

 First Received: 2 January 2018	 Final Proof Received: 19 March 2018
--	---

THE SUBSTANCE OF THE FORMAL PROHIBITION OF THE *RIBA*: ISLAMIC FINANCE AND THE TIE WITH THE REAL ECONOMY

Latif Mustofa

Email : lmustofa@student.unimelb.edu.au

Currently Working at Payakumbuh Religious Court, West Sumatera

ABSTRACT

Islamic Financial Institutions come up with sharia-compliant products mimicking one of their conventional counterpart. This particular development is one of the unintended consequences under the interpretation of the prohibition of interest. Islamic Finance Institutions need to find substitute for profit-generating mechanism. There is no consequential difference between 'interest-free' and interest-bearing products on the practical level. This paper attempts to deal with the question of the interpretation of riba on a theoretical level. This paper argues that equity-financing should be preferred to debt-financing. In doing so, this paper embraces a juristic approach to arrive at the intended conclusion. However, debt-financing could be utilised where deemed appropriate and no equity-financing method is applicable to a particular project.

Keywords

*Islamic Finance;
Equity Financing;
Riba*

INTRODUCTION

This paper revisits the theoretical discussion of the interest prohibition. It attempts to establish a different approach on Islamic Finance using a juristic and legal reasoning of Islamic Law. In so doing, I argue that the development of Islamic Finance should be directed towards the substance rather than the form. The substance is the principle emphasizing that Islam requires financing to have a tie with the real economy. It's a part of economy that represents the actual goods and services production and development. Rather than just mere selling and buying activities in financial market, primary or secondary (Foster & Magdoff, 2008). The development shouldn't stop at finding the substitute for interest. It has to keep moving towards the substance. Because if Islamic Finance undermines the substance, it's susceptible to be trapped in the use of various legal stratagem to avoid the prohibition of interest. And eventually, it has no distinct characteristics.

On this research assignment, I am keep to contribute to the discussion of the interpretation of *riba* in Islam. I shall attempt to build a juristic argument that should change the directive of the Islamic Finance development. This assignment will be structured in five parts. The second part will lay down legal basis for the prohibition of the *riba*. I devise general rules applicable to the rest of the discussion on this part. Part three will discuss the current *riba* proposition that establish the sharia-compliant products in contemporary financial transactions. I will argue that many of the Islamic Finance financial instruments depart from the society-empowering nature of Islamic Finance although still structured in conformity with sharia law. This is partly because of the emphasis of the prohibition of interest *per se*. Part four then builds the argument for the principle behind the prohibition of *riba* using the Islamic legal interpretation frameworks and how it is justified in today's financial transactions. Then, I will propose the starting point for reform on the Islamic Finance regulatory constrains based on the established principle.

The prominent aspect of the Islamic Finance is its interest-free operational framework (Khan, 1986). There are several aspects that also form the Islamic Finance as a whole system including the prohibition of uncertainty and gambling-like transaction (Farrar, 2011). But, the interest-free aspect is the one appealing the readers of this alternative financial system. Many have discussed the idea of zero interest rate policies (Friedman, 2005). The studies established that a zero-nominal interest rate is necessary for the optimal allocation of resources. The experience of Islamic Finance over the last three decades shows the viability of the institutional overhaul of the finance towards zero interest rate policies. To start this part, this assignment revisits the theoretical discussion on the prohibition of the *riba*. To conclude an Islamic law, one is required to look up to the legal texts applicable. In the case of *riba*, the legal texts applicable come from two sources. One is from the Qur'an. Another is from the Prophet Muhammad PBUH sayings (hadith). Those are basically the primary sources of Islamic law.

The Qur'an uses the term *riba* eight times. The first verse revealed was Qur'an Surah Ar-Ruum Verse 39. It says, "Whatever you give for *riba* to increase within the wealth of people will not increase before Allah; but what you give in by way of *zakah* (charity) desiring the countenance of Allah, those are the multipliers." The second was Surah Ali 'Imran Verse 130 which expressly prohibits the practice of *riba*. It uses the language of 'do not consume *riba*' and clarified by way of stating the nature of the *riba* as 'double and multiplied'. However, the most comprehensive Qur'anic revelation on *riba* is found in the Surah Al-Baqarah Verse 275-281. I put the complete English translation in quotation marks because the analysis of this part frequently refers to the exact wording and sentences of those verses.

"Those who consume *riba* cannot stand (on the Day of Resurrection) except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is (just) like *riba*." But Allah has permitted trade and has forbidden *riba*. So, whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in *riba*] - those are the companions of the Fire; they will abide eternally therein. Allah destroys *riba* and gives increase for charities. And Allah does not like every sinning disbeliever. Indeed, those who believe and do righteous deeds and establish prayer and give *charity* will have their reward with their Lord, and there will

be no fear concerning them, nor will they grieve. O you who have believed, fear Allah and give up what remains (due to you) of *riba*, if you should be believers. And if you do not, then be informed of a war [against you] from Allah and His Messenger. But if you repent, you may have your principal – (thus) you do no wrong, nor are you wronged. And if someone is in hardship, then [let there be] postponement until (a time of) ease. But if you give (from your right as) charity, then it is better for you, if you only knew.”

There are two hadith. The first one is the hadith on the last pilgrimage, All *riba* of jahiliyyah is cancelled; yours is your principal only; you do no wrong, nor are you wronged” (Abū Dā’ūd Sulaymān ibn al-Ash`ath al-Sijistānī and Muḥammad Nāṣir al-Dīn Albānī, 1419). The second one is the famous hadith called as ‘six commodities hadith’. It says that, “Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt should be [exchanged] like for like, equal to equal, hand to hand. If the types [of the exchanged commodities] are different, then sell them as you wish, if they are [exchanged] on the basis of a hand to hand transaction.” (Muslim ibn al-Ḥajjāj al-Qushayrī, 1998)

RESULTS AND DISCUSSION

Legal Aspects of the Prohibition of the Riba

From the legal standpoint, both sources unequivocally prohibit the *riba*. That’s what’s clear. Allah has emphasized the magnitude of the *riba* prohibition up to the level of war threat. Islamic law does follow the principle of non-retroactivity. Thus, once the prohibition of the *riba* has been revealed, Muslims were supposed to abandon the still in place *riba* practices. They were commanded to take only the principle, not the *riba*. The missing part of both sources is the precise definition of the *riba*. The two hadith above are listed because those elaborate further the *riba*, rather than just repeat the prohibition. Even so, the hadith did little on that account.

The lack of precise definition could be attributed to the well-known and widely-practiced *riba* itself. The Arabic article ‘ال’ for *riba* throughout the Quranic Verses and hadith is consistently used. That article corresponds to the use of article ‘the’ in English. It indicates that everyone at the time uniformly understood the conditions attached to a transaction considered as *riba*. *Riba* was not a vague concept (Zaman, 2001). That leaves this paper with the task to define what the *riba* is. The urge to work firstly on those two issues illustrated by the Pakistani struggle on the adoption of Islamic Finance. In Pakistan, the law has witnessed series of banking reforms to undergo a major surgery to its economy. The major milestone was the 1973 amendment of the constitution. Article 38 letter f mandates the state to eliminate *riba* as early as possible. The Federal Sharia Court and The Sharia Appellate Bench then ruled to clarify that bank interest should be deemed as *riba*. But, in the highest judicial review proceeding, the Supreme Court of Pakistan overruled that decision. Five judges unanimously upheld the petition and set aside the previous decision on bank interest as *riba*. The legal reasoning is not my focus now, rather it reflects the implications of the absence of clear definition of the *riba* in the primary sources.

What is the Riba?

Riba is derived from three Arabic words of ر ب و, which means to grow, to increase, to rise or to swell, and to be greater and bigger (Saeed, 1995). In the context of the prohibition of the riba, the most appropriate lexical synonym in English language to be attributed is an increase. And for the sake of discussion, I use the meaning of an increase as a parallel meaning with the riba.

It's best to start with the features clearly referred on the primary sources. It is the situation where the riba occurred. I argue that the riba occurred where there was a debt transaction. It is referred in the Al-Baqarah Verses 275-281. How is that so? It says in case of one's repentance, one may have his principal. The repentance requires someone to give up the riba. And if someone is in hardship, the Verse asks to postpone the payment until a time of ease, or even forgive the principal. The elements involved are the principal, the riba, and the payment. Those three elements can be linked through a debt mechanism.

The six commodities hadith provides further elaboration on the nature of the riba. The attempt to provide a more detailed on the events where riba has occurred is based on the mafhum mukhalafah. The hadith itself speaks on the allowed practices of exchange. There are six commodities mentioned. Being like in like or equal, and has to be done in a hand to hand transaction. But, if between the exchanged commodities is not the same genus, the requirements are down to only hand to hand requirement. There are two provisions concluded from that hadith. First provision applies to exchange of the commodity of the same genus, while the second one concerns the exchange between commodities of different genus.

In the aftermath of Khaybar conquest, some Muslim soldiers took advantage of the frightened Jews. They exchanged their gold coins for Jews' gold bullions worth more than the equal countervalue of the coins itself (Muslim ibn al-Ḥajjāj al-Qushayrī, 1998). Another account is provided by Ibnu Al-Qayyim. He proceeds to say that duress was also rendered possible because of poverty in rural areas where currency was not available (Ibn Qayyim al-Jawzīyah, 1417). The poor would exchange two kilograms of wheat in the future for one kilogram of wheat now from the rich. Saeed himself asserts his own suspicion regarding that practice in the same tone (Saeed, 1995).

The first provision now makes sense. The requirements to do the exchange of the same commodity on their equal countervalue on the basis of hand to hand transaction was to curb those practices. At one level, the first provision regulates the permissible exchange of the same genus out of six commodities. But, since such exchange is not sensible as an economic transaction, it has to be envisaged through its a contrario understanding as a provision to forbid the practices mentioned as the contexts. That leads to the question of 'what practice?' On the Muslim-Jews context, the prohibition applies to an exchange of the same commodities with unequal countervalue.

The second provision on six commodities hadith is not as strict as the first provision. It allows an exchange between different commodities without many requirements as long as being done on hand to hand basis. The explanation is easy. An exchange between two different commodities is essentially a trade, or barter in a more simplistic economy. Latif had five kilograms of wheat, while Mustofa had ten coins of silver. It was completely plausible on economic ground that Mustofa exchanged his coins for three kilograms of

wheat from Latif. Prophet Muhammad PBUH only requires that the exchange must be done in on the spot basis. The mafhum mukhalafah would be that the riba could happen if the exchange was not done in hand on hand transaction.

To sum up the legal aspects of the primary sources, there were two requirements in order for an exchange to be considered not as the riba. One was of equal countervalue and another was of hand to hand basis. Where the requirements are not met, there are three scenarios which could be deemed as the riba. First, the riba occurred as an increase on the exchange of the same commodity on the spot basis. Second, the riba occurred as an increase of the same commodity exchanged on deferment basis. Both value and time requirements were not met. Third, the riba occurred as an exchange of two different commodities or trade that wasn't on the basis of hand to hand transaction. There was no need for the two different commodities to be equal in countervalue.

Devising General Rules on the Riba

As a starting point, I analyse the features of the riba. First feature, the nature of the riba is an increase from the principal. It is clearly shown on the Qur'anic Verses and contexts that someone has only the right for the principal. The rest which is the increase is the riba. This is the first established element of the riba.

Second feature, the situations where the riba could happen were of two transaction. On the debt and on the exchange. On the debt transaction, there were two possible causes. The debt could be caused by a loan or the deferment of the delivery on an exchanged commodity. The second cause was elaborated from the six commodities hadith. I argue that the distinction of the debt causes is inconsequential. Because the deferment on the delivery of an exchanged commodity is more fitting to be considered as a loan. The term deferment of delivery was used to reflect its nature as an exchange of six commodities excluding gold and silver.

On the exchange -real time exchange without delay element- the riba occurred as the excess of the same commodities exchanged. The situations of the second rule led the classical distinction between riba al-fadl and riba an-nasiah of the Islamic Jurisprudence (As-Sayyid Sabiq, 1419). Lexically, riba al-fadl means increase in the excess while riba an-nasiah means increase in the delay. From the standpoint of Islamic Jurisprudence, the first scenario of the six commodities hadith is the riba al-fadl. While the other envisaged scenarios that happened under the debt transaction, be it a loan or the delay on the delivery of an exchanged goods, are considered as riba an-nasiah. Literally means an increase (because) of delay (As-Sayyid Sabiq, 1419). The increase itself could take place either on the debt agreement or on the extension of the actual debt period.

Third feature, the object of the riba must be of the same commodity mentioned by the six commodities hadith. Not gold for silver, nor wheat for barley. Because if the object of the riba are between different commodities, it is called trade or barter. That lead us to the fourth feature of the riba. The situation of the riba, specifically applies to a trade. It could occur on the increase of the different exchanged commodities from the agreed value in hand to hand transaction.

From a lexical meaning of an increase, the prohibited riba could be defined as follows. The definition on the first type of the riba, a riba on debt: 'It is an increase on the

amount of the principal lent out in a debt transaction.’ The debt transaction covers loan and delayed delivery on an exchange of the same commodities. Under the Islamic Jurisprudence classification, it is the *riba an-nasiah*. The definition of the second type of the *riba*, a *riba* on real-time exchange: ‘It is an increase on the countervalue exchange between the same commodities.’ This is the *riba al-fadl*. The definition of the third type of the *riba*, a *riba* on trade: ‘It is an increase of the countervalue outside a hand to hand transaction between two different commodities.’

Juristic Approach on the Prohibition of Interest

The legal maxim for the worldly affairs is that everything is permissible unless prohibited. Hence, one should be tempted to raise the question of the legal texts prohibiting the interest. Any Islamic legal jurist would then recourse to the established theoretical basis discussed earlier. In so doing, I address to questions. First, what is interest? Second, do the legal texts apply to the contemporary currency?

There is interest and then there is interest rate. Interest is the increase on the principal, where the rate is the per cent of premium charged on principal at one date in terms of money to be in hand one year later (Fisher, 1965). Theoretically, the principal could be anything from currency to sort of goods and commodity. But practically in contemporary transactions, only currency/money that is traded between present and future. The case of the *riba* on the debt during prophetic era is an example of theoretical possibility of interest applicable to commodities. The real interest rate is the real percentage of value gain. Say that the nominal interest rate is 7%. Throughout the year, the inflation hikes at 4%. The real interest rate is 3% at the end of the financial year. It represents the real increase of the value of principal money.

At its simple formula, the interest rate is applicable only to the principal. There are also interest rate which is applicable to not only to the principal, but also to the earned interest. There are several types of interest in financial instruments. But, relevant to the discussion, interest almost definitively represents an increase to the principal as a result of time trade of the principal. On this account, interest has been dubbed as the time value of money or price of money (Homer & Sylla, 2005).

The Islamic Jurists are divided into two. The *Zahiri* school of thought argues that the prohibition of the *riba* is confined on those six commodities, as its name suggests (Saleh & Ajaj, 1986). But, it’s the minority. Other four school of thought, *Syafi’I*, *Hanafi*, *Maliki*, and *Hanbali* extend the prohibition of six commodities. They use the concept of *illah* or rationale on the six commodities (Al-Jazeera, 1986). The specific *illah* for each commodity varies among them. On the gold and silver, the applicable *illah* is that they are currency. While on other four, the applicable *illah* is that they are foodstuffs commodity.

But, the argument against that often invokes an intriguing discussion. The one that shouldn’t be overlooked in order to robustly claim a sound legal basis. Most prominently regarding the claim of today’s money which doesn’t share the same feature as gold or silver. Gold and silver as currency have their own intrinsic values. On the other hand, today’s money is a fiat money after the Federal Reserve of the United States of America broke the US Dollar peg to the gold under the President Nixon administration in 1973 (Ritter, 1995). It is a freely floating currency. And it is supposedly doesn’t have any intrinsic value. It is

just a piece of paper. As, a free-floating currency, fiat money is often subject to inflation and deflation, or even the hyper one. It is currently happening in Zimbabwe and Venezuela. That among other things are the argument of the Pakistani Supreme Court Case.

I address this on my own account instead of proposing how the Islamic Jurists would address that. I argue against the inflationary argument based on two premises. First premise is based on the nature of paper money. It is true that the today's currency is fiat and free-floating currency without real tie to the value of other physical assets. But, it is wrong to argue that it is just merely a piece of paper. One of the Keynes' contribution on his General Theory is an analysis primarily of money as a store of value (Tily, 2012). That leads to the prevalent view of money as an asset, a liquid one (Modigliani, 1944). To suggest that money doesn't have its own value isn't plausible. One would argue that unlike gold and silver, the value of paper money is assigned because of the society perception. Because if we trace back the value of gold and silver, their current value is also perceived by the society. In fact, almost any value is perceived.

Second premise is based on the nature of gold and silver. It has been argued that gold and silver isn't susceptible to inflation because of its own intrinsic value. That is also has no sound foundations since an assigned value is correspondingly related to supply and demand. The value of a currency is influenced by demand for that currency. Let's suppose that there is an economy where its currency is gold and silver coin. The value of that metal currency is still prone to the inflation. Its purchasing power could still fluctuate over time. And Prophet Muhammad PBUH still prohibit an increase on the principal in the form of gold or silver lent out on a debt transaction. There is no ample evidence showing that gold and silver is time-proof asset to store value (Diba & Grossman, 1984).

Islamic Finance as We Know Today

Profit and loss sharing (PLS) is the way Islamic Finance circumvents the prohibition of interest. It's an equity financing. Let's call PLS as the first mode of substitute. In Islamic Finance terms, it should be mudarabah and musyarakah. Mudarabah is a partnership in which the capital owner advances money to the investment manager. The investment manager then trade with the money vouchsafed in which both capital owner and manager share the profits upon contractually agreed ratio (Hassan & Lewis, 2008). The capital owner is essentially the sleeping partner, while the manager invests his effort in entrepreneurship and time. In practice, Islamic Banks work based on two-tiered mudarabah. The first tier is concluded between a client and a bank. Second tier is between a bank and actual investment manager. It is a trust financing. The loss to be born solely by the capital owner. To address the problem of moral hazard of that, there is possibility to restrict the manager from charging the mudarabah account if the manager found negligible (Sarker, 1995).

Musyarakah is a financial contract where two or more parties agree to contribute capital to a project and share its risks and rewards (Hassan & Lewis, 2008). The loss to be born according to the capital contribution ratio, where the profit is shared upon agreed ration. Ideally, those two mode of financing is the theoretical workhorse of Islamic Finance. Quite contrary, Islamic bank concerns not only on the payment of profit, but also on the profitability of a project. Because the profit is linked to the real return of a project.

Consequentially, as real return goes up, the return on Islamic Bank keeps up. So, does where there is loss. That's where some proponents of Islamic Finance argue that it put emphasis on justice.

That's undeniably a compelling alternative to the interest mechanism. But, there are financing where the PLS principle is not applicable. More common in short-term and trade-related financing (Hassan & Lewis, 2008). It takes form of a credit purchase and leasing principle (Iqbal, 2005). Three most prominent instruments are murabahah, ijarah, and sukuk. Those translated as cost-plus financing, leasing, and participation securities respectively and already documented in a standardized method (Hassan & Lewis, 2008). In murabahah, the bank and the client enter into a contract. The contract says that the bank agrees to buy an asset from third party and then resells it to the client with a marked-up price. While murabahah generates profit from mark up, ijarah does so from leasing an asset. The bank acts as a lessor leasing to lessee a productive asset with a predetermined payment. Ijarah originates as a trading activity, but becomes more common as a financing one.

Sukuk has been dubbed as the Islamic bond. It rose to prominence amidst the need for sharia-compliant financial instruments for major Muslim population. The difference with the conventional bond is on the use of interest as core transaction. The rate of return in sukuk is tied with the exchange of the underlying asset. The exchange itself must be under sharia-compliant contracts.

The Legal Basis of the Substitutes

The basis for both modes are bit different. The first one is based on the old partnership contract since the pre-Islamic Middle East along with the riba mechanism (Crone, 1987). Prophet Muhammad PBUH came and forbad the latter. The mudarabah and musyarakah survived as primary economic activities mode within Muslims.

The second mode is based on the frequently cited verse of Qur'an on riba prohibition. On Surah of Al-Baqarah Verse 175, God has permitted trade and has forbidden riba. As the trade is put in the same sentence with riba, it is argued that the profit made from trade is permissible. That's one. Another basis is that on trade the countervalue of different exchanged commodities doesn't have to be equal. The only requirement is that the countervalue should be agreed on hand to hand transaction. It is construed as the agreement of the countervalue when the exchange is made. As long as the countervalue of the trade is agreed when the exchange is made, there would be no problem at all with the transaction. Riba would occur then, if the countervalue is raised after the agreement of the trade is made. Since the second mode of substitutes operates in trade mechanism, it's lawful under Islamic Law. On Islamic Banks' asset side, there is proliferation of instruments with fixed rate of return. The rate of return is fixed through specified pre-agreed period of time. Except for the ijarah instruments on a property. The agreement contains interval inspection of its rate of lease to reflect the fluctuating market condition.

At macroeconomic level, the course where ijarah-based sukuk development is heading exemplifies the reference of rate of return to the conventional rate of interest. As discussed before, sukuk represent Islamic version of bonds. It is a participation securities with rate of return tied to the exchange of underlying assets based on sharia-compliant contract. As such, the contract could be arranged ranging from the kind of equity financing

contract to non-PLS contract. At the initial phase of the Islamic Finance development around 1980s, lots of sovereign effort were dedicated to strengthen the infrastructure for equity financing (Sarker, 1995). Pakistan, Jordan, and Malaysia were among those which produced series of legal frameworks to introduce the sovereign certificate based on mudarabah financing.

But, it seemed obvious then, that there were not enough investor's interests on equity financing. The risk variable on the mudarabah instruments did not meet that sense of the safety of an investment. That's where ijarah-based sukuk stepped in. It is sukuk in which the core transaction is based on the exchange devised from leasing payment of an assets.

To go for a detail regarding the structure of sukuk ijarah would eat almost half of the dedicated space for part two. But, there are several highlights to be made in light of the interest-free claim. It is again based on Malaysian sukuk where many of other sovereigns' sukuk is replicated afterwards (Wedderburn-Day, 2010). As most securities, sukuk was issued by a government special purpose vehicle (SPV) for the insolvency-remoteness reason. The SPV issues sukuk to the investors represent the ownership of a land under its beneficial title. The rate of return is based on the lease payment of the land. So, instead of using interest mechanism, the sukuk is using the lease payment to replicate the rate of interest. The use of ijarah contract on sukuk is regarded as the most effective way to comply with the sharia requirements. First, it circumvents the interest prohibition. And second, it renders sukuk as a tradable instrument. It is argued that debt sale is forbidden by Islamic Law ruling bodies in the majority of Islamic Countries, except Malaysia (Rosly & Sanusi, 1999). That sophisticated sukuk structure that complies all sharia requirements was replicated by many Muslim and Islamic nations since then.

On General Aspects of Islamic Finance

There are two different accounts should be established within an Islamic Bank. The first account is the demand deposit account and the second one is the investment account. The demand deposit account is just plain account for people to safekeeping their money in an Islamic Bank. People can deposit and withdraw their money whenever they like. The account doesn't incur any increase on the amount of money deposited by the client. The investment account is the account where people put their money for the banks to invest in financing activities. The financing activities could range from debt financing to equity financing. On debt financing, it could incur a rate of return based on the applicable instruments. On equity financing, there is pre-agreed ratio of profit and risk.

A simple two different accounts model isn't new concept for Islamic Finance. But, that model is soon replaced by quasi-guaranteed profit demand deposit account to attract customers. There are pros and cons under two models. The former model operates under the assumption that there is no increase on the deposited money without exposing to the risk element. If the person wants to safekeeping money in Islamic Bank, the only way to do that is to deposit in demand deposit account or saving account. There is no way of generating any increase on the deposited money under Islamic Law just because of safekeeping money. In fact, it's appropriate if the Bank charges money for safekeeping the money.

Under a simple two account, however, there are cons. One of those would be against the Islamic teaching of not hoarding wealth. I argue that the pros outweigh the cons. It's better to keep the Islamic Bank's sources of fund under two simple account, rather than developing several accounts that generate increase based on permitted Islamic transaction. It has been argued that the quasi-generated profit account is a merely reverse engineering of the conventional banks accounts (Vogel & Hayes, 1998). The bad thing about reverse engineering is that the legal stratagem is used. Islamic Finance needs to define its own characteristics. Better to invent a perfectly legitimate financial instrument rather just mimicking the one of conventional counterpart. Two simple account is the best starting points of reform in Islamic Finance.

CONCLUSION

There is an obvious diverging regulatory approach if Islamic banks are to follow its central tenet as intermediaries between capital and the real economy. The problem is to overcome the reluctance to substitute the comfort way of generating profit through non-PLS mechanism. Once the reforms are established, some of inherent problems of conventional banks are necessarily gone. The ideal Islamic Banks aren't prone to bank run. Liquidity is no longer problem. Islamic Banks as the party whose equity placed in the client's business are also required to do their due diligence.

The prohibition on the riba on debt isn't merely juristic approach anymore to get around with sharia-requirements. But, as a part of Islamic way of financing through equity financing. Debt is placed on its own appropriate use. First, as a mean to help person facing hardship in life. That's beneficial loan without incurring any increase. Second, as a way of financing where PLS principle isn't applicable. And it should be confined within that boundaries.

The challenging task ahead of this proposition actually lies on regulatory design that allocates Islamic Banks' financing activities more on equity financing. The tasks include the determination of a ratio between equity and debt financing. It's essentially the reform needed to establish the tie of Islamic Finance with the real economy. Where there is no financing-ratio requirement, Islamic Finance would likely to end up having more than two thirds of its financing in the form of debt financing again. Included as the urgent task, is to define the applicable sets of criteria to determine whether a financing could be done through equity or just debt is accepted.

REFERENCES

- Abū Dā'ūd Sulaymān ibn al-Ash`ath al-Sijistānī and Muḥammad Nāṣir al-Dīn Albānī. (1419). *Ṣaḥīḥ Sunan Abī Dāwūd*. Maktabat al-Ma`ārif lil-Nashr wa-al-Tawzī', al-Ṭab`ah 1., lil-ṭab`ah al-jadīdah.
- Al-Jazeera, A. (1986). *Kitab Al-Fiqh Ala Mazahib Al-Arba*. Beirut: Dar Ihya Al-Turas Al-Arabi.
- As-Sayyīd Sabiq. (1419). *Fiqh Al-Sunnah Volume 3*. Dār al-Fikr, al-Ṭab`ah 2.
- Crone, P. (1987). *Meccan trade and the rise of Islam*.
- Diba, B. T., & Grossman, H. I. (1984). Rational Bubbles in the Price of Gold. *NBER Working Paper*, (March), 1–23. <https://doi.org/10.3386/w1300>
- Farrar, S. (2011). Accommodating Islamic Banking and Finance in Australia. *UNSW Law Journal*, 34(1), 413–442.
- Fisher, I. (1965). *The Theory of Interest*.
- Foster, J. B., & Magdoff, F. (2008). Financial Implosion and Stagnation: Back to the Real Economy. *Monthly Review*, 60(January), 1–29.
- Friedman, M. (2005). The Optimum Quantity of Money Revisited. In *Transaction Publishers*.
- Hassan, K., & Lewis, M. (2008). Handbook of Islamic banking. *Choice Reviews Online*, 45(6), 45-3304-45–3304. <https://doi.org/10.5860/CHOICE.45-3304>
- Homer, S., & Sylla, R. E. (2005). *A History of Interest Rates*. Book.
- Ibn Qayyim al-Jawzīyah, M. ibn A. B. and M. `Abd al-S. I. (1417). *A`lām Al-Muwaqqi`īn `an Rabb Al-`Ālamīn*. Dār al-Kutub al-`Ilmīyah.
- Iqbal, M. (2005). *Islamic Finance and Economic Development*. Palgrave Macmillan.
- Khan, M. S. (1986). Islamic Interest-Free Banking: A Theoretical Analysis. *IMF Staff Papers*, 33(1), 1–27. <https://doi.org/10.2307/3866920>
- Modigliani, F. (1944). Liquidity Preference and the Theory of Interest and Money. *Econometrica*, 12(1), 45. <https://doi.org/10.2307/1905567>
- Muslim ibn al-Ḥajjāj al-Qushayrī, N. and M. F. `Abd al-B. (1998). *Ṣaḥīḥ Muslim*. (Dār Ihyā' al-Kutub al-`Arabī : Dār al-Kutub al-`Ilmīyah, 1992).
- Ritter, J. a. (1995). The Transition from Barter to Fiat Money. *The American Economic Review*, 85(1), 134–149. Retrieved from <http://www.jstor.org/stable/2118000>
- Rosly, S. A., & Sanusi, M. M. (1999). the Application of Bay` Al-`Inah and Bay` Al-Dayn in Malaysian Islamic Bonds : An Islamic Analysis. *International Journal of Islamic Financial Services*, 1(2), 16.
- Saeed, A. (1995). The moral context of the prohibition of riba in Islam revisited. *American Journal of Islamic Social Sciences*, 12(4), 496–517. Retrieved from http://i-epistemology.net/attachments/409_V12N4 Winter 95 - Saeed - The Moral Context of the Prohibition of Riba.pdf
- Saleh, N. A., & Ajaj, A. (1986). *Unlawful Gain and Legitimate Profit in Islamic Law: Riba Gharar and Islamic Banking*.
- Sarker, A. A. (1995). Islamic Financial Instruments: Definition and Types. *Review of Financial Economics*, 4(1), 1–16.
- Tily, G. (2012). Keynes's monetary theory of interest. *BIS Papers*, (65), 51–81.
- Vogel, F. E., & Hayes, S. L. (1998). Islamic Law and Finance: Religion, Risk, and Return.

Brill, 16, 262--263.

Wedderburn-Day, a R. (2010). Sovereign Sukuk: Adaptation and Innovation. *Law & Contemporary Problems*, 73(4), 325–333. Retrieved from <http://search.ebscohost.com/login.aspx?direct=true&db=a9h&AN=60501202&lang=es&site=ehost-live>

Zaman, S. M. H. (2001). Conceptual foundations of riba in Qur'an, Hadith and fiqh. *Journal of Islamic Banking & Finance*, vol.18, 18(iii), 17–25.