

Rethinking Riba in an Agency Theoretic Framework: Islamic Banking and Finance beyond Sophistry

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Abstract : The efficiency of a financial intermediation system is assessed by its ability to achieve allocative efficiency, asset transformation, and the subsequent economic development. Islamic Banking and Finance (IBF) was conceived to serve as an alternate financial intermediation system adherent to the injunctions of Islam. A critical appraisal of the state of contemporary IBF reveals that it neither fulfills the aspirations of Islamic rhetoric nor is efficient in terms of asset transformation and economic development. This paper is an intuitive pursuit to explore the economic rationale of established principles of IBF, and the reasons of the persistent divergence of IBF being accused of ruses and sophistry. Disentangling the varying viewpoints, the underdevelopment of IBF has been attributed to misinterpretation of Riba, which has been explicated through a narrow fiqhi and legally deterministic approach. It presents a critical account of how incorrect conceptualization of the key injunction on Riba, steered flawed institutionalization of an Islamic Financial intermediation system. It also emphasizes on the wrong interpretation of the ontological and epistemological sources of Islamic Law (primarily Riba), that explains the perennial economic underdevelopment of the Muslim world. Deeming 'a collaborative and dynamic Ijtihad' as the elixir, this paper insists on the exigency of redefining Riba, i.e., a definition that incorporates the modern modes of economic cooperation and the contemporary financial intermediation ecosystem. Finally, Riba has been articulated in an agency theoretic framework to eschew expropriation of wealth, and assure protection of property rights, aimed at realizing the twin goals of a) Shari'ah adherence in true spirit, b) financial and economic development of the Muslim world.

Keywords : agency theory, financial intermediation, Islamic banking and finance, ijthad, economic development, Riba, information asymmetry

Conference Title : ICIF 2018 : International Conference on Islamic Finance

Conference Location : Zurich, Switzerland

Conference Dates : July 30-31, 2018