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# Riba Free Loan in Islamic Finance: Key to Social Development and Welfare

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**Abstract**

Worldwide Islamic financial institutions (IFIs) do not offer loan for avoiding interest/usury, confine their Shariah interpretations to a particular school of thought and offer products for rich people only. Loans are however demanded by the underdeveloped social actors in economy for welfare and development. As per Islam usury (Riba) free loan (Qard – e – Hassan or Dain) is a key to social development. Modern implicit and explicit shapes of master-servant relation among individuals and institutions are legal phenomena with diversified standards and patterns. As per Jaferia school of thought, Islam allows presetting Hadya (gift) in loans among master-servant. These options were utilized by our study for proposing a Pro-Hadya Riba Free Loan among master-servant. Such model of loaning can help stakeholders of Islamic finance improving the existing landscape from pro-commercial creed to pro - social development approach. It is further a potential replacement of fixed rate of interest/usury with Hadya. Such loan can be utilized for turning pension, gratuity, provident fund and other investment schemes Shariah based easily by taking advantage of master-servant setup. Findings and recommendations of this study contributes novel and further invites future research on its engineered model of loaning.

**Keywords:** Hadya (gift), Riba (interest/usury), Master-Servant Relation, social development & welfare

## Introduction

Kahf in 2002 reported that the cause of Islamic financial institutions (IFIs) is skewed to commercial benefits. Commercials IFIs yet serve the rich while Islam encourages social development of the weak in a society (Al-Quran, 2:245, 280 and 64:17). By now IFIs imitate pro usury (hereafter Riba) products/services of conventional banking and mold them as equity based products/services using Arabic titles, Shariah compliant documentation and procedures, and prefixed compounded profit. For all products IFIs employ formulas of compound interest for profit calculations (Hassan, 2008). These facts project IFIs as imitators of conventional banks following the same capitalistic creed of enabling rich the richer and neglecting the needy in society. Contrarily social actors among low income class need loans instead of equity based Ijara, Musharaka, and Murabaha etc. Kahf (2013) acknowledged that IFIs are yet meant only for the rich Muslims. IFIs hence do not entertain people needing loans for their development. Avoiding loans despite capacity is questionable as Islam orders to embrace it completely instead of accepting it in parts of choice (Al-Quran, 2:208). Islam further stresses on loaning the under developed sector in society (Al-Quran, 64:17). Indeed all in society do not qualify the criteria for existing equity based Islamic products of IFIs but still need financial assistance for development. Further loaning in Islam promises 18 virtues and is an honorable way of extending financial assistance to needy instead of charity (Sadooq, 1996). Can a financial system that does not pull the poorest in a society towards self reliance be pure Islamic? Are the existing commercial IFIs really Islamic while they do not serve desired social development and welfare of the poor? Can IFIs be encouraged and motivated to offer Riba free loans for all in society as loans are usually needed by majority?

Most IFIs across the world further seem confined to one out of the four schools of thoughts in Islam that are Hanafi, Maliki, Shafi, Hanbali and Jaferi. This fact reveals that IFIs can yet be encouraged to optimize their approach to diversity management. IFIs in Pakistan and most Islamic countries yet do not consult the Jaferi school nevertheless it carries potential solutions for financial issues. Such approach does not negate nepotism and bias which Islam forbids. IFIs incorporating and entertaining all the Islamic schools of thoughts will be more dynamic and potent of capturing diversified and larger market share of clients. Our study thus tries to introduce how Jaferi School can help IFIs in enriching their product mix.

The objectives of this study are not limited to answering its identified questions. Rather it targets contributing a Shariah based loaning model both for IFIs and low income social actors such as farmers, laborers, young entrepreneurs, disabled workers and senior citizens that require social development and welfare. It intends helping IFIs find and adopt a Shariah based mode of loaning without loss. This is thus a significant qualitative research that is result of year's long observation, experience, review and analyses of relevant practices and literature in Islamic finance. The study further targeted assisting IFIs in adopting a pro social development creed.

***The Gap***

A worthy noticing gap in the practices of IFIs that this study identified is that they do not offer Riba free loans to social actors that really deserve social development valuing it as a priority service. IFIs further confine their interpretations and practices to a specific Islamic school of thought which limits their product dynamism and outreach to diversified clients in a Muslim society. A large number of under developed social actors in societies like Pakistan need Riba free loan for their welfare and development. Loaning by IFIs for under developed social actors is though realized as a need but yet calls for further research aspiring possible Shariah solution (Tahir, 2003).

## Methodology

This foundational and philosophical qualitative study targeted an epistemological contribution counting on the work experience and direct observations of the authors with IFIs in Pakistan, analyses of relevant sources of Shariah rulings especially as per Fiqa-e-Jaferia on the subject, practices in IFIs and relevant literature (Savin-Baden & Major, 2013). It delved into the findings on Riba, compound interest and modern manifestations of master-servant relations in light of Fiqa-e-Jaferia as explained by Sadooq (1996) and Sistani (2000). Acknowledging Riba free loan as a social need and tool for welfare it employed deduction and induction methods to derive a model of Pro-Hadya oriented Riba free loan among master-servant. Subsequently its discussed benefits and implications of its conclusion and recommendations. The principal author verified this proposed model through an e-mail from Ayatollah Aqae Syed Ali Sistani (RA) (Sistani, 2014).

## Riba in Islam as per Fiqa-e-Jaferia

Sadooq (1996) explained that as per Fiqa-e-Jaferia Islam states Riba prohibited (Haram) and a felony sin. Jaferia School interprets Riba as any undue financial or quantitative gain that is acquired through unethical exploitation (Istehsaal) of an associate engaged in any financial legal contract (Al-Quran 4:161). Unethical financial exploitation (Riba) can thus spoil any legal (Halal) contract involving finances. It renders sinner of Riba to be sentenced to death by sword only through the court of Divine's Imam. In Islam a loaning contract bestows 18 virtues to the lender and hence much encouraged for people with capacity. On the other hand Islam also advises loan seekers to prefer avoiding it as first priority. However if availed for any valid reason then it must be returned essentially as committed or otherwise forgiveness and salvation is not possible in the afterlife (Sadooq, 1996). Based on further Hadith, Fiqa-e-Jaferia explains Riba and related topics as under:

Riba-fi-Bai or Riba-al-Fadal (Interest in Sale/Exchange/Trade) as per Sadooq (1996) is an amount unduly gained through cheating in Sale (Bai) of items/commodities that are sold by weighing or measuring. Sale of items exchanged not by weighing or measuring is not prone to Riba unless victimized by cheating/unethical exploitation. It further explains that when commodities like wheat, barley, gold, silver, salt, dates etc. are to be exchanged with homogeneous commodities, like wheat with wheat, silver with silver etc., these must be equal in weight. However if these are being exchanged with heterogeneous items like wheat with currency notes or barley with rice etc., condition of equal weight is not applicable. Usmani (2002) explaining Sunni school of thought in Islam confirmed same interpretations under Riba-al-Fadal.

Riba-fi-Qard or Riba-an-Nasiya (Usury in Debt/Loan/Credit), as per Sadooq (1996), is an amount of any item/currency that is preconditioned and/or charged over and above the principle amount of debt (Qard). In Qard Islam demands only the return of actual amount lent with no markup or surplus or interest at all. Qard – e – Hassan is a type of Qard where lender may forgive the actual amount if borrower is in extreme difficulties. Dain is another subtype where lender is not required to be considerate for forgiving the actual amount or debt but will just consider extending the time for return. Arranging witnesses and pledging any security are also advised in Dain. A Muslim may receive Riba from non – Muslim but is not allowed to pay it to non-Muslim unless under compulsion or living as minority in country of non-Muslims. A borrower must return the principle amount of loan/debt essentially or otherwise s/he cannot earn forgiveness in afterlife. In case a borrower dies prior returning his/her debt, it is transferred to his heirs who must pay it for the forgiveness and salvation of the deceased in afterlife. On returning principle amount of debt a borrower may gift a nominal additional amount with free will without having it preconditioned. Such gift is called Hadya while Usmani (2002) termed it as Hiba. Predominantly Islam advises lenders not to precondition Riba and simultaneously it allows and encourages borrowers to gift an optional Hadya on return of actual amount with free will to ensure that yesterday’s seeker has been developed as today’s contributor. Further through optional Hadya Islam expects borrowers to enable the lenders such that they can help more needy people in future. Hadya is never compulsory on borrowers but just optional and lender must never precondition Hadya as it will then be Riba. In its natty gritty Fiqa-e-Jaferia states that Islam allows Muslims bound in relations of husband and wife, real father and son and master-servant/slave, to mutually agree at certain Hadya over the principle amount of debt as among these relations this will always be rendered as Hadya and not Riba. Fiqa-e-Jaferia does not set any limit for amount/ratio of Hadya but stresses it to be nominal for avoiding exploitation among Muslims in any of the mentioned relations.

Formulas of Compound Interest: Fiqa-e-Jaferia declares that Islam forbids all formulas of compound interest rendering them Haram (prohibited) as these incorporate compounding which leads to Riba, Maysir (speculation), capitalistic creed and adherence to the concept of time value of money. This study interpreted from hadith narrated by Sadooq (1996) that the holy prophet Muhammad (SAAW) said the seeker, giver, witnesses and person who calculates/writes Riba are equally responsible in the sin. In this saying of prophet Muhammad (SAAW) the word, ‘calculates/write Riba’, refers to the formulas used for computing compound interest which he SAAW forbade.

Numbers and Kibor in Islam: All numeric figures and ratios are Halal (legal). Terms or alias to recognize any numeric ratio/figure are Halal as well unless unethical or vulgar (Sadooq, 1996; Sistani, 2000). Like half represents ½ and thus Halal. Karachi Interbank Offer Rate (Kibor) always represents a variable numeric figure, so as term or alias it is Halal for not being vulgar or unethical. However, it always connotes as rate of interest/usury and thus misusing the number or ratio associated with Kibor for calculating interest/compound interest (Riba) is a Haram act.

**Master-Servant in Today's World**

The diversified order of Islam for debt among master-servant seeks clarity on this relation in today's world. As per Ali Z. & Ali H. (2006) and Amjad (2001) master-servant relation among both individuals and entities (institutions/organizations) does exist in this modern age. To be a master an individual or institution needs only three major rights and roles; 1) to pass orders/directives to people under command/influence/subordination for getting work, 2) to inspect entities/individuals under supervision/command for reforming, rewarding and/or punishing them, and 3) to manumit the servants while exercising this right is not mandatory. However this third right is still reserved and exercised in this era by relieving any servant from job/assignment for various legal and logical reasons. Further in this context the modern and improved standards have bestowed upon servants to resign from the employment of their master.

In ancient times the fourth right for being master used to be the ownership of servant in personal capacity either through purchasing a human or capturing in war. Today to be a master one does not need any such right to buy or sell or capture servants for personally owning them. Rather only the contracts of employment and/or regulatory binding determining the work standards for people/entities in command or subordination are enough to establish master-servant relation assuring first three rights of mastership. Nevertheless personal ownership of Ghulam (slave/servant) and Kaneez (concubine) is still reported in certain rural areas and/or orthodox aristocrats especially in Arab countries and Pakistan, it is indeed an obsolete and illegal standard of human resource acquisition in this modern age. In certain developed and advanced countries ownership of human is rather considered a crime. Therefore in this current age employer-employee relation and regulator-regulated institutions are the two latest legal and socially acceptable manifestations of the ancient master-slave relation. In the law of Pakistan both these modern relations have been prescribed as master-servant relation (Ahmad, 2008). Various traditions reported on this subject by Sadooq (1996), Majlisi (1966a), Majlisi (1987b) and lessons learnt from Al-Quran, chapter 12 substantiated that the Pakistan's labor laws prescribing these modern master-servant relations are Shariah compliant. This study further inferred that the master-servant relation is an indispensible natural phenomenon that always exists in various shapes following diversified social and legal standards to carry on business and distribution of living among humans in the world. Exploiting this phenomenon is necessary in right manner for benefiting its associates. Pro-Hadya Riba free loan among master-servant is a possible Shariah based utilization of this phenomenological construct for benefiting the mankind and enabling IFIs towards pro - social development creed.

**Qard – e – Hassan and Dain: Keys to Social Development**

As explained above Islam has stressed on Riba free debt among Muslims as it not only pleases Allah (God) but further enables the weaker in society to develop oneself while being responsible for returning the principal amount and earning success in this life and afterlife. Allah promises His intervention for assuring return of such Riba free debt owning its responsibility (Al Quran 64:17). Our study thus inferred, Islam demands only and only Riba free debt among Muslim as it promises social development as well as Divine's favors. Islam further allowed the borrower to gift Hadya for manifesting that Riba free loan among Muslim really develops yesterday's seeker into today's contributor by virtue of God's intervention. Indeed God happens to be the third player among lender and borrower who commit no Riba. His intervention turns Qard without Riba such beneficial that in most cases He develops and enables the borrower to pay the Hadya with free will over and above the actual amount. Hadya further strengthens brotherhood among Muslims and also encourages the lender to help other poor in society with greater confidence. This study thus inferred that Riba free debt affairs among Muslims is key for Allah's intervention and guarantee for leading and concluding them really pro – welfare and social development. It further inferred that Allah wants lenders to avoid Riba and borrowers to exercise the option of gifting Hadya manifesting greater social responsibility and piousness. As Fiqa-e-Jaferia allows preconditioning Hadya among master – servant, this study next proposes a model to best use this option among entities or people in this relation for benefiting the society.

A significant fact is that most poor in society do not qualify for the asset/equity based products currently being offered by IFIs. Majority ever needs loans for their development and growth. The success of most recent Prime Minister's Youth Loan Scheme 2013 in Pakistan is an evidence that loans are yet primary choice of underdeveloped social actors. Expecting a Riba free loan from an IFI is further natural in a Muslim society. However potential borrowers face disappointment finding IFIs being replica in their thoughts and products of the conventional banks offering Islamic products for merely commercial objectives. Such replication has somehow not been favorable for the growth and acceptability of IFIs in Pakistan. The share of Islamic banking was reported to be 10% by State Bank of Pakistan 2014 - 2018 and further being kept conservative. Unlike modern Ijara, Musharaka, Murabaha and other Islamic products, loans usually do not require tangible share or equity from its seeker. The maximum a loan demands is guarantee or lien or pledging which most loan seekers usually afford. This study forecasts that inclusion of Riba free loan based products in the product mix of IFIs will enhance their acceptability and market share in Islamic countries especially in Pakistan. This recommendation of current study is already acknowledged by financial sector because during 2008 to 2010 an IFI in Pakistan tested microfinance Riba free loans up to PKR 25,000 which remained successful. Certain NGOs like Akhuwat, Naymat etc. are also exercising Islamic microfinance Riba free loans targeting social development and poverty alleviation and have recorded good impact.

A philosophical rationale for advocating Riba free loan from IFIs is the order of Islam for embracing it completely (Al-Quran, 2:208). Islamic banks in Pakistan seem preferring certain Halal modes limiting their product mix by imitating leasing under Ijara, house financing under Diminishing Musharaka, corporate financing under Murabaha, and bonds under Sukuk. Takaful (Islamic Insurance) yet employs a mix of Wakala and Kafala. The richness in the product mix of IFIs assuring inclusion of Bai-e-Salam, Bai-e-Istisna, Qard-e-Hassan, Dain, Sadaqaat, Waqaf, Wakala, Kafala, Ariyat, Dhaman, Muzaray etc. are yet under research and considerations in Pakistan (Tahir, 2003). Critics of Islamic banking object that IFIs use Islam as per their choice instead of embracing it as a whole. However our study finds such evolution of Islamic products phenomenal. It does acknowledge the significance of using variety of Islamic modes for constituting a product mix for any IFI. The scope of this study is however limited to Riba free Qard for including it in the product mix of IFIs in Pakistan and other Muslim countries especially for farmers, industrialists, new graduates and/or the poor aspiring to undertake entrepreneurship, senior citizens needing funds for education and/or marriage of their children, disabled workers etc. It forecasts that including Riba free loaning for underdeveloped social actors in a country will improve economic activity bestowing a better image and role to IFIs.

The study advocates its stance mentioning the fact that role of financial institutions as per the theories of economics is to reinforce and supplement economic activity in a country and not just to make money from money (McConnell and Brue, 2002). While non-Muslim economists agree with such theory, it is strange that IFIs despite being intermediaries tend to be profit making commercial institutions only while with an Islamic tag in their purpose and identification they are expected to be address social development as well. To economists loaning means money lent for welfare where as debt connotes money lent for money (McConnell and Brue, 2002). As most IFIs in Pakistan seem adhered with same capitalistic creed while exploiting molded Islamic products, it is necessary to encourage and help IFIs optimize their approach from money for money to money through social development. This study forecasts that adopting and offering Riba free loan products by IFIs will improve their image depicting them as intermediaries lending money for welfare of mankind.

**Proposed Model of Pro - Hadya Riba Free Qard among Master-Servant**

The exception available to master-servant relation in debt contracts in Fiqa-e-Jaferia is recommended to be utilized for offering a Shariah based loan product seeking nominal amount of Hadya provided it is not calculated using the formulas of compound interest. In an earlier contribution although the same principal author Naqvi (2010) did recommend such model, but in this study it's further optimized version is being contributed.

A possible solution for turning loan products Shariah based is that an IFI may offer a time bound employment contract to the eligible loan seekers meeting its criteria binding them to undertake an entrepreneurial or agricultural or social welfare (such as marriage of daughter, education of child, construction of house etc.) venture that targets achieving self employability or reliance or betterment in society within stipulated timeframe and earning manumission from the loan based employment on its accomplishment. That is how an IFI and loan seeker can enter into a master-servant relation for a time bound period which shall be destined to end by liberating the IFI (master)'s servant as a self employed/reliant entrepreneur/farmer or an upgraded/developed person. Since the beginning IFI (master) and loan seeker (servant) may further mutually agree at some Hadya which may be calculated any percentage abandoning formula for compound interest and Kibor. IFIs may also offer and preset different amount of Hadya for different servants as per their capacity and status. During loan period master IFI shall further reserve the right to audit and inspect the progress on the promised ventures of its servants under loan contract and guiding them towards necessary improvements. IFI may further exercise rewards (for example; relaxing Hadya or extending payback period) or impose penalties if needed. IFIs may also consider same scheme for its employees seeking Pro-Hadya and Riba free loans for betterment.

For institutions in implicit master-servants relation such as State Bank of Pakistan (SBP) and all its regulated banks, Higher Education Commission (HEC) and all the educational institutions in Pakistan, Security Exchange Commission of Pakistan (SECP) and all the business entities its regulates etc, any loan contract among them will not require any new employment or regulatory contract. Thus these institutions may enter into any loan contract meant for betterment or development committing an amount of Hadya among them without using formula of compound interest and Kibor. Loans among government or private bodies and their respective subsidiaries will also be immune from Riba as any amount committed by either side over and above the principle debt amount will be Hadya. SBP and IFIs may opt Riba free loan committing and seeking Hadya with each others for required treasury functions and liquidity arrangements. IFIs that are competitors of each other however cannot take benefit of this option. A solution could be to rout such loans among competitors IFIs through master SBP. Later Hadya may be collected by SBP and its portion may be gifted to the lending bank. This model will be a key to resolve objections on the treasury deals for and by Islamic banks that yet adopt commodity murabaha, Tawaruk and/or other modes which are controversial. Indeed banks require treasury business for liquidity management and instant financial gains. Routing interbank treasury loans through master SBP with promised Hadya for servant is an alternate possible way for further research and development. Seestani (2014) was inquired to remark on this proposed model and he declared it acceptable. Further in Iran similar practices are reported among government entities (Dar, 2014).

The Muslims and institutions following Sunni Islam can also be persuaded to adopt such model without preconditioning and presetting amount of Hadya in Riba free loans. On accomplishment of the tenure of such loan, servant may submit Hadya with free will. Such exercise will still lead the economy to calculate the average rate of Hadya at post stage as loans are paid. While for Shia Muslim in master – servant relation presetting Hadya is recommended to be allowed, for Sunni Muslim it can be allowed at post return stage of a Riba free loan.

**Discussion and Conclusion**

Riba free loan (Qard-e-Hassan and/or Dain) by IFIs and their regulators is a key to social development and welfare as such loans guarantee Divine's intervention for these noble purposes. Option of Hadya in such Riba free loan is a key to persuade borrowers and lenders to be more responsible and pious. In today's world all institutions work in an implicit master-servant relation with their respective regulators. Explicit master-servant relation is created through legal employment contracts with individuals. As most social actors find Riba free loans a tool for welfare and development, it is recommended to utilize the permission in Islam for seeking Hadya in Riba free loan among master-servant. IFIs and their regulators in Muslim world especially in Pakistan are required to be guided and encouraged towards Hadya oriented Riba free loan without compounding. Relevant and effective regulatory directives are yet needed for the smooth implementation of Hadya oriented loans among master-servant in Pakistan. Adoption of the proposed model will help IFIs improve their course from pro-commercialization to pro-social welfare and development. Further as for different servants an IFI may exercise different rates of Hadya. Such exercise will help us replace existing fixed rate of usury/interest (Kibor) with Shariah based average rate of variable Hadya promising better economic activity. Such recommended change will also help IFIs improves their reputation, services and market share. This theoretical research remained limited to the philosophical analyses of its model and related concepts. Future research is recommended to focus on the required practical documentation and procedures to implement this model and its post implementation effects.

The Riba free loan seeking Hadya is already in practice in the economy of Iran since the Islamic Revolution of 1979 (Ashraf and Giashi, 2011). Similar model of master-servant loan among government enterprises is reported in Iran (Dar, 2014). The new manifestation of such Riba free loan among master-servant as contributed by this study for clients and employees of IFIs is novel and pragmatic. This model categorically rules out the use of formula of compound interest replacing it with Halal Hadya. It is anticipated that in a pure Islamic economy the prevailing rate of Hadya will replace rate of interest or usury (such as Kibor). This desired attribute in an Islamic economy will serve various positive objectives such as Halal implementation of pension, provident funds, gratuity and other social welfare funds and investments. These long term investments for social welfare will generate Hadya instead of interest in an economy promising benefits for pensioners, senior citizens and disabled workers, the poor and young entrepreneurs in this life and after life. Further it will help avoid Sukuk that predominantly demand asset based arrangement which is not possible in most significant investments like pension, provident fund etc. This proposed model will drive the stakeholders towards an economy that transforms today's seekers to donors in future.

Another advantage that Riba free loans seeking Hadya among master-servant promises is no need of molding conventional banking products with Islamic modes. As informed earlier IFIs mostly count on Ijara, Musharaka and Murabaha but yet employ compounding for profit calculations. The adoption of Hadya without compounding will provide IFIs an unobjectionable

Shariah compliance carving their purpose of business from commercial interest to welfare of underdeveloped social actors in society. Indeed economic growth is not concentration of wealth in few hands rather it is distribution of wealth among honest social actors stimulating higher amplitude of economic activities (McConnell and Brue, 2002).

This model also enables IFIs to set different Hadya rates for different servants leading an economy to a range of Hadya with larger bandwidth. Such feature will lead IFIs entertain good range of social servants representing all walks of life which is yet not possible with fixed rate of interest and compounding. Following the suggested model an IFI may seek 1 percent Hadya from a servant with small business such as grocery shop and 5 percent Hadya from another servant running well established restaurant. Such diversified treatment will lead the economy to an average rate of Hadya that may be altered as per the capacity and needs of the servant thus promising high rate of return and/or recovery plus welfare. The average of such proposed variable rates of Hadya thus possesses potential to replace the fixed rate of interest such as Kibor in Pakistan.

In addition an academic advantage of this model is that it calls furthering research for learning and contributing the implementation of pension, provident fund, gratuity and other social welfare funds/scheme as per Pro-Hadya Riba free loaning among master-servant. Shariah based term of employment, legal standards and documentation, training material for human resource engaged in this new model and their trainings, post implementation review standards and criteria, improvement plans etc. are the new dimensions in which future researchers will be required to contribute knowledge.

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