CHAPTER FIVE

Interest free financial transactions-

A comparative view
Interest is the predetermined price paid for the use of savings over a given period of time. Economists have given different definitions to interest. ‘Interest is the excess of money paid by the borrower to the lender over and above the principal for the use of the lender’s liquid money over a certain period of time. Accepting this broad definition, the practice of interest can be traced back approximately to four thousand years (Jain, 1929). References to the concept such as the counsel against excessive interest can be found in the texts of the Abrahamic religions. During its subsequent history it has been repeatedly condemned, prohibited, scorned and restricted, mainly on moral, ethical, religious and legal grounds. It’s most visible and vocal critics can be seen in the religious doctrines of Hinduism, Buddhism, Judaism, Christianity and Islam. Ancient western philosophers and politicians, as well as various modern socio-economic reformers also can be listed here in this context.

Theologians, philosophers, social thinkers, philanthropists public men and economists have been debating the ethics of interest from the time immemorial. The oldest known references to interest are found in ancient Indian religious manuscripts. Jain (1929) provides an excellent summary of these. The earliest of such records derives from the Vedic texts of Ancient India (2000-1400 BC) in which the “usurer” (kusidin) is mentioned at several contexts and interpreted as any lender at interest. More frequent and detailed references to interest payment are found in the later Sutra texts (700-100 BC), and in the Buddhist Jatakas (600-400 BC). It is during this latter period that the first sentiments of contempt against interest are expressed. For example, Vasishta, a well known Hindu law-maker of that time, made a special law which forbade the higher
castes of Brahmanas (priests) and Kshatriyas (warriors) from being usurers or lenders at interest. Also, in the Jatakas, interest is referred to in a demeaning manner: “hypocritical ascetics are accused of practising it”.

By the second century AD, however, interest had become a more relative term, as is implied in the Laws of Manu of that time: “Stipulated interest beyond the legal rate being against (the law), cannot be recovered: they call that a usurious way (of lending)” (Jain, 1929: 3-10). This dilution of the concept of interest seems to have continued through the remaining course of Indian history so that today. It is still condemned in principle. Among the Ancient Western philosophers who condemned interest, Plato, Aristotle, the two Catos, Cicero, Seneca and Plutarch got prominence (Birnie, 1958).

The criticism of interest in Islam was well established during Prophet Mohammed’s life and reinforced by of his teachings from the Holy Quran dating back to around 600AD (Choudhari, 1992). In Islam, the ruling against interest is very clear and final. Almighty God has clearly stated in the Holy Quran, “Those who devour usury will not stand except as stands one whom the Evil one by his touch hath driven to madness. That is because they say "trade is like usury". But God hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist shall be pardoned for the past; their case is for God (to judge); but those who repeat (the offense) are companions of the fire they will abide therein (for ever)” (Ali, 1934: 2:275)

Prophet Muhammad strictly warned against interest. Prophet abolished all interest, which the people owed to them. He issued strong instructions that if they persisted in demanding interests, war should be declared on them. He said, “All
Interest on loans taken during the period of ignorance (i.e. Pre-Islamic era) stands abolished. And I abolish all interest on loans advanced by my uncle Abbas”. “He who takes interest and he who pays it and the scribler who writes the contracts of interest and he who utilises it will have the curse of the God upon them” (Akram Khan, 1992:159-160)

Building on the authority of Bible, the Roman Catholic Church had by the fourth century AD prohibited the taking of interest by the clergy; a rule which they extended in the fifth century to the laity. In the eighth century under Charlemagne, they pressed further and declared interest to be a general criminal offence. This anti-interest movement continued to gain momentum during the early Middle Ages and perhaps reached its zenith in 1311 when Pope Clement V made the ban on usury absolute and declared all secular legislation in its favour, null and void (Birnie, 1958).

Some may be surprised to discover that Adam Smith, despite his image as the “Father of the Free-market Capitalism” and his general advocacy of laissez-fair economics, came out strongly in support of controlling interest (Jadlow, 1977; Levy, 1987). While he opposed a complete prohibition of interest, he was in favour of the imposition of an interest rate ceiling. The great twentieth century economist John Maynard Keynes held a similar position believing that “the disquisitions of the schoolmen [on usury] were directed towards elucidation of a formula which should allow the schedule of the marginal efficiency to be high, whilst using rule and custom and the moral law to keep down the rate of interest, so that a wise Government is concerned to curb it by statute and custom and even by invoking the sanctions of the
Moral Law” (Keynes 1936:351). The modern interest critics like Douglas (1924), Fisher (1935), Simons (1948) and Soddy (1926) proclaim that it is completely wrong and unacceptable for commercial banks to hold a monopoly on the money or credit creation process as they bear no sacrifice or opportunity cost.

5.1 Economic impacts of interest

Interest is unjust and thus inexpedient. It is the destabilizing factor in the economy. It is detrimental to growth and development, a negation of distributive justice and heavily loaded in favor of rich class. It is exploitative in nature and creates a gulf between the rich and the poor. Interest distorts the signaling mechanism of price system through an unjust distribution of reward between the financier and entrepreneur, which brings about misallocation of resources and ultimately slows down the capital formation. Interest mars the development opportunities, causes depression and delays the recovery process. Interest stands in the way of fuller utilization of resources thereby creating unemployment in the society.

It is argued that interest is like double billing. As money a consumable good, for which the ownership passed from lender to borrower in the course of the loan transaction, with the fair price of ‘sale’ therefore being the exact amount of the money advanced. Hence to ask for more in the form of interest was illegal and immoral, “like selling a loaf of bread and then charging in addition for the use of it” (Birnie,1958: 6). Or, as Aquinas intimated in his Summa Theologiae, it would be to sell the same thing twice (Ruston, 1993).
Interest is exploitation of the needy as it is evident from this quote: “It is Usury - the rankest, most extortionate, most merciless Usury - which eats the marrow out of the bones of the raiyat [cultivators] and condemns him to a life of penury and slavery” (Jain, 1929: 110-111). Ruston (1993) claims that usury still exists in modern times as exploitation of the needy. “It's like being caught, gotcha, and then they [the banks/lenders] start winding you in”. Hence, the poor have to sweat doubly so that the rich might live on interest. Interest acts as a mechanism by which 'the rich get richer and the poor get poorer'. “Interest, by making capital a quasi-monopoly, effectually prevents the establishment of a true competitive system” (Birnie, 1958: 1).

The psychological effect of this on the relatively poor can be seen to be magnified when merely quantitative evaluation of transfers from poor to rich is superceded by consideration of the qualitative cost of such a wealth transfer. For the relatively rich, the utility gain provided by usury is marginal to the already substantial utility of the principal sum. The principle of the diminishing marginal utility of wealth therefore applies to each incremental unit of wealth procured by interest earnings. The poor, however, experience the converse of this. For them, the loss in utility incurred by having to pay interest is qualitatively much greater than the gain to the rich. Each unit of interest paid incurs increasing marginal utility loss. Permitting usury to operate in an economy therefore reduces overall utility in the economy. This must count as one of the strongest arguments against usury.

One major reason to condemning interest is that it is an agent of economic instability. An interest based system is inherently unstable due to lack of synchronization between
enterprise’s payment obligations to its financier and its expected receipts (siddiqi:1998).

Gesell’s (1904) main objection to interest is that it is an endemic factor in the instability of interest-based economies, i.e. the cycles of boom and bust, recession and recovery. Ahmad, arguing from an Islamic perspective, claims “the greatest problem in the capitalist economy is that of the crises [and] interest plays a peculiar part in bringing about the crises” (1958: 36).

Even Keynes, the campaigner for interest-based monetary policy, admits the fact that “the rate of interest is not self-adjusting at the level best suited to the social advantage but constantly tends to rise too high” (1936: 350). Kennedy (1995) is bolder, suggesting that the compounded growth of interest may in fact cause inflation.

Another reason cited for condemning usury relates to the concept and practice of discounting future values. Because compound interest results in an appreciation in invested monetary capital, it is presumed rational for people to prefer having a specified amount of currency now than the same amount some time in the future.

“The theory of interest has long been a week spot in the science of economics, and the explanation and determination of the rate of interest still gives rise to more disagreement among economists than any other branch of general economic theory” (Haberler, 1937:195).

Since in an interest based system funds are provided on the basis of strong collateral and the end-use of funds does not constitute the main criterion for financing, it encourages people to live beyond their means. The rich people do not borrow for productive projects only, but also for conspicuous consumption. Similarly, governments borrow money not only for genuine development programs, but also for their lavish
expenditure and for projects motivated by their political ambitions rather than being based on sound economic assessment. Non-project-related borrowings, which were possible only in an interest-based system, have thus helped in nothing but increasing the size of our debts to an awesome extent.

When business is financed on the basis of interest, it brings injustice either to the borrower if he suffers a loss or to the financier if the debtor earns huge profits. Although both situations are equally possible in an interest based system, there are many examples where the payment of interest has brought total ruin to the small traders. The injustice brought to the financier is more pronounced and much more disturbing to the equitable distribution of wealth.

In India while distress suicide and starvation deaths stalked our rural areas, the number of individual billionaires increased from 71 to 311 during the course of last year. They have a net worth of Rs.364000 crore. At an 8 per cent of interest they would be earning Rs. 29000 crore a month or 80 crore a day (Yachoori, 2006). The villain behind the miserable fate of Waynad district of Kerala is the competition among the financiers with easy loan. The study reveals that the farmers have not been driven to death by poverty but by unbearable debt burden due to excessive rate of interest, exploitation and public humiliation by the hands of loan giving agencies (Kumar, 2004:42). The interest oriented global economic order has created great divide between rich and poor.

5.2 A comparison of various finance systems

A comparative analysis of Kurikalyanam with other finance system is done.
5.2.1 *Kurikalyanam* and Chit Finance

Chit finance is one of the oldest forms of indigenous systems. Now it is institutionalized and legalized. There are similarities and dissimilarities between chit finance and *kurikalyanam*. In chit finance a limited number of subscribers are enrolled on behalf of a foreman for a specified period and each pays equal instalments monthly/weekly/daily and the whole amount is given to one who is decided by the lot or auction. In this, collecting cash from many and giving it to one are similar to *Kurikalyanam*. But it differs in many angles. Presence of a foreman, limited number of subscribers, equal instalments and a specified period etc. are exclusive features of chit finance. While chit finance is legalized the other maintains its indigenous form.

5.2.2 *Kurikalyanam* and micro finance

Microfinance is a set of schemes, which provides financial services like credit, micro saving, micro insurance and training in entrepreneurial development. It is a new origin and is getting popularity. As small amounts are collected and micro credit facility exists, it resembles with *Kurikalyanam*. But in its essence, practice and procedures it differs from it. The objective of extending financial credit to as many unbanked borrowers as possible is coming in to conflict with sustainability of microfinance institutions. These institutions are gradually moving towards making microfinance activity a profit venture. In order to improve profitability of MFI, additional costs in the form of margin money, compulsory savings and insurance premium are being imposed on borrowers. Majority of MFI borrowers are poor and illiterate women. They are not expected to understand and realize various financial jargons used by MFIs and their effective cost. The effective interest cost ranges from 30 per cent to 193 per cent per
annum (Mitra, 2005). Fancy terms like membership fee, service charges, flat rate of interest, margin money, savings and insurance are quite confusing.

5.2.3 Kurikalyanam and interest free institutions

There are many similarities between Kurikalyanam and interest free institutions (IFI). First of all, both these systems are strongly against the interest with all its kinds and categories. Secondly both have an element of solidarity to the fellow being. Thirdly, the cash is not kept idle and it is being circulated among the members of the society according to their needs. Fourthly, both create a social consciousness in the use of money. The deprived and the poor will be protected and helped by the society. Though some similarities exist both Kurikalyanam and IFI are different in their nature, structure and practice.

A comparative analysis of Kurikalyanam with chit finance, micro finance, interest free institutions and money lenders is done in respect of certain criteria. These criteria are credit facility, terms of credit, amount of loan, saving facilities, returns from savings, investment opportunities, social commitment, transparency, convenience, legal protection, government control, participation of society, chances of exploitation and so on. It is given in the Table 5.1

The table explains the differences in the functioning of various finance systems existing in the society. Kurikalyanam facilitates credit in need easily, without interest and other formalities. The amount depends on circumstances which never lead to debt trap. It stimulates saving habit, timely returns, social commitment, participation of the society and social security. It lets off the hook of government control, legal protection, link to
any formal set ups, lottery system and exploitation and it is popular in the areas where it is practiced.

Table 5.1
Comparison of various financing facilities

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Kurikal yanam</th>
<th>Chity</th>
<th>Micro finance</th>
<th>Interest free institution</th>
<th>Money lenders</th>
<th>Formal sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Credit facility in time</td>
<td>Easy</td>
<td>not easy</td>
<td>easy</td>
<td>easy</td>
<td>easy</td>
<td>Not easy</td>
</tr>
<tr>
<td>2 Interest on loan</td>
<td>nil</td>
<td>nil</td>
<td>high</td>
<td>nil</td>
<td>Very high</td>
<td>Mkt. rate</td>
</tr>
<tr>
<td>3 Amount of loan</td>
<td>flexible</td>
<td>Fixed/auctio</td>
<td>flexible</td>
<td>limited</td>
<td>depends</td>
<td>depends</td>
</tr>
<tr>
<td>4 Debt trap/burden</td>
<td>no burden</td>
<td>no debt</td>
<td>shared</td>
<td>no burden</td>
<td>high</td>
<td>trap</td>
</tr>
<tr>
<td>5 Saving habit</td>
<td>Compulsory</td>
<td>Compulsory</td>
<td>Encourages</td>
<td>Encourages</td>
<td>nil</td>
<td>motivates</td>
</tr>
<tr>
<td>6 Chance to loss</td>
<td>minimum</td>
<td>exists</td>
<td>no</td>
<td>no</td>
<td>exists</td>
<td>no</td>
</tr>
<tr>
<td>7 Investment</td>
<td>low</td>
<td>low</td>
<td>yes</td>
<td>low</td>
<td>No</td>
<td>yes</td>
</tr>
<tr>
<td>8 social commitment</td>
<td>full</td>
<td>partial</td>
<td>full</td>
<td>full</td>
<td>nil</td>
<td>partial</td>
</tr>
<tr>
<td>9 Legal protection</td>
<td>no</td>
<td>partial</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>yes</td>
</tr>
<tr>
<td>10 govt. control</td>
<td>no</td>
<td>yes</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>yes</td>
</tr>
<tr>
<td>11 Link to formal sector</td>
<td>nil</td>
<td>yes</td>
<td>yes</td>
<td>no</td>
<td>no</td>
<td>yes</td>
</tr>
<tr>
<td>12 participation of society</td>
<td>full</td>
<td>yes</td>
<td>partial</td>
<td>partial</td>
<td>nil</td>
<td>partial</td>
</tr>
<tr>
<td>13 Exploitation</td>
<td>nil</td>
<td>low</td>
<td>nil</td>
<td>nil</td>
<td>yes</td>
<td>possible</td>
</tr>
<tr>
<td>14 Insurance</td>
<td>partial</td>
<td>no</td>
<td>group</td>
<td>no</td>
<td>no</td>
<td>depends</td>
</tr>
<tr>
<td>15 Popularity</td>
<td>average</td>
<td>high</td>
<td>high</td>
<td>low</td>
<td>limited</td>
<td>high</td>
</tr>
</tbody>
</table>

Source:- Primary data, 2006
For comparative purposes numerical values are assigned for each criteria depends on the easiness of the system which ranges from 3 to -2 in descending order. The Table 5.2 gives a clear picture.

Table No. 5.2

Comparison of various finance facilities (numerical values)

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Kurikal-yanam</th>
<th>Chity</th>
<th>Micro finance</th>
<th>Interest free institution</th>
<th>Money lenders</th>
<th>Formal sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Credit facility/in time</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>2 Interest on loan</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>-2</td>
<td>-1</td>
</tr>
<tr>
<td>3 Amount of loan</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>4 Debt trap/burden</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>-1</td>
<td>-1</td>
</tr>
<tr>
<td>5 Saving habit</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>2</td>
<td>-1</td>
<td>0</td>
</tr>
<tr>
<td>6 Chance to loss</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>7 Investment</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>1</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>8 Social commitment</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>9 legal protection</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>10 Govt. control</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>11 Link to formal sector</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>12 Participation of society</td>
<td>3</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>-1</td>
<td>2</td>
</tr>
<tr>
<td>13 Exploitation</td>
<td>3</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>-1</td>
<td>2</td>
</tr>
<tr>
<td>14 Insurance</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td>0</td>
<td>-1</td>
<td>1</td>
</tr>
<tr>
<td>15 Popularity</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>Total</td>
<td>36</td>
<td>26</td>
<td>35</td>
<td>25</td>
<td>-1</td>
<td>19</td>
</tr>
</tbody>
</table>

Source:- Table 5.1

The Table 5.2 proves that *kurikalyanam* is the most convenient and easy finance systems among all other systems. It helps the people to mobilize easy loan with least effort and procedures.
5.3 *Kurikalyanam* as an interest free arrangement

It can be seen that though a large volume of money has been flown through hands of the rural people in their needs it never bears any type of interest. The modern era is characterised by the tremendous growth of financial institution where interest is the keystone. And there is a strong conviction that interest free transactions are utopian. The banking habit has grown and people depend on such institutions to meet their financial needs. Money lenders also provide financial services to its customers. While financial institutions charge a market rate of interest the money lenders extract an abnormal rate of interest. Exploitative interest is honoured and legalised by the modern system.

The analysis of ‘economics of *Kurikalyanam*’ (4.14) proves that thousands of rupees are transacted through various hands on their needs and for specific purposes. These transactions never involved any rate of interest or collateral security. It also be seen that, it has successfully brought together the saving surplus units and deficit units and it has been continuing for a long period. Hence, it can be confirmed the hypothesis that *Kurikalyanam* is an interest free financial arrangement which promotes the well-being societies who practice it.

5.4 Modelling of an interest free financial system

An entrepreneur plans to undertake a project with capital of Rs. 10 lakhs. The entrepreneur borrows the amount from a financier on specific date at 10 per cent rate of interest. The entrepreneur has to pay Rs. 1 lakh as interest by the end of one year. The entrepreneur is responsible to pay the agreed interest whether the actual profits
are above or below the expected profits. He must pay predetermined amount of interest even if he incurs a loss.

The same transaction can be done in an interest free structure in a more equitable way. Assume that entrepreneur has the same project and approaches the financier. Both the entrepreneur and financier look in to the profitability of the project. Both expect that the project will yield 25 per cent profit during the year. The financier gives Rs.10 lakhs to the entrepreneur and both agree to share the profit in a 40:60 ratio among them respectively. At the end of the year, if the actual profit turn out to be the same as the expected profits then the financier receives Rs.1 lakh in the form of profit share and the entrepreneur keeps the rest i.e. Rs.1.5 lakhs. If the actual profit is more than that of expected rate, the financier gets a higher amount at the same ratio and if it is less than that of expected profit, he receives a lower amount in that ratio. If the business is break-even, the financier gets no return. If the business incurs losses, the losses are taken from the capital and born by the financier.

While in an interest based system, the yield for the financier is fixed in advance irrespective of actual profitability, in the interest free system, the actual profit (which cannot be determined in advance) of the project distributed between the entrepreneur and financier on a pre agreed ratio. This procedure ensures the real output growth of the economy and just distribution. It also guarantees the stability, real growth and equity (Siddiqi, 2000).

The above illustration gives a pattern for financial transaction of interest free institutions. They offer a wide range of services in various kinds. Some of them are given below.
5.4.1 Profit sharing

One party deposits its capital which the other party uses for trade or investment. If the project is profitable, the profits are shared between both parties in the ratios agreed at the beginning. Clients receive funds from the bank or the financier and manage operations independently. Loss, if any, unless caused by the negligence or violations of the terms is borne by the provider of capital. The illustration is given in diagram 5.1

Diagram 5.1

Business activity of profit sharing

1. Client
2. Investment / Asset
3. Positive Profit
4. Negative Profit
5. Bank

Dotted line indicates flow of funds

Activity 1: Bank and Client discuss business plan; Bank provides funds to client towards capital investment;
2. Client sets up the business and manages its operations;
3. Business generates positive or negative profits;
4. Profits if positive, are shared between Client and Bank as per a pre-agreed ratio;
5. Profits if negative, are absorbed by Bank; effectively bringing down the value of the asset created with its investments

Source: Obaidulla, 2005
5.4.2 Partnership

Under the active partnership bank provides fund which mingles with the funds of owners of the business enterprises. All providers of capital are entitled to participate in management but are not necessarily to do so. Profits are distributed among the partners, strictly in proportion to respective capital contribution. The business activity is presented in diagram 5.2.

Diagram 5.2

**Business activity of Partnership**

1. Client and Bank discuss business plan and jointly contribute to capital of the venture;
2. Client and Bank jointly set up the business venture and manage its operations, sharing the responsibilities as per pre-agreed terms; Business generates positive or negative profits;
3. Profits if positive, are shared as per a pre-agreed ratio;
4. Profits if negative, are shared in proportion to capital contributions; effectively bringing down the asset value while keeping their respective shares in it unchanged.

Source: Obaidulla, 2005
5.4.3 Mark up contract

A client wants to purchase an equipment or goods, request the bank to purchase the item and sell them to him at a cost plus a declared profit. And the client pays the price in future as shown in Diagram 5.3.

Diagram 5.3

Business activity of mark-up contract

Activity 1. Client approaches Bank-Vendor and identifies commodity, collects relevant information that includes base price and the mark-up;
2. Bank sells commodity, transfers ownership and possession to Client at marked-up price;
3. Client pays marked-up price in full or in parts over future (known) time period(s).

Source:- Obaidulla, 2005

5.4.4 Leasing

Leasing is a hire- purchase agreement between a bank and its client. The bank agrees to buy and rent a building, equipment or other facility for the client, together with an undertaking from the client to make periodic payments. By the end of lease period the asset reverts to the bank or the client becomes the owner of the asset, depends on the agreement. It is shown in Diagram 5.4
These banks provide many other financial services like deposit and borrowing.

One can deposit in these banks on profit loss sharing basis. Then the banks make use of the fund and share the profit among the depositors. Demand deposit schemes, saving
deposits and time deposit schemes are available there. Banks also provide loan for nonproductive purposes without charging any rate of interest.

5.5 Advantages of Interest free Banking and Finance

Justice and fairness to all concerned was the main feature of a model of financial intermediation whose core was profit-sharing. Interest was essentially unfair because our environment does not guarantee positive returns to business enterprise financed with borrowed money capital. Current practice penalizes entrepreneurship by obliging it to return the principal even when part of it is lost due to circumstances beyond the entrepreneur’s control. Justice requires that money capital seeking profit should share the risk attached to profit making. A just system of financial intermediation would contribute to a more equitable distribution of income and wealth.

Interest free finance will foster greater stability as it synchronizes payment obligations of the entrepreneur with his or her revenues. This is possible only when the obligation to pay back the funds acquired from the financier and pay a profit is related to realization of profits in the project in which the funds are invested, as it is in the profit-sharing model. Contrary to this, in the debt-financing model the payment obligations of the entrepreneur are dated as well as fixed in amount. The same is the case with the financial intermediaries; their commitment to the depositors in time and saving accounts is to pay back the sum deposited with interest added. When a project fails and businessman defaults, the financial intermediary must also default with ripple effects destabilizing the whole system. The debt based financial system of capitalism is inherently prone to recurrent crises. This malaise of the capitalist financial system is well discussed by Minskey Hyman (1986).
The linking of depositors’ entitlements to the actual profitability of the projects in which their moneys are invested through the services of the financial intermediary, the bank, would almost eliminate the risk of runs on the bank in so far as the investment accounts are concerned. A report or rumour that the bank investments are not doing well will not prompt a rush of withdrawals from investment accounts as depositors could get only what is actually salvageable. Waiting till the situation improves would be a more rational option. Interest free finance is more efficient as it allocates investable fund on the basis of expected value productivity of projects rather than on the criterion of creditworthiness of those who own the projects, as is the case in debt based finance. There is no guaranty that the most promising projects seeking finance will come from the most wealthy and the most innovative may be empty handed. But debt finance would not serve these. It would prefer those who, on the basis of other assets owned by them, would be able to pay back the sum borrowed, interest added, even when the project being financed failed to create additional wealth.

Last but not the least, interest free finance will be less prone to inflation and less vulnerable to gambling-like speculation, both of these being currently fueled by the presence of huge quantities of debt instruments in the market. Debt instruments function as money substitutes while equity-based financial instruments do not. And speculators find it much easier to manipulate debt instruments than those based on profit-sharing. In the case of productive loans the borrower may sometime lose, yet interest based lending obliges him/her to repay the principal plus interest. Some time the borrower may reap huge profits, yet the lender gets only the stipulated rate of interest which is usually a very small part of the actual profits.
Modern researches have shown that interest has bad consequences for the economy. It results in inefficient allocation of society’s resources. It contributes to the instability of the system. Also, it increases the inequality in the distribution of income and wealth as it guarantees a continuous increase in the moneys lent out, mostly by the wealthy, and puts the burden of bearing the losses on entrepreneurs and, through loss of jobs, the workers. Interest free economics research has shown that the economic system can function without interest. A system using profit-sharing modes where possible and trade based modes, e.g. mark up contract, leasing, etc. where necessary, will be more equitable, more efficient and more stable than the current interest based system. In the case of consumption loans, if it is for food, drinks, clothing, etc. necessary for survival, charging interest violates the nature of social life which requires cooperation, care and help of the needy by the well to do. If the loan is for consumer durables aiming at increase in efficiency, mark up contract provides a safer, better way of financing than interest based lending.

The claimed advantages of the Interest free banking approach to finance are that it results in: more just and equitable distribution of resources; more responsible and profitable lending due to the necessarily closer bank-client relationship; less volatile business cycles; and more stable banking systems (Taylor & Evans, 1987); as well as “the relative efficiency of the interest-free money system over the alternative interest-based system” (Darrat, 1988). The strict directions of Islam against interest motivated people especially the Muslims to establish interest free institutions. There are number of mainstream interest free banks functioning all over the world. Such banks are also known as ‘Islamic Banks’.
To conclude, the practice of interest was severely condemned by all societies. It is only the greed of human mind that advocates interest as a method of thriving. Shakespear’s Shylock represents the dirty face of greed and selfishness. Interest is an evil with social as well as economic consequences. It is an unjust practice which aggravates inequality. It dampens the economic development and destabilizes the economy. To maintain a peaceful equitable society interest should be eliminated. Interest free finance will foster greater stability, it is more efficient, less prone to inflation and it ensures more just and equitable distribution of resources. The indigenous finance systems like \textit{Kurikalyanam} provide a model for financial transactions without interest. Based on human values of \textit{Kurikalyanam}, various forms of financial activities can be undertaken. The principles of interest free financial arrangements which are getting great acceptability now can be absorbed for the purpose. Thus the hybrid of interest free financial institutions and \textit{Kurikalyanam} will provide an ideal model for healthy financial flow in our society.