Interest Free Banking according to Shahīd Ṣadr

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ABSTRACT: The focus of the paper is Shahīd Ṣadr's model of interest free banking. Having explained the Ṣadr's viewpoints on this issue, the paper in details will discuss the concept of *muḍārabah* as one of the most important concepts in relation with the bank interest in Islamic banking. The paper will also introduces some other model of investments in Islamic banking such as investment deposits, saving, and current deposits which may have been included in the free interest. Ṣadr's arguments as well as the logic behind his hypothesis and their advantage to his other contemporary models will also be elaborated in the article.

KEYWORDS: bank, interest based banking, interest free banking, current account, saving, investment, *muḍārabah*, agency, interest free loan.

Introduction

When the capitalist system (and in particular the banking industry) entered the Islamic countries, statesmen, merchants, artisans, and bankers faced the problem of the illegality of "interest" (*ribā*). To solve it, they consulted religious scholars. At this point, thinkers divided into two groups: one group accepted the capitalist system and interest based banking and tried to provide a new interpretation of "interest" which may be consistent with bank transactions; while accepting the phenomenon of banks, the second group tried to design bank transactions based on Islamic teachings. Interest free banking was the product of their attempts.

While acknowledging the role played by banks in mobilising idle savings and turning them into useful and productive capitals,[1] Shahīd Sayyid Muḥammad Bāqir Ṣadr stipulates that the conventional bank is based on interest savings and loans which are, according to Islām, "*ribā*", and thus unlawful (*ḥarām*).[2]

In response to the first group of the religious scholars who sought to legitimize interest paid on bank deposits, he argues in detail that deposits received by conventional (interest based) banks are not in the strict juridical sense deposits (whether complete or incomplete) but rather they are loans. Accordingly, the interest received by depositors will be interest received on loans.[3]

Based on this view and to fill the gap of conventional banking in Islamic societies, Shahīd Ṣadr undertook to present a banking model on the basis of the financial teachings of Islām.

It goes without saying that when he presented his own operational model for interest free banking, the idea of establishing a bank free of *ribā* (interest) was, for many thinkers, only a dream, and for others, almost a scientific joke. Thus, according to the proverb "privilege is that of the pioneer", he should be regarded and appreciated as one of the founders and pioneers of the idea of interest free banking; this does not mean, of course, that the story ends and the desired model has been achieved. Reflecting upon the ideas of great figures such as Shahīd Ṣadr, thinkers and experts on Islamic banking should water this young tree and turn it into a fruitful one.

Depicting the model recommended by Shahīd Ṣadr for interest free banking, the present article seeks to criticise and discuss it. Before explaining the model, it is necessary to note some important points which show the then prevalent social circumstances as well as Shahīd Ṣadr's concerns and beliefs.

Important Notes

1. Shahīd Ṣadr authored his *al-Bank al-lā Rabawī* early in the 1960's and in response to the question raised by the Ministry of Endowments of Kuwait concerning interest free banking for Muslim religious scholars.[4]

2. Shahīd Ṣadr was of the opinion that interest free banking may be conceptualised on two different levels:

a- Interest free banking within the framework of the Islamic system, that is to say that interest free banking – all the parts and elements and parts of which are devised, based on the teachings of Islām – will be present in society;

b- Interest free banking within the framework of a non-Islamic system, that is to say that interest free banking – the parts and elements of which are not entirely based on Islamic teachings –will be established in a society and interest free banking will operate alongside interest based banks and credit and monetary institutes.

3. Though he thinks that interest free banking may be founded at the desired level only within the framework of an Islamic system, Shahīd Ṣadr believes that interest free banking can also be executed in other systems and should not be neglected under the pretext that other parts and elements are not in harmony with it; he presents his own model for such a system while taking into account the political-economic circumstances[5] of that time.

4. By devising interest free banking, Shahīd Ṣadr does not mean to propose a charitable institute or "good loan" fund, but he seeks to devise a bank in the true sense of the term; for this reason, he thinks that banks (including the bank recommended by him) should enjoy the following characteristics:

- A bank is an entirely commercial firm seeking to gain profit;

- A bank mobilises idle capitals and pushes them towards productive activities;

- In financing agricultural, industrial, and trade firms, the bank, on the one hand, produces work opportunities to employ the jobless, and on the other helps economic growth and development;

- In promoting monetary transactions through cheques and services provided for current accounts, the bank helps promote commercial activities and the development of the market.[6]

5. Shahīd Ṣadr thinks that there are some important differences between interest based banking and interest-free banking (as proposed by him):

a- In the interest based bank, legal relations between bank and depositors, on the one hand, and bank and borrowers, on the other are on the basis of an interest based loan which according to Islām constitutes *ribā,* and is thus, is unlawful (*ḥarām*); however, in interest free banking such relations are founded on contracts acceptable to Islām.[7]

b- An interest based bank regulates and defines its operations as those of an investor; in contrast, an Islamic (interest free) bank acts as an agent and sets its income not on the basis of interest but rather as an agency fee.[8]

c- Throughout its long history, interest based banking has weathered many dangers; interest free banking is, however, in its infancy; thus, to promote the new way of banking, interest free banking must initially confine itself to low profits and be prepared to face all kinds of risks; it should be noted that at present, in addition to commercial responsibility, it has the responsibility of freeing the Islamic nation from the system of interest and disbelief.[9]

The Proposed Model

Though considering banking's diverse roles and contributions, like most economists and banking experts, Shahīd Ṣadr thinks that the main role to be played by the bank is as an intermediary between depositors and investors; this is why most of his model along with most of his *al-Bank al-lā Rabawī* is devoted to operations to mobilise and allocate resources. Emulating him, we devote most of the present article to this important point.

Interest Free Banking Activities

In this section, initially through a list, we will familiarise ourselves with the main activities to be performed by interest free banks in accordance with the model prescribed by Shahīd Ṣadr. They will then be described in detail.

Activities to be performed by interest free banks according to Shahīd Ṣadr's Model:

1. Mobilisation of monetary resources
    1-1. Current accounts
    1-2. Saving accounts
    1-3. Term accounts
2. Allocation of monetary sources
    1-1. *Muḍārabah*
    1-2. Interest free loan
    1-3. Encashing trade documents
3. Provision of Various bank services
    1-1. Receiving cheques
    1-2. Sending financial documents
    1-3. Sending bills
    1-4. Receiving promissory notes and warrants
    1-5. Trading securities
    1-6. Protecting expensive items as well as securities
    1-7. Provision of bank guarantees
    1-8. Trading foreign currencies
4. Investing
5. Making transactions with interest banks.

1- Mobilization of Monetary Sources

Under "mobilisation of monetary sources", Shahīd Ṣadr has maintained the structure of conventional banking and devised his own model based on common bank accounts such as checking, saving, and term accounts. The main difference between his model and conventional banking lies in the legal relationship between the bank and the depositors.

1-1. Current Account

A current account is an amount deposited by an account holder at the bank against which he receives a check book. By signing these cheques, he or others may receive money from the bank. Usually no interest is paid into such an account and, unlike a permanent account, it should be returned to the account holder on demand. In other words, commensurate with his commercial activities or if required by his consumptive needs, he may demand his money whenever he wishes, and the bank is obliged to pay it back.[10]

According to the model proposed by Shahīd Ṣadr, juridically, the current deposit is of the nature of an interest free loan, ownership of the fund deposited transfers to the bank, it is considered to be the bank's assets and the bank is entitled to make any modification to them.[11] To spend the balance of current accounts, he makes three proposals:[12]

a- Part of the current account balances should be remain in cash with the bank so that the bank can use them to fulfil requests made by the depositors and requests made by term account holders;

b- Part of the current account balances should be granted as loans to those bank applicants with whom the bank is not able to enter into a *muḍārabah* contract;

c- Part of the current account balances should, through *muḍārabah* contracts, be given as capital to investors and the profits should be shared by the bank as the owner (proprietor) of the capital and the investor as the agent.

Shahīd Ṣadr is of the opinion that opening a current account and depositing funds is the same as a customer’s granting the bank a loan. Withdrawing money from the current account means demanding settlement of the loan. He does not accept the opinion of western jurisprudents who believe that depositing and withdrawing funds are like loans given by customers to the bank and by the bank to its customers respectively.[13]

In Appendix 1 of his *al-Bank al-lā Rabawī*, Shahīd Ṣadr thinks that current accounts could be interpreted in a different way. According to this interpretation, the bank operates as the depositor's agent; in other words, in opening the current account and depositing funds, the depositor appoints the bank as his agent, giving his funds as a loan to the applicants. According to this interpretation, ownership of the deposit does not transfer to the bank; instead it acts as an intermediary between the lender (the depositor) and the borrower and may receive an agency fee for the service; however, no part of this agency fee will be given to the depositor.[14]

1-2. Savings Account

A Savings account is an amount deposited by its owner in the bank against which the depositor receives a bank book in which all payments and withdrawals are recorded. The savings account holder is entitled to make as large a withdrawal from his saving account as he wishes, whenever he wishes. It is in the banks' interest to encourage savings account holders not to make withdrawals from their accounts. To achieve this, banks pay interest on the balance of such deposits. Thus, in one respect, savings accounts are similar to current accounts in that the owner of the account is able to make a withdrawal from his account whenever he wishes but in another respect they are similar to term accounts in that bank pays interest on their balances.[15]

Shahīd Ṣadr is of the opinion that in savings accounts, the relationship between the depositor and the bank in interest based banking is that of a loan; since interest is paid on such a deposit, it is an instance of interest loan and cannot be executed in interest free banking. Thus, he proposes an agency relationship between the bank and the depositor; in other words, the bank as the agent receives the depositors' deposits and grants loans to investors under *muḍārabah* contracts.

In the agency relationship of agency, ownership of the capital deposited remains the depositors' and does not transfer to the bank; the bank as the agent of the owners of the capital puts it at the disposal of investors (agents of *muḍārabah*), and pursuant to the *muḍārabah* contract, receives the profit made by the agents on the capital and pays it to the owners of the capital (the depositors).

The bank divides capital obtained through saving deposits into two parts: one amounting to approximately 10% of the deposits to be kept in cash in the bank to fulfil requests made by the depositors. The other part, amounting to approximately 90%, is granted to the investors under *muḍārabah* contracts. Evidently, in such circumstances, the part kept in cash [in the bank] will produce no profit. In this way, the depositor is able to withdraw his money from his account whenever he wishes. Simultaneously, he is encouraged to keep his money with the bank, for the bank to pay him profit.[16]

1-3. Term Deposit

A term deposit is an amount deposited with bank by the depositor to receive income. The bank stipulates that the depositor should not withdraw money from his account for a fixed term (e.g. 6 months) and against which the bank will pay profits on such deposits. In interest based banking, the relationship between bank and depositor is an interest based loan relationship; as a result, it cannot be employed in interest free banking. Thus, Shahīd Ṣadr proposes changing the loan relationship to that of agency; in other words, as in savings accounts, the bank receives deposits from depositors as their agent, puts them at the disposal of investors under *muḍārabah* contracts and shares the profits pursuant to these contracts.[17]

As proposed by Shahīd Ṣadr, three financial characters are involved in banking *muḍārabah*:[18]

1. The depositor who assumes the role of the owner of the capital (*muḍārib*);

2. The investor who assumes the role of the agent (*muḍārab*);

3. The bank which assumes the role of the agent of the depositor (the owner of the capital) and intermediary in the *muḍārabah* contract.

For term deposits, Shahīd Ṣadr applies certain conditions:[19]

1. The depositor should undertake to keep his deposit in the bank for at least six months. If he does not, the bank will not employ his deposit in *muḍārabah* or agree to be his agent for this purpose;

2. The depositor agrees to the terms and conditions stipulated by the bank for *muḍārabah* contracts;

3. In addition to the term deposit, the depositor should have current account with the bank.

According to Shahīd Ṣadr's model, there is no minimum or maximum term deposit because the bank does not employ each deposit in a separate *muḍārabah* contract; instead, it uses the sum total of all term deposits in all *muḍārabah* contracts. Accordingly, however low the amount deposited might be, it is still useful to the bank.[20]

Under the agency contract, the bank has to identify fields in which the *muḍārabah* contract will be successful and employ the amount of the term deposits in such fields. The bank is not entitled to delay in employing deposits.[21]

Rights of the Depositors

Three factors encourage those with capital to deposit it in interest based banks:

1. Guarantee of the original deposit: the interest based bank guarantees the original deposits for the depositors as loans paid to the bank;

2. Payment of interest: in addition to the original deposits, the interest based banks pay constant interest on their balances;

3. Possibility of drawing money: the interest based bank allows the customer to withdraw his entire deposit or part of it at maturity.

Shahīd Ṣadr shows that such factors may also be included in the interest free banking as follows:

Guarantee of Deposits

A guarantee of deposits may also be provided in interest free banking, but not through considering the deposit to be a loan (as in interest based banking) because no profit can be paid to the depositor and the borrowers, i.e. the agents of *muḍārabah*, cannot be forced to guarantee the deposits; according to the Sharīʿah, the agents cannot be obliged to guarantee the original capital. However, as the third party and intermediary in the *muḍārabah* contract, the bank guarantees that if the investor incurs losses in employing the capital, the bank will recompense his losses. In Appendix 2, Shahīd Ṣadr shows that there is no prohibition on the third party's guaranteeing the capital in a *muḍārabah* contract.[22]

Income

In interest free banking income is provided by the profit resulting from the *muḍārabah* contract. As mentioned, the bank (as agent) gives investors the term deposits under a *muḍārabah* contract; at the end of the fiscal year, the profit earned from investing the capital is divided among the depositors. One difference is that, in interest free banking, income is not fixed. Its amount depends on the success of the investor and economic firm.[23] The other difference is that, in interest based banking, the term deposit account bears interest from the first depositing day; however, in interest free banking, the deposit is invested and may earn profit.[24]

Possibility of Withdrawal

In interest based banking, the depositor is entitled to withdraw, after maturity, his entire deposit or part of it from the bank. In interest free banking, this is somewhat difficult because the term deposits have been commercially and industrially invested under *muḍārabah* contracts; if they are withdrawn from the economic projects, these projects will face problems. To solve this problem, Shahīd Ṣadr proposes an accurate plan to employ the deposits so that at the end of every six months, approximately 10% of the projects financed through *muḍārabah* may come to an end and approximately 10% of the term deposits may reach maturity allowing the deposit account holders to withdraw their money.[25]

The Bank's Rights

In interest based banking, the difference between the interest received from loans and facilities, on the one hand, and the interest paid on deposits (usually at a constant rate) is the bank's income. In interest free banking, Shahīd Ṣadr proposes two sources of income:[26]

> 1. Fixed income received from the investor: as said, the interest free banker is an intermediary between the owner of the capital (depositor) and the agent (the investor) in the *muḍārabah* contract. In this way, it provides some services for the depositor and others for the investor. The interest free banker may receive a constant fixed wage for the services he provides to the investor. This wage may be as much as the difference between the interest received and the interest paid out in interest based banking.
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> 2. Changeable income received from the depositor: as his agent, the bank is entitled to receive part of the profit earned for the depositor through the *muḍārabah* as its agency fee for services rendered to the depositor, such as protecting his deposit and finding an agent for it.

In the Appendix 3, he explains the juridical basis of the legitimacy of receiving part of the depositor's profit as agency fee.[27]

2- Allocation of Funds

After deducting legal reserves and liquid reserve assets, the interest based bank gives the money earned on current, saving, and term deposits through loans and credits to the investors and customers. Since loans and credits are, by juridical nature, interest based loans, they cannot be employed in interest free banking. Accordingly, Shahīd Ṣadr chooses other contracts.

2-1- Muḍārabah

The most important allocation of money in Shahīd Ṣadr's model is *muḍārabah*. The interest free banker undertakes to grant *muḍārabah* facilities to investors in two ways:

a- Granting *muḍārabah* as the owner of capital: as the owner of the capital (and after deducting legal and cushion reserves), the interest free banker puts the bank's resources and the effective balance of the current accounts at the investors' disposal in various production and commercial enterprises and shares the profit resulted from their economic activities.[28]

b- Granting muḍārabah as the depositor's agent.

As the depositor's agent, the interest free banker gives the effective balance of saving and term accounts to investors in various productive and commercial enterprises and (as the agent of the depositors) shares in the profit earned through the economic activities of the investors (the agents of *muḍārabah*).[29] In such a case, the depositor, the investor, and the bank play the roles of owner of capital, agent of *muḍārabah*, and depositors' agent respectively.[30]

Conditions to Be Met by muḍārabah Investment Agents

To assure the correctness and success of the transaction and to safeguard the interests of clients (depositors), Shahīd Ṣadr proposes certain conditions be fulfilled by the *muḍārabah* investment agents.[31]

1. The investor should be trustworthy. Two persons deemed by the bank to be righteous should confirm his trustworthiness;

2. It should be proved to the bank that the venture proposed by the investor is profitable;

3. The bank should be sure that the investor is sufficiently experienced and capable in the proposed venture;

4. The investment proposed by the agent should be known and certain to enable the bank to study results and possibilities;

5. The investors should agree with the bank's *muḍārabah* terms and conditions, the most important of which are:

a- Conditions concerning profit sharing;

b- Having a current account with the bank;

c- Having accurate and regulated ledgers as requested by the bank;

d- Correct and in time provision of data as requested by the bank.

According to the proposed model, investors with a clean record are preferred.

Investor's Responsibility and Profit

As the nature of *muḍārabah* dictates, the investor (agent of *muḍārabah*) does not guarantee the original capital and profit resulting from the economic activity. Thus, it is possible that, in spite of all attempts made by the investor, the economic activity does not generate a profit and may even incur a loss. In this event, the investor is not responsible for the absence of profit or the loss. He only loses his position and receives nothing for the venture he has undertaken.

As stated under "term deposits", as the agent and the third party, the bank guarantees the account holders' original deposits. As a result, even if the *muḍārabah* contract incurs a loss, it is the bank which recompenses the loss incurred. Thus, the bank is liable for loss of capital while the *muḍārabah* investment, the agent and depositor shoulder loss of profit.[32]

If the investment does return a profit, it will be shared by the bank and the agent (investor) in proportion to the rates agreed upon. Then, the bank receives part of its share of the profit as an agency fee and distributes the remainder among the depositors.[33]

Ethical Risks for the Investor

As required by the nature of the *muḍārabah* contract, the profit, and the bank and depositor's share thereof depend upon the profit returned by the venture. The investor may wrongly underreport the profit returned by the venture or even falsely claim a loss. The bank can take the following steps to eliminate false reporting:[34]

1. The trustworthiness of the investor should be verified: the Bank may have a special department to verify the capability, experience, and trustworthiness of *muḍārabah* investment agents;

2. The subject of the economic activity should be sufficiently familiar: the bank should have some familiarity with transactions made in that field and know the probability profit or loss. This enables the bank to recognise false reports;

3. The bank should require the investor to provide necessary information on the purchase price, costs, sale price, and market price throughout the period. In turn, it should establish a department for economic studies to gather and classify necessary information on economic circumstances, purchase and sale price levels and the average costs in various economic fields. Through comparing the reports made by investors and data gathered by the economic department, the bank can distinguish true reports from false ones.

4. From the outset, the bank should supervise and control the economic activity, inform the investor of what earns a profit or incurs a loss, require him to proceed as instructed by the bank and keep accurate and regulated ledgers describing his activities and transactions.

> The bank may stipulate that if the investor acts contrary to the bank's proposal and does not provide records of income and loss as requested by the bank, the bank will not accept his claim for losses. In addition to the original capital, the bank will demand the profit which may ordinarily result from that activity.[35]

Guarantee of the Original Capital by the Investor

The primary requirement of the *muḍārabah* contract is that the agent (investor) is not responsible for losses and cannot be taken as a guarantor. Jurists disagree over whether an owner can stipulate that the capital be guaranteed and the agent can accept such a stipulation. While presenting a detailed juridical discussion, Shahīd Ṣadr comes to the conclusion that although as a rule there is nothing wrong with a condition that the investor guarantees the capital, there is a special *ḥadīth* on *muḍārabah* on the authority of Muḥammad ibn Qays.

The Commander of the Faithful said, "Whoever trades with capital and stipulates that half the profit is his, is not a guarantor …." He also said, "Whoever takes a guarantee (for his capital) from the merchant is entitled for nothing but his capital. None of the profit is his."

Although he has another explanation for the *ḥadīth*, Shahīd Ṣadr accepts that it apparently shows incompatibility between a guarantee and profit sharing; in other words, as the *ḥadīth* says, the owner has to choose either a guarantee for his capital or profit sharing, but not a combination of the two.[36]

2-2- Interest Free Loan

The second allocate of funds proposed by Shahīd Ṣadr's model is interest free loans for special applicants. According to this model, the bank tries to fulfil all requests through *muḍārabah* which is a profitable contract; where a *muḍārabah* contract is not possible (for example when the applicant for a loan intends to use the funds to pay bills, debts wages, and so on), the bank allocates part of its funds to interest free loans for such applicants and the borrower accepts to repay the loan according to a specified schedule.[37]

Conditions to Be Fulfilled by the Borrower

The bank should consider the following conditions for the borrower:[38]

1. Trustworthiness and prompt payment of his debts: references from two persons approved by the bank are necessary;

2. The borrower – whether an individual or a firm – is financially capable of repaying the loan;

3. The repayment term should not be more than three months;

4. The amount loaned should not exceed funds allocated by the bank for this purpose;

5. The money should be loaned against sufficient securities.

Bank's Income Received from Borrowers

In interest based banking, the following justification is given for receiving interest from borrowers:

1. Costs incurred from unpaid loans: every year, for various reasons, some borrowers do not repay their debts to the bank. Interest banking uses interest received to write off such loans;

2. Operational costs: granting loans requires numerous operations such as absorption of deposits, accounting, cashiery, execution of contracts, preparation of deposit and loan books, receipt of the instalment requiring personnel, hire, depreciation costs, and so on. Interest based banking allocates part of the interest received to pay such costs.

3. Profit on the capital: the interest paid by the interest bank to the depositor.

Shahīd Ṣadr is of the opinion that the first factor can be ignored and the interest free bank can take sufficient securities from the borrower. If, in spite all these security measures, some loans still remain unpaid, the bank can solve the problem through insuring the loan in two ways:[39]

a- The bank itself may insure every loan given to borrowers or all one year loans with an insurance company and the insurance company agrees to repay all unpaid loans. This is the case when the total paid for insurance premiums is the total of the unpaid loans.

b- The bank may ask the borrower to insure payment of the loan by paying the insurance premium. According to the Sharīʻah, the bank is only entitled to give loans to those who pledge sufficient collateral. The bank may consider the insurance to be sufficient security. The bank will, therefore, grant loans only to those who insure repayment of the loan.

As the borrowers' agent, the bank may, by taking a fixed percentage of the loan, insure all one year loans with an insurance company; in this way the borrowers do not have to deal directly with the insurance company. The bank then has the borrowers each pay a share of the premium.

Concerning the second factor, Shahīd Ṣadr thinks that the interest free bank may receive an agency or registration fee from the borrowers; in other words, the bank may grant loans only to those borrowers who pay part of their loan as an agency or registration fee; this is essentially not the same as interest paid to interest based banks because fees are not paid against the loan so it cannot be considered to be interest (*ribā*). [40]

The third factor is completely eliminated in interest free banking through the bank's requiring the borrower to take out a mutual interest free loan; in other words, the bank may stipulates that after repaying the loan, the borrower has to give an amount to the bank for a fixed period of time (for example 5 years) to the bank so that the bank may use it; according to Shahīd Ṣadr, there is nothing wrong with such a stipulation since it is not considered to be interest (*ribā*).[41] He proposes that the interest free bank could deposit funds acquired pursuant to such stipulations with non-Muslim interest based banks and receive interest; it is in his opinion permissible to receive interest from such banks.[42] The second solution is for the interest free bank to encourage borrowers to dedicate an amount equivalent to the interest paid by the interest banks instead of taking out a mutual loan. The bank may even divide borrowers into two classes, giving priority to first class clients, i.e. those who, firstly, repay their debts at maturity, and secondly, dedicate to the bank voluntarily an amount equivalent to the interest paid by the interest banks.[43]

Thus, a customer taking out a loan with an interest free bank pays no interest for the funds he borrows. He does, however, incur the following costs:

1. Received insurance premium;
2. Agency (registration) fee for loan related operations;
3. Mutual loan or voluntary dedication.

2-3- Liquidation of Corporate Notes

In interest based banking, corporate note holders ask to receive the value of their notes in cash. Proportionate to the amount and the time to maturity date, the bank deducts part of the amount registered in the note and pays the balance; at the maturity date, the bank demands the face amount of the note from the debtor; and if the latter does not pay, the bank demands the amount from the one who discounted the note; and if payment of the amount registered in the note is delayed, the bank receives interest accrued proportionate to the amount and the delay.

Shahīd Ṣadr considers liquidation of corporate notes in the bank to consist of the following three contracts and deduction of part of the amount as discount in proportion to the amount and the amount itself to be interest (*ribā*):

a- Loan: When the bank discounts a customer's corporate notes, it is in fact, giving him an interest based loan;

b- Order: when the corporate note holder receives the loan from the bank and gives the term corporate note to the bank, he is in fact ordering the bank to refer to his debtor to receive payment of the debt;

c- Guarantee: when a corporate note holder endorses a note such as a promissory note, he is, in fact, acting as guarantor for the debtor; in other words, he is promising to repay the debt if the debtor fails to do so at maturity.[44]

Since Shahīd Ṣadr considers discount loans with the rate of discount as the registration fee and the costs incurred to receive the note's amount and transfer it to the discounting branch to be interest (*ribā*), in his model he allows the bank only to deduct the costs of discount operations from the face amount of the corporate note; thus, discount operations on corporate notes in Shahīd Ṣadr's model may be considered to be similar to granting interest free loans. For this reason, he allows the bank to ask the one discounting the note to grant a mutual loan to the bank.[45]

Shahīd Ṣadr also conceives the discounting operation differently – the bank pays a fixed amount as the interest loan to the note holder against which amount the corporate note is trusted with the bank by the borrower, to liquidify at maturity date and withdraw the original debt as well along with interest on it. According to this interpretation, there is no actual discount and the bank receives only its fee for liquidation of the note.[46]

The table of ways to mobilise and allocate funds in interest free banking

Mobilization of funds			Allocation of funds		
Title deposit	Legal relationship	Profit	Title of loans	Legal relationship	Profit
1- Current deposit	Loan	Zero	*1- Muḍārabah*	*Muḍārabah*	Variable
2- Saving deposit	Agency	Variable	2- Interest free loan	Loan	Agency fee
3- Term deposit	Agency	Variable	3- Liquidation of corporate notes	Loan	Agency fee

3- Provision of Bank Services

As in the interest based banks, in addition to mobilising and allocating funds, the model proposed by Shahīd Ṣadr for interest free banking provides other services for the clients as follows:

3-1- Liquidation of Cheques

A cheque deposited in a customer's account may be issued by another bank perhaps even in another city or country. After going through technical steps, the bank liquifies the cheque and deposits the amount received in the customer's account. The bank may receive an agency fee for the provision of such services.[47]

3-2- Sending Financial Documents

In imports and exports, the purchaser usually promises to pay the value of the goods whenever he receives them in a specified place. In such cases, transactions are usually carried out through the bank. The exporter submits the shipping documents to his own bank. The bank sends documents to the purchaser or importer's bank. The bank examines the documents and, if they are correct, pays the value of goods purchased; the bank then receives it from the purchaser. This service is intended to facilitate trades. The bank is entitled to receive, in addition to the price of goods, an amount for acting as intermediary and costs such as communications.[48]

3-3- Sending Bank Money Orders

Shahīd Ṣadr provides four interpretations for bank money orders. He is of the opinion that the best interpretation is that which is consistent with jurisprudence. In other words, in paying money to the bank, the debtor orders the creditor to refer to the bank to receive his money. Then, by sending the money to its branch in the city intended, the bank is ordering the creditor to refer to the branch to receive his money. Shahīd Ṣadr thinks that the bank is entitled to receive an agency fee for the provision of this service.[49]

Some bank money orders are to send money to non-creditors, e.g. as a loan or present. In this case, even though the order is not juridical, sending it through the bank is correct and bank is entitled to receive some money for it; for example, when someone pays money into the bank to receive it in another city or country.[50]

3-4- Liquidation of Monetary Notes and Bills

Some days before the maturity date, the monetary note and bill holder submits them to the bank. The bank informs the debtor that at a specified time, he has to pay a specified amount for a monetary note. After receiving the value of monetary note, the bank transfers it to the monetary note holder’s current account. Shahīd Ṣadr considers this banking transaction to be correct and in accordance with the Sharīʻah. The bank is entitled to receive an agency fee for liquidating the monetary note. The bank is not, however, entitled to deduct an amount for the duration and value of the note.[51]

3-5- Sale and Purchase of Securities

One of the services which may be provided by banks is the sale and purchase of companies' stocks and bonds issued by governments or companies. Banks undertake to do so in two ways:

i. as an intermediary, they only help sale and purchase transactions and receive an agency fee for doing so or;

ii. by undertaking basket purchase of all securities before retailing them. Like merchants, they earn profit constituting the difference between the sale and purchase prices.

According to Shahīd Ṣadr, the lawfulness of the transaction and the profit earned depend upon the lawfulness of the securities. If, according to the Sharīʻah, the securities are of the kind of stocks which can permissibly be bought and sold, the bank's role (as intermediary, or purchaser or vendor) is correct and the revenue (profit or agency fee) is lawful (*ḥalāl*). However, if the securities are usurious bonds, the original transaction is invalid and revenue earned through it is unlawful (*ḥarām*).[52]

3-6- Depositing Valuables and Securities

One of the other services which may be provided by banks for clients is safety deposit boxes for their valuables and securities. Shahīd Ṣadr considers this service and the agency fee for the provision thereof to be correct and lawful.[53]

3-7- Provision of Bank Guarantee

One of the valuable services provided by banks is the provision of bank guarantees. Bank guarantees produce mutual confidence between two parties to a transaction and facilitate commerce and investment. There are various kinds of bank guarantees. In a detailed discussion,[54]Shahīd Ṣadr describes the juridical nature of bank guarantees to provide a model for the lawful provision of such guarantees; however, he does not accept interest based bank guarantees.

3-8- Foreign Currency Exchange

One of the other services provided by banks is foreign currency exchange. To fulfil their clients' needs, banks undertake to purchase and sell foreign currency, earning profit from the difference between purchase, and sale prices. Foreign currency is bought and sold in two ways: in cash or term (*mu'ajjal*). Term (on credit) sale and purchase are where the client purchases goods on credit in a foreign currency, wants to pay for them at the maturity date but thinks that in future currency will increase in value, or when he sells goods in term (on credit) he thinks that the rate of currency may decrease. Shahīd Ṣadr considers that cash and credit sale and purchase of currency and the profit earned are permissible and valid.[55]

4- Investing

When a bank has a surplus of funds it allocates them to purchase and hold securities. The revenue gained can be used to pay interests on deposits. Banks may find certain securities to be highly efficient and, accordingly, allocate part of their funds to purchase and hold these securities.

Shahīd Ṣadr is of the opinion that banks' investment on securities is similar to investments made by real persons. In other words, if the sale and purchase of securities (such as stocks) is lawful and valid, then as it is permissible for a real person to invest, it is permissible for an interest free bank to invest. However, if the sale and purchase of securities [such as bonds based on interest (*ribā*)] is unlawful, it is unlawful for the interest free bank to invest on such securities. However, if the bonds are issued by governments or companies from which it is not unlawful to receive interest, there is nothing wrong with the interest free bank's investing in such securities.[56]

5- Transactions with Special Interest Banks

According to the Shahīd Ṣadr's expert opinion which he considers to be in harmony with the majority Shi'a and Sunni opinion, it is permissible to receive interest from non-dhimmi unbelievers. Thus, he allows the interest free bank to deposit cash in non-Muslim interest based banks whenever it is in the bank's welfare to do so.[57]

Critique and Discussion of Shahīd Ṣadr's Model

Though it was not fully executed, Shahīd Ṣadr's model for interest free banking influenced many other models. A bold claim can be made that all models of interest free banking in Iran, Jordan, Pakistan, Sudan, and elsewhere are influenced by it. The model was effective at a time when many people did not believe it was possible. Nevertheless, like all other models for interest free banking, this model can be criticised, we can improve upon it, and develop a model which the whole Muslim nation can accept and use for all their monetary and financial transactions. If we ignore minor problems and difficulties, there are fundamental problems with Shahīd Ṣadr's model. Similarly, some of his juridical understandings can be challenged.

A. *It Does Not Serve All Allocations of Funds*

A successful banking model should be designed to serve most depositors, particularly the bank's main clients. A study of the objectives and tastes of depositors shows that most depositors do not select the bank proposed by Shahīd Ṣadr.

Objectives of the Depositors

In Islamic countries, people and legal persons deposit their funds in banks for various objectives and reasons the most important of which are as follows:[58]

1. To keep their money in a safe place to spend in the future;

2. To facilitate monetary exchange;

3. To gain revenue from their deposits;

4. To earn the reward of giving a good loan (*qarḍ al-ḥasanah*);

5. To help the development of the country.

Evidently, such objectives are mostly compatible with each other. It is only the reward for giving a good loan which is incompatible with making a profit.

Depositors' Tastes

Depositors seeking to earn a profit can be divided into three groups:

1- Low risk depositors: some depositors want banks or institutes to invest their money with a monthly or quarterly return to enable them to regulate their consumer costs accordingly;

2- High Risk depositors: some depositors accept a degree of risk to earn greater profit;

3- Ordinary depositors accept a certain level of risk but beyond this level they will not deposit their money; for example if it is stated that variation of bank's profit will be within ± 2%, they will deposit; but if it is stated that variation will be within ± 4%, they will avoid depositing their money.[59]

The following will not deposit their money with banks based on Shahīd Ṣadr's model:

1- Generous depositors: as stated above, in the light of the spiritual teachings of Islām, some Muslims are interested in granting good loans and earning a reward in the world to come. They want institutes and banks to help them with this. The practical experience of interest free banking in the last thirty years (in particular in Iran) shows that approximately 10% of the bank funds are allocated to this;[60] however, no provision has been made for this model of Shahīd Ṣadr. Funds may of course, be deposited in charitable institutions and good loan funds but until such institutions are established, banks play an important role in mobilising and allocating such funds.

2- Low risk depositors: as stated, some depositors want fixed revenues to base their living expenses around. However, the return for saving and term depositors in the Shahīd Ṣadr's model Ṣadris from *muḍārabah* contracts between the bank – as agent – and investors, because *muḍārabah* is risky , there is a risk of little or no return.

3- Ordinary depositors: it was stated above that even ordinary depositors accept a low level of risk; however, in Shahīd Ṣadr's model depositors shoulder all the risk.

In conclusion, it may be said that his model provides solutions only for current account holders and those who want a profit and accept risks. However, provided Islamic law is complied with, non-profitable (good loan) and profitable (with a specified profit) deposits may be designed.[61]

B. It is not Applicable to All Allocations of Funds

A complete banking model should fulfil most customers' needs. A study of customers' objectives, needs, and tastes shows that Shahīd Ṣadr's model is only applicable to some of the above.

Customers' Objectives and Tastes

Customers can broadly be divided into the following two groups:

1- Consumers

The first is families who use banks to meet their consumer needs such as buying appliances, paying dowries, house purchase, rental or repair, education, health care, travel and so on. They want transactions on the basis of contracts with fixed to enable them to make plans to repay their debts.

2- Investors

The second consists of investors who need facilities to provide or complete the capital required for their commercial firms. This group is, in turn, divided into three groups:

a- High risk investors who prefer to take all the risks for their firm and accept no one as their partner. Thus, they prefer to work with banks and institutes which provide their requirements at specified rates.

b- Low risk who prefer to transfer as many of the risks of investing and economic activity as possible to others. As a result, to provide their capitals, they go to banks and institutes which share the firm's risk.

c- Ordinary investors who have no special preference and decide in accordance with the their firms' economic circumstances and interests of their firms; they usually combine two sources of capital – through fixed profit contracts and through partnership contracts.[62]

Bank Customers' Financial Requirements

In terms of quantity and duration, bank customers have different financial requirements. Sometimes a consumer or investor needs bank facilities for a short period of time. For example, a family wants to repair their house, a farmer wishes to purchase a tractor, a factory owner wants to give his staff a new-year's present or a merchant wishes to change his store. Obviously, such customers do not want partners or partnership.

Other customers want a considerable capital for a medium term. Even though such cases may be financed either through partnership or fixed profit, customers usually prefer fixed profit. They sometimes need considerable cash capital with a long term repayment plan to start a project or develop their economic activity. In such cases, they prefer partnership.

As stated above, to allocate sources, Shahīd Ṣadr's model is based mainly on *muḍārabah* but also includes interest free loans, liquidation of financial documents, and other facilities. A look at customers' objectives, tastes, and needs shows that the Shahīd Ṣadr's model only provides solutions for those low risk investors and those seeking a business partnership. The following groups are un-provided for in this model:

1- Applicants for consumer welfare facilities who want contracts with fixed profits;

2- High risk investors who take all risks of the economic activity and do not want partners;

3- Considerable short and medium term financial requirements which do not fit partnership;

4- Requirement of amounts insignificant in comparison to the capital of the firm meeting them through *muḍārabah* or partnership.

However, these groups are the main clients of commercial banks in various societies. Islamic studies show that if religiously lawful contracts are worded correctly and appropriately, all the above needs may be met.[63] In other words, in term of allocation of funds, Shahīd Ṣadr's model may only suit development banks and investment.

C. Juridical Problems with the Proposed Model

Even though Shahīd Ṣadr is one of the greatest Shīʿī jurists and his juridical opinions some of the most correct ones, in order to devise a banking model in a society in which customers follow different marājiʿ , we cannot content ourselves with opinions which he alone held. Only opinions agreed upon by all, or the majority of jurists should be followed. In this regard, there are problems with the model proposed.

C.1. Wider Application of Muḍārabah

According to the majority of Shiʿa and Sunni jurists, *muḍārabah* is restricted to trade and cannot be employed in other sectors.[64] However, to Shahīd Ṣadr's model, however, *muḍārabah* is possible in the economic, agricultural, industrial, service, and trade sectors. As a result, only a small number of Shi'a and Sunnis are able to use his model.

C.2. Juridical Problem with Mutual Loan

According to Shahīd Ṣadr's model, the bank grants interest free loans to customers whose requests do not fit *muḍārabah* and is entitled to stipulate in the loan agreement that the borrower is obliged to give a loan for a period equal to that of the loan he has received, to enable the bank may be able to profit by depositing the amount in interest based banks from which it is permissible to take interest. However, jurists are of the opinion that any extra objective or speculative stipulation which leads to any form of financial profit still counts as usury. Clearly a mutual loan stipulated in the loan agreement, is an extra financial stipulation.[65]

C.3. *Discount and Debt Purchase*

Shahīd Ṣadr interprets the discount of corporate notes with banks in various ways. In his *al-Bank al-lā Rabawī*, he writes: The discount of corporate notes with a bank consists of a debt, order, and guarantee. The deduction made by the bank from the face amount of the note is usury. Elsewhere,[66]he provides another interpretation according to which the discount of corporate notes is a transaction consisting of a debt, deposit (of the note with the bank to be liquidated) and guarantee. According to this interpretation, the amount deducted from the face amount of the note is usury. However, on the next page, he interprets discount on the basis of debt purchase and says that even though selling a debt for an amount lesser than the face amount is not usury and is permissible according to the opinion of the majority of jurists, we cannot accept it because of certain *hadiths*. He then, refers to two *hadiths* reported by Ibn Ḥamzah and Muḥammad ibn Fuḍayl.

Ibn Ḥamzah says:

> I asked Imām Ṣādiq (as) about a man who had a claim on another;

> the other man had purchased that claim against some goods, then he gone to the debtor and asked him to pay for his claim. What is the rule for such a situation? He replied, 'The debtor should repay the same amount which the client paid the creditor as the price.'[67]

Muḥammad ibn Fuḍayl says:

> I told Imām Reḍā (as): A man purchased another man's claim; he then asked the debtor to repay that man (the seller's) claim. The Imām said, 'The debtor should pay the same amount paid by the client to the creditor (the seller). He is not liable for the remainder.'[68]

Even though, based on these *hadiths*, selling the debt to a third party is not an instance of usury in Shahīd Ṣadr's opinion, he believes that according to these *hadiths* the purchaser of debt is not entitled to receive more than the amount he paid the seller.

Here two remarks may be made about Shahīd Ṣadr's opinion: Firstly, even though the bank's discount transaction on corporate notes may theoretically be interpreted in various ways, what is done in practice both by interest based and interest free banks is no more than to purchase the debt. Though endorsing the note, the holder guarantees its timely payment; in fact by transferring the note, he sells his credit and has no claim arising from it.

Secondly, as acknowledged by Shahīd Ṣadr himself, the two *hadiths* are unreliable both in terms of the chain of narrators and in terms of their meaning. For this reason, the majority of Shī'ī jurists have ignored them.[69] Thus, there is no need to disallow transactions made by followers of other marāji', because of our own particular opinions and ignore their rights in the proposed model.

Notes

1. Sayyid Muḥammad Bāqir Ṣadr, *al-Bank al-lā Rabawī fi'l Islām*, (Beirut: Dar al-Ta'aruf li'l matbu'at, 1410 A.H.), 20.

2. Ibid, 21.

3. Ibid, 210.

4. Muḥammad ʻAlī Taskhīrī, *Panjāh dars dar iqtiṣād Islāmī*, (Tehran: Farhang Mashreq Zamīn, 1382), 418.

5. "He had another model for interest free banking within the framework of the Islamic system which, unfortunately, did not manage to present it". Sayyid Nūr al- Dīn Ishkivarī, *Dar Maḥḍar Shāgerdān Ustādh*, (The Book of Shahīid Ṣadr Conference), (Qum: Mofid University, 1384), 3.

6. Sayyid Muḥammad Bāqir Ṣadr, (*al-Bank al-lā Rabawī fi'l Islām*), 7-8.

7. Ibid, 8.

8. Ibid, 11.

9. Ibid.

10. Ibid, 23.

11. Ibid, 48.

12. Ibid, 66.

13. Ibid, 85-95.

14. Ibid, 179.

15. Ibid, 23.

16. Ibid, 64-65, and 97.

17. Ibid, 24.

18. Ibid, 26.

19. Ibid, 27.

20. Ibid, 27.

21. Ibid, 30.

22. Ibid, 33 and 184-204.

23. Ibid, 33-37.

24. Ibid, 36.

25. Ibid, 37-40.

26. Ibid, 41-47.

27. Ibid, 205.
28. Ibid, 47.
29. Ibid, 25.
30. Ibid, 26.
31. Ibid, 28-30.
32. Ibid, 45.
33. Ibid, 47.
34. Ibid, 50-52.
35. Ibid, 209.
36. Ibid, 184-203.
37. Ibid, 66-67.
38. Ibid, 68.
39. Ibid, 69-70.
40. Ibid, 71.
41. Ibid, 71-72.
42. Ibid, 72.
43. Ibid, 72.
44. Ibid, 155-156.
45. Ibid, 157.
46. Ibid, 158.
47. Ibid, 106-110.
48. Ibid, 111-112.
49. Ibid, 112-117.
50. Ibid, 118-119.
51. Ibid, 119-131.
52. Ibid, 123-125.
53. Ibid, 125-126.
54. Ibid, 128-134 and 235-243.

55. Ibid, 138-139.

56. Ibid, 161-163.

57. Ibid, 13-14.

58. Sayyid ʻAbbās Musaviyān, "Anwāʻ Bānkhā-ye Bidūn Ribā", in *Iqtisād Islāmī Professional Quarterly*, no. 11, (1382 (Fall)), 59.

59. Ibid, 59.

60."Iranian Institute of Higher Education for Banking", in *The Special Book of the 14th Conference of the Islamic Banking*, (Tehran: The Central bank of the Islamic Republic of Iran, 1382), 409.

61. Sayyid ʻAbbās Musaviyān, "Sepordeh-hāye ba Bāzdehi-ye Sābit dar Bankdāri-ye Bidūn Ribā", in *Iqtisād Islāmī Professional Quarterly*, no. 7, (1381 (Fall)), 40.

62. Sayyid ʻAbbās Musaviyān, (Anwāʻ Bānkhā-ye Bidūn Ribā), in *Iqtisād Islāmī Professional Quarterly*,60.

63. Ibid, 63 onward.

64. Marājiʻ Taqlīd, *Tawḍih al-Masā'il*, vol. 2 (Qum: Publications of the Society of Mudarrisin of the Qum Scientific Seminary, 1378), 267.

65. Ibid, 338; See also Muḥammad ʻAlī Taskhīrī, (*Panjāh dars dar iqtiṣād Islāmī)*, 424.

66. Ibid, 158.

67. Muḥammad ibn Ḥasan Al-Ḥurr al-ʻĀmilī, *Wasā'il al-Shīʻa*, vol. 18, (Beirut: Institute of Āl al-Bayt li Iḥyā' al-Turath al-ʻArabī, 1413 A.H.), 348.

68. Ibid.

69. Muḥammad Raḥmānī, "Bayʻ-e Dayn beh Kamtar", in *Professional Journal of Fiqh and Uṣūl*, no. 1, (The Global Center of Islamic Sciences, 1384), 50.