QARḌ ḤASAN FINANCING IN ISLAMIC BANKS

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Abstract

Qarḍ ḥasan—commonly defined as an interest-free loan—is a benevolent economic behaviour, an outlet for the placement of savings, an instrument of finance and an institution for bona fide lending. Having such versatile attributes, it is distinguishable from other charitable financial activities such as waqf (endowments) and infāq (spending in the way of Allah) as well as other modes of finance used in Islamic financial institutions. The purpose of this paper is to present the alternative prospects of this Islamic instrument and to provide an explanation for each form of its application. Applying Tobin's (1958) Portfolio Theorem, the paper explains why people extend loans to others without the expectation of return and position this bona fide loan among the other recommended financial activities in Islam. Furthermore, the paper investigates why Islamic banks continue to make use of this financial instrument despite the fact that they gain no financial return from it. Data on Islamic banks' application of qarḍ ḥasan financing and its share compared to other banks' assets portfolio are presented. It is further argued that qarḍ ḥasan is an act of worship and benevolence and should be distinguished from the qarḍ (loan) contract, which is simply a permissible type of exchange and a mode of saving deposits in Islamic banks. The paper concludes with recommendations to the financial community for more extensive and effective use of this interest-free loan.

Keywords: Qarḍ ḥasan, benevolent behaviour, Islamic finance, Islamic bank, qarḍ contract.

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