed under the Islamic wealth-redistribution mechanism of *zakat*. The particular feature of *riba* as a regulator of market prices is that, because it is focused on intra-generic trades in the spot market, and credit trades of food or credit trades of gold and silver, it only becomes relevant in times of crisis where it becomes impossible to trade around the rules due to shortages in these commodities. Accordingly, it is a simple price setting mechanism that by its own terms operates only in emergency or near emergency situations and loses its relevance once that crisis has passed. This interpretation of *riba* is consistent with other short-term regulatory strategies adopted by Muslim jurists in times of economic strain intended to protect the interests of urban consumers against a broader policy of *laissez-faire* with respect to private bargains.

This analysis can be criticized for its dependence on an economic history of the Islamic state in Madina under the Prophet Muhammad that is speculative; however, it seems clear that without some historical perspective about the economic context in which these rules were initially introduced, it will be impossible to offer a rational interpretation of these rules. Moreover, because the majority of Muslim jurists have assumed that the doctrines of *riba* can be justified rationally, it seems relatively unproblematic to make reasonable assumptions regarding the economic characteristics of the society in which these rules were first formulated. Accordingly, this analysis is consistent with, though different from, the trend within Islamic law that has treated the ex-ante *riba*-restrictions as prudential rather than mandatory. And accordingly, it stands firmly on the side of those Muslim jurists who believe that Islamic transactional law must be primarily understood functionally, rather than as an exercise in fidelity to religiously normative texts.

The unsettled state of Islamic law with respect to *riba*, combined with classical Islamic law's willingness to respect contractual bargains, even those that include credit terms with implicit interest rates in excess of the prevailing market rate, and an unwillingness to subject the economic terms of any formally valid contract to substantive tests such as fairness, equity, or efficiency provide the legal context in which *shari'a* arbitrage can flourish. To go beyond *shari'a* arbitrage, Islamic law must offer an alternative explanation of the historical doctrines of *riba*. After all, if the doctrines of *riba* are, at bottom, faith-based claims,

then *shari'a* arbitrage is not a problem. If, on the other hand, Muslims believe that Islamic law, especially in the area of commerce, is intended to further secular human welfare, then they should find the incoherence of pre-modern Islamic law regarding *riba* to be troubling. The legal strategies underlying Islamic finance, far from contributing to a resolution of this doctrinal incoherence, exploit them for the gain of the private financial sector, which may even have an interest in perpetuating this incoherence. If this Article can succeed in giving a plausible functional account for the historical doctrines of *riba*, it may prove helpful in combating the trend in Islamic finance to exalt form over substance with the attendant risk of accomplishing nothing other than imposing dead weight costs in the form of increased transaction costs.