

The Sanctions of Riba and Alternatives of Interest in Islamic Economics

¹Farshad Sameni Keivani, ²Mohammad Reza Almasi,
³Ramtin Safabakhsh Ghasemi, ⁴Sara Makouei, ⁵Morteza Bayat, ⁶Zeinab Khalili Sourkouhi

¹ School of Social Sciences, Universiti Sains Malaysia, 11800 USM, Pulau Penang, Malaysia

² Dept. accounting, Ataturk University, Turkey

³ Department of Management, Qazvin Branch, Islamic Azad University, Qazvin, Iran

^{4,5} Department of Accounting, Zanzan Branch, Islamic Azad University, Zanzan, Iran

⁶Department of Accounting, Roudsar and Amlash Branch, Islamic Azad University, Roudsar, Iran

Received: September 1 2013

Accepted: October 30 2013

ABSTRACT

In conventional economics and banking, the interest is a phenomenon that is considered under the economic law and also it is in the banking and business calculations as a basic issue. The Interest rate is achieved of equality of supply and demand for money on the money market. Islamic religion has prohibited paying and getting of interest. Banking and finance should be non-interest. But sanctions of the interest in the Islamic will disrupt the money market unless suitable alternatives are defined. On the one hand, the study says the money speculative is lawful on the Islamic and there are two sides of money demand and supply in the Islamic economics, but on the other hand, Due to the severe sanctions of the usury in Islam, according to the principles of Islamic economy, profits rates of partnerships and transactions contracts are considered as inappropriate alternatives for the interest.

KEYWORDS: Islamic economics, usury, interest, transactions contracts, partnerships contracts

INTRODUCTION

Money is one of the most important economic variables. Money is any object that has been accepted in every society as a means of exchange for buying and selling of goods and services or repayment of debt [1, 2 and 3]. In general, Money is defined with its four duties as money as follows [4, 22]:

- The tools of exchange: money is tools for facilitating of exchanges. The money is used as a means of receipts and payments and thus, the economic transactions will be encompassing the lowest cost.
- Enumeration unit: Money is a means of measuring of economic values. It makes possible to compare the values of goods and services.
- The tools of the saving of the economic values: money is a tool in order to save of economic values. Through the time, the saving of economic values will improve the economic activity and thus, the purchasing power of money is caused a person can postpone of consumption spending.
- The tools of payments on credit (payments in future): The money makes possible to lend and borrow for the people and increases credit transactions.

Changes in the money stock effect on variables such as economic growth, inflation and unemployment. Many theories have been proposed about money in the economy. Monetary theories analysis behaviors of people faced with money and they are investigated the impact of money on the other economic variables. Interest rate is determined by the relationship between money supply and demand. The interest is the time value of money and it is the price of money rent. In other words; we can say that the interest is added to the principal amount under the precondition of the borrower and the lender who receives a claim [6 and 7, 24, 25 and 26].

What it be a certain amount or as a percent of capital which is added. On Islamic economy, the interest in the financial markets is riba. The riba means "added to the first thing" What it is the money or either goods. Quran expressly and strictly prohibited riba transactions and the riba was divided into two categories: the loan and transaction riba. The transaction or exchanging riba means that someone trades goods with more of the same goods and it has two conditions that need to be considered: First, two goods are similar to each other, and the second, the goods should have weight or mass. The loan riba means that someone will lend money or material or condition that you give him the money or give it something extra material. The loan riba is more important of transaction riba and it is more prohibited and it has been blamed more than any other. The transaction riba occurs usually on trading of goods to goods. Therefore most of the verses about the prohibition of usury are about the loan riba. Several verses have explicitly sanctioned the usury. (Baqarah: 275, 276, 278 and 279 ; Alle Imran: 130 and 131; NESAs: 160 and

161). In addition, there are many variants of the Holy Prophet (Salallah) and the Holy Imams (Salallah) about usury and its losses. Then as a result the functioning of the money market is challenged on the Islamic Economy. However, the interest rate is one of the most economic variables. It is effective direct and indirect on other variables. For example, interest rate is effective on savings, consumption, investment, economic growth; unemployment, etc. Money market has two sides supply and demand like any other market. other papers on this subject include [14- 20] The rental price of money is the interest rate which comes from intersection of the supply and demand curves for money and that is forbidden in Islam. The main research hypothesis is as the following:

-with regard to sanctions of the interest, it is still possible to provide the money demand function and we can obtain the equilibrium point of the money supply and demand.

-Profit rate of partnership and transactions contracts are as inappropriate alternatives for interest rates.

In fact, this research seeks to answer the following questions:

-Is it possible to offer a money demand function on the Islamic Economy?

- Are the profits rates of partnership and transactions contracts as the proper successor for the interest of the Islamic economic system?

Investigation of money market and the replaces of interest can help enrich the literature of Islamic Economics. The results can be assisting to Policymakers and Islamic banking in the realization of Interest-Free Banking. This study analyzes money markets in Islamic Economics, and also addresses the issue of the sanctity of Islam; it offers successors of interest and describes its functions in the Islamic Economy. Here the Substitutes of interest rates are the profit rates of partnership and exchange contracts.

METHODOLOGY AND RESEARCH METHODS

The study is the descriptive and analytical research method. To achieve the goal theoretical discussions and empirical studies will be conducted by library methods. The required data, the related background information on empirical studies and literature will be collected by internet and library methods [3].

The main objective of this research is due to prohibition of riba how to develop the goals of Islamic Banking. This study responds to this question: given Islam sanctions, what is the use of an alternative school in the money market?

Answering this question requires a clear understanding of the nature and operation of money market funds and the possibility of Islamic Economics [4]. The Quantity of the wealth a person desires to hold as money rather than as other assets is called an individual's quantity of money demanded. The motives for money demand are transaction, precautionary and Speculative Demand. The money transactions demand is an average of exchange that individuals hold money to do purchase goods and services, to perform trading. The money precautionary demand is held to account for unusually or unexpected transactions. The money speculative demand is the quantity of the money the individual held in order to gain profits in future due to interest rate expectations. Money transactions and precautionary demand is given by M^1 and M^2 is shown the money speculative demand so the sum of M^1 and M^2 indicates the money total demand: [1, 2, 21 and 23]

$$M=M^1+M^2$$

M^1 and M^2 depend on the national income and the interest rate directly and inversely respectively.

Money demand function in its general form in Islamic economics whenever is a significant that money addition to be used as Unit of Account and also used as store of value and applied for the speculation. If any of these functions is not allowed in Islam, the formation of money demand function is disrupted in the new method. According to Islamic texts and opinions of the Islamic Economics scholars, it can be concluded that the money in Islamic Economics is a store of value it is a property. There is no difference between the gold and silver metallic money which was common in the past and the paper money that is common in the new world. Another important subjects in the discussion of money in the Islamic Economies whether the money speculation is permissible or not. In Islamic Economics, the positive answer to this question is a condition to bring up discussions of money markets. The speculative is activities of buying and selling of goods, factories stock with the aim of achieving profits with risks of losing money (financial capital).

In other words, it is an activity based on speculation and conjecture about of anticipated of prices changes in future in order to achieve the profit that is the possibility of financial losses. There are different views about the lack of the speculation but we can say that an aggregation of the Islamic assembly of the Islamic religion and speculation in financial markets is religiously permissible by jurists. In terms of Islamic Economics, the fundamental assumptions of the money demand function can be expressed as follows:

-Muslims like any other people instinctively seek personal benefit. However, it is the Muslim's duty to comply with some restrictions on religious principles for the benefit of that person.

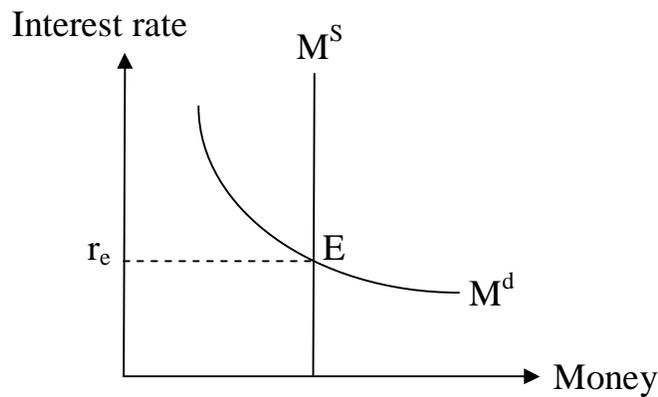
-Islam school emphasis philanthropy therefore the money charitable demand is also added to the money demand that there are no other economics schools.

-Advantage of profit opportunities in the market is permissible for a Muslim whose motive is speculative money.

- Riba is banned in Islamic Economics unlike the capitalist economy.

By applying money in the economy and assuming the supply and demand sides of the Islamic Economics, money market will be naturally formed. From the intersection of two the money supply and demand curves is obtained rental rates for money (See Fig.1) which is used in conventional economics and they call monetary interest which that is considered riba and it is forbidden. But Islam doesn't say that the same profits should be eliminated. Islam is not opposed to profit. [3 and 5]

Figure.1: Money demand, supply and equilibrium



There are many stories of great leaders Philosophy of sanctioned usury in Islam. For example, Imam Sadiq says that if usury was lawful, they would leave commerce and trade that they need. Imam Reza also applied sanctions of riba to prevent the destruction of property. The reason of sanctions of credit riba is to prevent of destruction of property and do not loss of good deeds and do not drop the debt.

The above discussion suggests that although Islam bans riba, trade and earning profits are legitimized through real activities as an alternative to usury. The risk is one of the essential characteristics of the economical real activities. In order to avoid of the risk, people give up the trading and they were engaged in usury if it was not forbidden usury. Islam does not agree the interest but it agrees with the economic activities profits which are included the risk.

Accordingly, the profits rates of partnerships and transactions contracts are considered as the alternatives of the interest rate. The partnership contracts are contracts which a partner should provide all or part of the funds needed for an economic activity. According to this contract, the activities profits are distributed among the partners. The partnership contracts are including civil Partnership, rights participation, Muzarabeh, Sharecropping, and Msaqat Contracts. Exchange contracts are contracts that are based on the exchange between two objects and they are including installments selling, leasing with condition of ownership, al-salaf, debt purchase, Joaleh and a liability or guaranty. Here are described some of the kinds of these contracts are as following: other papers on this subject include [8- 13]

Mudaraba is a k of partnership in which one partner finances the enterprise, whereas the other party manages it. Although similar to a *musharaka*, this case of financing does not need that a corporation be created; the financial institution supplies all of the capital and the customer is responsible for the management of the enterprise. The contract for agricultural purposes is a contract whereby one party gives land to another party in a certain period in the field of agriculture and the farming based on the split factor. The sharecropping transaction which is based on the tree or trees to perform the activities between the trees and the like shall be signed by the owner of the product. Dormant partnership is the contract whereby one party undertakes that it will finance the cash provided that another party does business and the profits are shared among them. The installment selling is the same as the cost of transferring it except for the case that all or part of the cost of annuity or equal to a certain receipts is received. By law, the installment sales method should only be required to provide financial resources to be used in manufacturing and service which is not in

business and personal use. The leasing with condition of ownership contract is a lease which the condition is at the end of the lease term if the lessee works on the same terms as the lessor does. The legal partnership is a kind of contract that provides a part of the capital of the new companies or to buy the existing companies shares. Producers who produce the different goods (industrial, agricultural, mining) and are short of working capital as part of its products sell them to banks to satisfy their financial needs that is called salaf contract. Financial guaranty contracts are concluded by someone else who has the obligation to take guarantee obligation by consent of another party. The banks may not be legal in every case such as the act of issuing clearance certificate, the goods back to the original undertaking and carrying out the obligations of the judiciary and the executive, tender and auction, etc. So Islamic banking can be used to replace any interest rate contracts and exchange contracts of partnership.

RESULTS AND DISCUSSION

Due to the prohibition of interest in Islam, it is necessary to introduce the interest alternative in Islamic economic. Due to the severe sanctions of the usury in Islam, according to the principles of Islamic economy, profits rates of partnerships and transactions contracts are considered as inappropriate alternatives for the interest. According to the literature review and analysis of Islamic economics, the profits rates of partnerships and transactions contracts can be considered as alternatives for the interest. There is difference between Islamic banking and conventional banking, and it reveals that there is fundamental difference between the nature of traditional banking and Islamic banking financing task but Islamic banking assets are in the partnership contracts or attorney on behalf of his business and given that traditional banking and finance don't not merely work in the financial sector so that it makes it special and indicates different conventional banking and Islamic banking term. Islamic banking carries out Financial task by those contracts which essentially are defined for the business. Researchers can investigate challenges of Islamic Banking system, interaction among Islamic banks and non-Islamic banks, how to expansion Islamic banking and so on in the future.

Acknowledgment

The authors declare that they have no conflicts of interest in the research.

REFERENCES

- 1- Akerlof, G. (1970), 'The market for "Lemons": quality and the market mechanism', *Quarterly Journal of Economics*, 84(August), 488–500
- 2- Fama, E. and M.C. Jensen (1983), 'Separation of ownership and control', *Journal of Law and Economics*, June, 301–25
- 3- Farahani, M. and Deh Abadi, M., (2012), "Influence of Rise in Volume of Money on Economic Growth in Iran during 1367-1387 (1988-2009)", *Journal of Basic and Applied Scientific Research*, text road, ISSN 2090-4304.
- 4- Grossman, S. and O. Hart (1986), 'The costs and benefits of ownership: a theory of vertical and lateral integration', *Journal of Political Economy*, 94, 691–719
- 5- Ghiasi, S. and Falezad, A., (2013), "On the Impact of Oil Revenues on Inflation in Iran", *Journal of Basic and Applied Scientific Research*, text road, ISSN 2090-4304, 3(7)374-379.
- 6- Hart, O. (2001), 'Financial contracting', *Journal of Economic Literature*, 39(4), 1079–1100
- 7- Hart, O. and J. Moore (1994), 'A theory of debt based on the inalienability of human capital', *Quarterly Journal of Economics*, 109, 841–79
- 8- Hart, O. and J. Moore (1998), 'Default and renegotiation: a dynamic model of debt', *Quarterly Journal of Economics*, 113, 1–41
- 9- Iqbal, Zubair and Abbas Mirakhor (1987), 'Islamic banking', *International Monetary Fund Occasional Paper 49*, IMF, Washington, DC
- 10- Jensen, M.C. (1986), 'Agency costs of free cash flow, corporate finance, and the market for takeovers', *American Economic Review*, May, 323–9
- 11- Mirakhor, Abbas (2005), 'A note on Islamic economics', *International Monetary Fund*, mimeograph.
- 12- Mirakhor, Abbas and Iqbal Zaidi (2005), 'Islamic financial contracts between principal and agent', *International Monetary Fund mimeograph*
- 13- Mishkin, Frederic S. (2007). *The Economics of Money, Banking, and Financial Markets (Alternate Edition)*. Boston: Addison Wesley. p. 8. ISBN 0-321-42177-9.

- 14- Mohammadi, Z. , (2013), Studying the Status of the Interest Free Loan Regarding Non-Usury Banking Law in Islamic Republic of Iran, *Journal of Applied Environmental and Biological Sciences*, text road, ISSN 2090-4304
- 15- Rothschild, M. and J.E. Stiglitz (1976), 'Equilibrium in competitive insurance markets: an essay on the economics of imperfect information', *Quarterly Journal of Economics*, XC, 629–49.
- 16- Sameni Keivani. Farshad et al, 2013, "The Estimation of The Potential Capacity of Zakah -A Case Study of Iran", *Journal of Basic and Applied Scientific Research*, text road, ISSN 2090-4304, 3(3)528-531.
- 17- Sameni Keivani. Farshad et al, 2013, "The Creation Of bankruptcy prediction model with using Ohlson and Shirata models" *Journal of Basic and Applied Scientific Research*, text road, ISSN 2090-4304
- 18- Sameni Keivani. Farshad et al, 2013, "The Estimation of the Underdevelopment Degree of Different Regions- A Case Study of the Cities of Guilan Province in Iran" *World Applied Sciences Journal*, 22 (10): 1395-1400, 2013, ISSN 1818-4952
- 19- Sameni Keivani. Farshad et al, "The Historical Lack of Capital Accumulation in Iran's Agricultural Part", 11(5) *IOSR Journals of Business and Management (IOSR-JBM)* e-ISSN: 2278-487X, p-ISSN: 2319-7668. Volume 10, Issue 4 (May. - Jun. 2013), PP 88-90
- 20- Sameni Keivani. Farshad et al, "Advantages and Barriers of E-Banking in Iran", *Nature and Science Journal* 2013;11(5)
- 21- Sameni Keivani. Farshad et al, "The role of Knowledge and confidence in reducing cost of electronic banking customers - a case study of Iran", *The 5th International Conference on Financial Criminology (ICFC) 2013 "Global Trends in Financial Crimes in the New Economies"*,
- 22- Sameni Keivani. Farshad, "Synchronization of Economic Growth and Income Distribution." In 2011 *International Conference on Sociality and Economics Development. IPEDR*, vol. 10, pp. 7-11. 2011.
- 23- Sameni Keivani. Farshad et al, 2011, "Conceptual Approach to E-government, Targets and Barriers Facing its" at the *International Conference on Construction and Project Management (ICCPM)*, September, 16-18, Singapore.
- 24- Sameni Keivani. Farshad et al, 2011, "Conceptual Evaluation E-commerce, Objectives and the Necessary Infrastructure" at the *International Conference on Construction and Project Management (ICCPM)*, September, 16-18, Singapore
- 25- Shleifer, A. and R.W. Vishny (1989), 'Management entrenchment: the case of manager-specific investments, *Journal of Financial Economics*, June, 123–40.
- 26- Stiglitz, J.E. and A.Weiss (1981), 'Credit rationing in markets with imperfect information', *American Economic Review*, LXXI, 393–410