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Beyond debt and equity Dissecting the red herring and a path forward for normative critiques of finance

Aaron Z. Pitluck

Abstract: A recurring theme in academic, moralizing, and religious discourses laments the individual and societal perils of debt and praises equity. Contemporary Islamic banking and finance is one conspicuous example. This article recontextualizes this conversation by demonstrating that since the 1980s financial practitioners have been interpreting debt and equity as increasingly illegible cognitive schemas that nonetheless retain their historical and moral connotations. This line of argumentation suggests that normatively contrasting debt and equity is a red herring—a literary device and theoretical construct that misleads and distracts from the fundamental discussion of what constitutes salubrious or odious finance. Little will change in social life if we seek to replace “debt” with “equity.” Rather, since all financial instruments describe social relationships, our conversation should turn to normatively proscribing the kinds of financial instruments that match our normative values for contractual relationships.

Keywords: credit, cultural economy, debt, equity, finance, interest-free banking, Islam, *riba*

A recurring leitmotif in the social sciences, as well as in diverse theologies and the secular humanities, is a normative discourse that condemns debt and praises equity. For example, predating Judaism, *iska* contracts were designed to avoid usury by replacing debt-like contracts with equity-like contracts. Similarly, in medieval Christianity, the *commenda* was a contractual form that was interpreted as an equity and not a debt relationship (Calder 2016). One of the most fully developed theorizations of these discourses has taken place in the contemporary

Islamic banking and finance industry, a 50-year-old global moralized niche market based predominantly in the Global South (Warde 2010). Among other practices, it seeks to avoid *riba* by creating “interest-free” banking alternatives, such as avoiding debt instruments and embracing equity products that incorporate risk-sharing (Maurer 2005, 2006).

This article's title is a playful reference to Daromir Rudnycky's (2018) recent book, *Beyond Debt: Islamic Experiments in Global Finance*. Rudnycky's subtitle refers to an experimental



moment when we can observe how Islamic banking and finance practitioners, national regulators, Islamic economists, and Shariah scholars in Malaysia are debating “how finance might be thought of, and practiced, differently” (2018: 21). Rudnyckyj argues that “reformers actively seek to reduce debt-based instruments and to make ones based on equity central to a new form of capitalism. Hence the title of this book: *Beyond Debt*” (2018: 8). Rudnyckyj’s own position appears to align most closely with that of the “reformers” in his critiques of debt and in his advocacy of “collaborative risk” (e.g., 2018: 98, 102). As Rudnyckyj explains elsewhere, “in the case of *Beyond Debt*, the goal was to illustrate how Islamic finance, in some versions, opens up alternatives to the prevailing practices of debt-based capitalism” (Mohamad et al. 2020: 379).

David Graeber documents how many religious traditions view debt relations as a situation in which everyone involved is “morally compromised. Both parties are probably already guilty of something just by entering into the relationship; at the very least they run a significant danger of becoming guilty if repayment is delayed” (2011: 12). In addition to these millennia-long religious discourses castigating debt, we can find numerous social scientists and public intellectuals making secular normative arguments that equate debt with unproductive activity and rent-seeking. For example, Mark Featherstone laments debt relations and contrasts debt with “a new political morality based in the need to invest in society and the real economy, rather than short term profits and the pursuit of consumer goods” (2019: 10). As Lisa Adkins observes among her fellow social scientists: “Foremost here is the assumption that debt disrupts, corrupts and corrodes the social order. . . . What is clear is that many sociologists understand debt to be a threat, and in particular understand it to be a menace to meaningful and sustainable social relations” (2019: 35).

The empirical record clearly demonstrates that debt relations can be exploitative, violent, and inhumane (Dwyer 2018). However, it is problematic when scholastic moralizing biases

the ethnographic record. For example, in Gustav Peebles’s *Annual Review* article he “surveys decades of anthropological literature on credit and debt” and discovers that “an astonishing consistency shines through much of the ethnographic data . . . a near universal crystallizes out from ethnographic reports, in which local populations describe credit as power and debt as weakness” (2010: 226). For Peebles, “debt” is a social science term that is challenging to define. But once defined, he finds that diverse interlocutors across time and space apparently share a negative evaluation of it. Chris Gregory provides a charitable but alternative semantic explanation for Peebles’s “astonishing” finding: “We use the word ‘credit’ when we want to say money lending is a good thing and the word ‘debt’ when we want to say that money lending is a bad thing” (2012: 385–386). Gregory provides the example of the Grameen Bank, in which appreciative observers describe the micro-lending as empowering “credit” while the critics describe the same practice as disempowering “debt.” In this reading of Gregory, Peebles’s consistency of local populations’ perceptions derives not from a cross-cultural universal critique of “debt” but rather from anthropologists’ tacit moralizing and categorizing of diverse lived financial arrangements as “[bad] debt” or “[good] credit.”

In contrast to the normatively negative evaluations of debt, numerous discourses praise equity. In addition to the previously mentioned *iska* contracts in Judaism, *commenda* contracts in Christianity, and numerous permutations such as *musharakah* in Islam, there are many widespread secular positions normatively arguing in favor of equity as inherently good. For example, Hernando de Soto has argued that the key impediment to socioeconomic development in the Global South is unclear property rights and byzantine economic regulations that inhibit the poor owning equity in their land, homes, and businesses. Similarly, in his second term as US president, George W. Bush advocated for an “ownership society” in which government would support wider equity ownership

in homes, small businesses, and the stock market. As Bush explained in a press release: “If you own something, you have a vital stake in the future of our country. The more ownership there is in America, the more vitality there is in America, and the more people have a vital stake in the future of this country” (Office of the Press Secretary (George W. Bush) 2004). More broadly, since the 1980s agency theory and the ideology of shareholder value have posited that corporations maximize their social impact (and their bottom line) when they focus on the interests of their equity owners rather than those of their non-owning stakeholders (Davis 2009; Heilbron et al. 2014; Quinn 2019; Shapiro 2005). Returning to the central thesis of *Beyond Debt*, it is common for academics and public intellectuals to simultaneously lament the growth of debt and praise the growth of equity.

This article argues, counterintuitively, that this contrast between equity and debt is a “red herring”—a literary device and theoretical construct that misleads and distracts from the fundamental discussion of what constitutes salubrious or odious finance. Specifically, this article argues that while the distinction between “equity” and “debt” may appear as a salient and natural distinction rooted in ideas of ownership versus liability, these categories are not bounded and exclusive categories derived from natural or intrinsic economic distinctions. Rather, they are in practice normative and cognitive cultural schemas that are growing increasingly illegible due to long-term changes in contemporary financial practices. On the one hand, I will demonstrate how these categories remain influential in the work of financial workers, market analysts, policymakers, regulators, tax authorities, and lawyers—as well as social scientists, Shariah scholars, and public intellectuals as introduced above. On the other hand, I will argue that, due to secular changes in the global economy, as well as to strategic behavior by financial engineers, over time the concepts of “debt” and “equity” have become increasingly incoherent and illegible, even as they continue

to hold a powerful influence on our social theories and normative discourses. This raises the question of how we should understand “debt” and “equity.” This article suggests that by recognizing financial instruments and products as relationships, practitioners and the public can normatively evaluate them using richer normative criteria than “debt” or “equity,” such as fairness, freedom, efficiency, and prosperity. In the conclusion, I examine the implications of this for normative arguments on moral financial systems, as well as for social science research.

The growing illegibility of the cognitive schemas of debt and equity

As this article will demonstrate, the concepts of “debt” and “equity” have changed over time, suggesting that they are not intrinsic natural phenomena found in market societies or functionally necessary economic concepts inferred by scholars as capital markets developed. Rather, “debt” and “equity” are historically variable cognitive schemas that are both representations of information and cognitive processors (Bandelj 2008; D’Andrade 1995; DiMaggio 1997). While analyzing these cultural schemas and how they have changed over time, I will make several points.

First, each financial instrument is a cultural object subject to multiple interpretations by different parties, such as investment bankers, accountants, regulators, and tax authorities. Second, there are multiple organizations and institutions conducting this interpretive work. We will observe scholars in academic journals, attorneys and judges in courts, lawyers and bureaucrats in tax offices, and national accounting bodies and securities regulators wrestling with this interpretive work. And of course, financial markets are designed to aid such interpretations since this cognitive work is a precondition for traders to arrive at a buy or sell decision (Caruthers 2010; Hayek 1945; Spillman 1999). Third, we will observe that the cultural objects of “equity” and “debt” are not only interpreted

differently across these professional life-worlds, but the cognitive categories from which they are derived are growing increasingly contested and less meaningful as categorical nouns. Investment banks will create any kind of financial instrument that satisfies issuers and investors—and the products of this negotiation need not neatly map onto the cultural objects of “equity” or “debt.” Nonetheless, both “debt” and “equity” remain widely used as qualified adjectives to describe the debt-like and equity-like attributes of a financial instrument. Moreover, “equity” and “debt” as cognitive categories remain important cultural objects, something that, at times, leads to their persistence but has more generally led to their erosion.

The continuing importance for practitioners of the categories of “debt” and “equity”

The categories of “equity” and “debt” without question continue to be socially consequential and cognitively relevant. “Equity” and “debt” are fundamental concepts for measuring reported income and retained profits, and therefore are fundamental for the creation of financial statements. Financial statements are deeply institutionalized throughout the financialized economy, and therefore the binary concepts are used by many parties for multiple purposes. For example, both concepts are necessary in widely used summary indicators such as debt–equity ratios and asset–equity ratios, and therefore for interpreting, thinking about, and communicating a firm’s risks and prospects. Such byproduct statistics are used extensively by market analysts to interpret the normative and economic value of corporations (Beunza and Garud 2007; Winroth et al. 2010). They are therefore directly influential on stock market prices and on managers’ compensation (which can be stock, or compensation based in part on stock market valuations), and are frequently used as rhetorical devices or contractual language in negotiations with employers for wage rates (Clarke and

Kahn 1990: 891–895; Pope and Puxty 1991). More abstractly, market supply and demand for financial instruments and secondary trading of corporate shares is shaped by how it is categorized, because investor behavior is shaped by these schematic categories (Zuckerman 2004). In short, insiders’, outsiders’, journalists’, and regulators’ epistemological understanding of a firm’s health and its trajectory through space and time are fundamentally shaped by the concepts of “debt” and “equity.”

The erosion of debt and equity as a binary code

Nonetheless, the distinction between “equity” and “debt” is unraveling, contested, and debated. If a layperson asked an accountant for a formal or working definition of “equity” and “debt,” the accountant might tell a stylized “just so” story from a simpler time when all financial instruments were unambiguously classified into one of these two categories. For example, Martin Schmidt, the Chair of International Accounting at the ESCP Business School in Berlin, describes a mythical seventeenth-century ship-owner seeking financing to fund an expedition across the Indian Ocean to procure spices. (The slave trade and colonial expropriation were framed out of Schmidt’s vignette). The proprietor invests his own private assets in the form of money and the ship. This equity “was funding provided by the *legal owner* (the proprietor), which was *subordinated, serviced and settled* depending on the endeavour’s *success* and granted the owner certain *control rights* over the endeavour” (2013: 204; emphasis in the original). A bank provided debt financing: “Liabilities [i.e., debts] were funding by a third party (the bank) contractually granted *fixed claims* in terms of servicing and settlement and was to be settled *first* and irrespective of the endeavour’s success” (2013: 204; emphasis in original).

Schmidt is describing a West European financial culture that enabled people to readily understand, think about, and communicate the

social relationship between shipowners and banks. As illustrated in Table 1, equity and debt were understood in relation to one another, constituting a binary relationship. They were distinguished from one another by their source (proprietor vs. third party) and by two distinctive combinations of four interconnected characteristics: key legal rights over the business (control vs. no control), the order in which profits would be distributed (subordinated vs. paid first), the determination of the return on investment (performance-related vs. fixed settlement), and the temporality of the investment (permanent investment vs. promised redemption on a specific date).

Today, there is a broad international consensus among accounting standards, wholly compatible with Schmidt's myth, on the conceptual

definitions of assets, equity, and debt (Pope and Puxty 1991: 891). This definition emphasizes temporality, including the historical source of the revenue flow and the present and future direction of revenue flows. The International Accounting Standards Board (IASB; 2018a: 4.3–4.4) defines an asset as a “[present] right that has the potential to produce economic benefits” that is “controlled by [an] entity as a result of past events.” In contrast, a debt, termed a “liability,” is “a present obligation of the entity to transfer [outwards] an economic resource as a result of past events” (2018a: 4.26). Equity is arithmetically defined as assets minus liabilities (Fargher et al. 2019; Pope and Puxty 1991). An “almost identical” conceptual definition was adopted by the United States' Financial Accounting Standards Board (FASB) and the United Kingdom's

TABLE 1. Binary typology distinguishing equity from debt, interpreted from Schmidt (2013)

Distinguishing Characteristic	Equity	Debt (Liabilities)
Source of funding	Funding sourced from an owner of an enterprise.	Funding sourced from a third party, such as a bank or other creditor.
Control	Investor can influence enterprise's business decisions.	Investor cannot influence enterprise's business decisions.
Prioritization of profits	Equity owners have residual claim to revenue. Their receipt of profits is subordinated to others.	Debt holders have first claim to any revenue. Debt holders are paid prior to equity holders.
Determination of profits	Equity owners' claims to profit are entirely contingent on an enterprise's performance.	Debt holders' claims are contractually fixed and unrelated to an enterprise's performance. E.g., creditors receive interest payments irrespective of the enterprise's performance.
Temporality	Funding represents a permanent investment unless the ownership stake can be sold.	Funding represents a temporal relationship that expires with promised redemption on a specific date. E.g., the financing relationship ends when the debt is repaid.

Accounting Standards Board (ASB) (Pope and Puxty 1991: 891). In sum, the international consensus is that a company's debt consists of present obligations to send out a revenue stream in the future, while a company's equity consists of any assets that remain with the owner after such liabilities are met.

Why is the distinction between equity and debt so problematic if the concepts are so clearly and consensually defined? One long-standing problem is that some well-established financial instruments can be convincingly interpreted as either debt or equity. Preference shares and non-voting equity shares are financial instruments that are well interpreted as forms of equity with significant debt-like characteristics. *Preference shares* are shares (i.e., "stock") and therefore a paradigmatic form of equity; however, in contrast to equity and more similar to a debt, they confer a contractual right to a future revenue stream. This financial instrument and this categorization dilemma are long-standing; Neil Fargher and colleagues (2019: 8) identified a 1927 article discussing it. *Non-voting equity shares* are identical to common shares with the exception that the owner lacks the right to vote in general meetings, and therefore such equity-holders are similar to debt-holders in lacking control over the corporation.¹ There are also long-standing common financial instruments that are readily interpreted as debt but that also have strong equity-like characteristics. For example, *convertible loan stock* is a debt instrument that includes a contractual right at a specific future point in time to be exchanged for an ordinary share—it therefore begins its life as debt but rather than expiring at the end of the contract it can transform into a perpetual form of ownership without any attached liabilities. These three financial instruments are not exotic or novel, but each blends the characteristics of debt and equity as understood in Schmidt's aspiringly binary distinction.

There have been four broad changes in the social context of contemporary finance that have made the cognitive categories of "equity"

and "debt" increasingly illegible. Consequently, financial practitioners are increasingly less likely to find the binary concepts as meaningful. First, the globalization of financial markets and the increasing circulation of financial instruments across these transnational spaces have strained national interpretations of financial instruments. For example, Schmidt (2013: 202) notes that when Anglo-American accounting interpretations of debt and equity are used in Continental Europe it can lead to a "lack of relevance and understandability" in countries in which equity shares in some company structures have strong debt-like characteristics. Specifically, in some national contexts actors having ownership stakes in partnerships, co-operatives, and even some forms of limited liability company may be legally constrained so that their equity ownership lacks some fundamental equity-like characteristics (such as the ability to be sold) and possess some significant debt-like characteristics (such as the obligation of the entity to buy the owner's equity in exchange for a predetermined settlement amount). In many Continental European countries, the majority of business entities have (equity) ownership structures like this that are fundamentally debt-like when interpreted using Anglo-American accounting practices (Schmidt 2013: 207–210).

A second cause has been broad changes in financial culture such as the intellectual development of agency theory and shareholder value ideology (Shapiro 2005) and its institutionalization in corporate governance policies and compensation packages in corporations, putatively to better align the incentives of managers and shareholders (Davis and Kim 2015). These developments altered the cognitive schema of "equity" to emphasize its characteristic as a "residual claim" while de-emphasizing its other three historic connotations (see Table 1).

A third cause of the blurring of equity and debt is the ascendance of relational investment bankers who specialize in structured finance (Engelen et al. 2010; Frame and White 2010;

Goetzmann 2016; Nesvetailova 2014; Pernel 2020). These so-called “financial engineers” (Shiller 2012: 69) specialize in creating novel “hybrid” financial instruments that blur the traditional distinction between debt and equity. Financial engineers design financial instruments to simultaneously raise capital for corporations and to attract investors by offering “investors any set of rights that can be described in words, subject to any conceivable set of qualifications and in consideration of any conceivable set of offsetting obligations” (Hariton 1994: 500–501). For example, before financial engineers design or modify bespoke financial instruments, they attend closely to their clients’ interests and then work with the clients (or the relationship managers) to create a cognitively interpretable financial instrument that meets as many of the clients’ often conflicting requirements as possible. Clients typically desire to raise capital at the lowest possible cost, but they also have numerous other objectives such as obtaining a favorable domestic or foreign tax outcome,

obtaining a favorable rating agency treatment, meeting a specified regulatory objective, getting a certain accounting treatment, matching anticipated payments with anticipated cash flows, hedging a perceived exposure to price or interest rate risk, reducing exposure to the operation of certain high-risk businesses, hedging against perceived cyclicalities in business operations . . . manipulating control of the company, altering the perceptions of market analysts and providing incentives to employees and management. (Hariton 1994: 501)

Financial engineers seek to structure the financial instrument so that it is as favorable as possible to their client by simultaneously meeting as many of these objectives as possible.

However, financial engineers must also attend closely to the objectives of prospective investors, who could purchase the financial in-

strument. Investors, too, desire hybrid financial instruments. Not only do they want them for their projected cash flows contingent on market forecasts, but also to meet tax, accounting, and regulatory objectives or constraints. Consequently, such financial instruments (or components of them) are designed not to resemble “debt” or “equity” but to meet the multiple conflicting requirements of their corporate clients and the prospective investors in the financial instruments.

Other important parties that financial engineers attend to from the very beginning of the financial innovation process are the credit-rating agencies and market analysts whom, depending on the financial instrument, will interpret and evaluate the issuer and/or the financial instrument. Later in the commodity chain, when institutional salespeople in the investment bank attempt to sell the financial instrument issued by their bank to investors, their sales pitch involves interpreting the financial instrument and making a case for why their client would benefit by purchasing the financial instrument (investing) and thereby becoming a contractual party in the financial relationship. When professional investors speak to their supervisors in investment manager meetings to propose the purchase or sale of a financial instrument, they make their case by interpreting the financial instrument and how their firm would benefit by entering or exiting the financial contract. In all these locations within the financial service commodity chain, parties and prospective parties in the financial instrument must negotiate the meanings of the financial instrument in order for it to be successfully traded (cf. Arjalies et al. 2017; Pitluck 2020).

A fourth motivation for this proliferation of hybrid instruments is regulatory arbitrage designed to profit from regulatory and tax requirements that differ for equity and for debt (e.g., Hariton 1994; Pope and Puxty 1991). Consequently, since the 1990s, in order to reduce taxes and increase the returns for investors, or to create tax shelters for their corporate issuers,

financial engineers have created large markets in financial instruments that have both equity-like and debt-like characteristics, such as convertible capital bonds and variable rate preference shares (for descriptions of these two financial instruments, see Pope and Puxty 1991: 907–909).

With such diverse causes, there are few countervailing social forces compelling corporations or investors to create financial instruments that unproblematically resemble the cultural categories of “debt” or “equity.” There are three notable exceptions. First, as I just mentioned, having a financial instrument categorized as debt or equity can have regulatory or tax advantages. While such incentives may encourage novel hybrid financial instruments, it can also constrain financial innovation and encourage financial engineers to create financial instruments that can be easily interpreted by tax authorities, regulators, and outside observers as equity or debt. A powerful example of this institutional isomorphism is encouraged by countries’ conformance with Basel III. Second, financial innovation is cognitively taxing and therefore temporally and economically costly. It requires investment banks to create something new and market it to prospective clients, and it requires investors to learn something new and decide whether to purchase or trade the financial instrument. This additional cognitive labor caused by novelty encourages all parties to use preexisting financial instruments such as paradigmatic forms of equity or debt or, for that matter, preexisting hybrid instruments mixing debt-like and equity-like characteristics. Since financial innovation is costly, absent a compelling motivation corporations and other issuers prefer to use existing forms—thereby encouraging financial engineers to conform to the preexisting categories of “debt,” “equity,” and “hybrid” financial instruments that blend the two.

In sum, “equity” and “debt” as cognitive categories and cultural schemas remain important and at times this leads to their persistence, for example, when financial engineers design fi-

nancial instruments to mimic “equity” or “debt” to take advantage of regulatory or tax requirements. However, the very importance of these cognitive categories has more broadly led to their erosion, for example when financial engineers conduct “regulatory arbitrage” to create new financial instruments that retain enough of a debt-like or equity-like characteristic to satisfy regulators or tax authorities. The net trend over the past 40 years has been the growing incoherence and illegibility of “debt” and “equity” and the proliferation of financial instruments poorly described as either.²

How do practitioners negotiate the erosion of these two important cognitive categories?

The erosion of the binary cultural schemas of “debt” and “equity” has increased ambiguity and uncertainty, yet we muddle on. Undergraduate students in U.S. financial accounting courses are taught that ideal-typical equity and debt have four essential characteristics quite similar to that told in Schmidt’s (2013) mythic genealogy of the seventeenth-century shipowner buying spices from Indonesia. However, in contrast to Schmidt’s ‘just so’ story, contemporary students are taught that these are two ideal-types that “vary along a continuum from pure debt, through hybrids to pure equity” (Gunderson 2013: 51). Konrad Gunderson’s (2013) students are asked to explore their “strong feelings” as to which of these four independent characteristics are the most “essential” or “crucial characteristics” as they attempt to rank a list of financial instruments from debt-like to equity-like.

Apparently, the same problem persists among experienced users of accounting data. In an experimental study involving business school alumni with five years of experience in banking, finance and related fields, “no single feature dominates conceptions of what constitutes a liability or equity instrument” (Clor-Proell et al. 2016: 1270). It appears that “there may not

be one binary classification that all individuals would agree with.” Indeed, in lawsuits contesting the categorization of equity and debt, in contrast to the five historic criteria proposed in Table 1, US judges have proposed laundry lists of 11 to 13 criteria (Chiang and Englebrecht 2013). However, as these cognitive schemas grow more complex, with longer lists of criteria to distinguish the dichotomy, this paradoxically magnifies the problem of identification by highlighting the numerous contradictory debt-like and equity-like qualities that coexist in contemporary financial instruments.

Academics and attorneys cannot resist the temptation to try to parsimoniously resolve the matter. Wei-Chih Chiang and Ted Englebrecht (2013), for example, examined 84 US Tax Court cases decided over 30 years in which a court ruled whether a financial instrument was an equity or a debt instrument. They found that two factors predicted judicial decisions—but the model could not accurately predict all cases, and one of the two factors is highly subjective.

For decades, regulators have attempted unsuccessfully to resolve the issue. In 1981, the Internal Revenue Service in the United States announced regulations to clarify the distinction, but the implementation was sequentially delayed and eventually withdrawn (Chiang and Englebrecht 2013). In 1986, the FASB started a project to determine how to categorize financial instruments that had debt-like and equity-like characteristics. This led in 1990 to an Exposure Draft for public feedback and ultimately a resolution in 2003 (FASB 1990, 2003). However, according to the American Bankruptcy Institute (2003), this was a “limited-scope statement” in which the FASB “has not reached a determination on certain other issues embodied in the Exposure Draft.”

The IASB joined the project and in February 2008 the boards co-published *Financial Instruments with Characteristics of Equity* for open comment. According to Schmidt (2013: 207), this discussion paper was “excoriated by external reviewers.” It took a decade before the IASB

(this time without the FASB) would publish the next and most recent version of the document (IASB 2018b). As of the time of this article’s publication, a working group within the IASB continues to meet and continues to struggle with distinguishing the concepts of “debt” and “equity” (IASB 2018b: fn 11; International Financial Reporting Standards Foundation 2022a, 2022b).

Although decades of discussion inside and outside of the IASB have not yet resulted in a conclusion, in the most recent draft of *Financial Instruments with Characteristics of Equity* the IASB’s most recent proposal is as follows:

The Board’s preferred approach would classify a claim as a liability if it contains: (a) an unavoidable obligation to transfer economic resources at a specified time other than at liquidation; and/or (b) an unavoidable obligation for an amount independent of the entity’s available economic resources (IASB 2018b: Section 2.1(a) and (b), also see Section 2.33(a) and (b)).

In this proposal, financial instruments are broadly categorized as a liability (i.e., a debt) if they can be characterized as having *either* of the two criteria. “Equity” remains a residual category with an intentionally narrow definition; a financial instrument can only be categorized as an equity if it possesses *neither* of the two criteria.

In sum, the adjective of characteristics that describe a financial instrument as “debt-like” have grown, thereby expanding the universe of what financial instruments are interpreted as debts. In contrast, the cultural category of “equity” has grown increasingly narrow, particular, and strict, so that any financial instrument that is tainted with a debt-like characteristic would in itself preclude the financial instrument from being categorized as an equity. The cognitive universe for debts is expanding, while the cognitive universe for equities is contracting.

Re-theorizing debt and equity for social scientists

Given this genealogy, how should social scientists discussing finance do their work? How should public intellectuals (including Shariah scholars) concerned with “debt” or in favor of “equity” make their case for what constitutes “good” finance? This article argues that we can make progress on these questions if we conceptualize financial instruments as material and relational cultural objects that intrinsically describe social relationships. By understanding financial instruments and markets as “cultural objects,” I am working within the Weberian interpretive tradition (Swedberg 2007) and with the work of scholars who have argued that markets are necessarily meaning-making organizations and institutions (Abolafia 2020; Carruthers and Stinchcombe 1999; MacKenzie 2011; Muniesa et al. 2007; Spillman 1999). As Nina Bandelj explains, “for an economic exchange between social actors to happen, all parties involved must make sense of the transaction, that is, they must attribute meaning to it” (2008: 675).

By specifying that financial instruments are not only cultural objects but are also “material and relational,” I am emphasizing that all contemporary financial instruments are physical contracts detailing the relationships between contracting parties (MacKenzie 2008; Riles 2010). For example, bespoke debt-like financial instruments are a physically thick package of legal contracts that specify the rights and obligations of the issuer, bond-holders, and the investment bank(s) from the moment the contracts are enacted to how these property rights shift with changing circumstances for the tenure of the relationship. However, “finance” is easily misunderstood if one excessively focuses on the paper and the ink, on the stable legal structure this contractual language represents. Finance is not a noun synonymous with “financial services,” “financial products,” or other ready nouns such as “credit,” “capital,” “equity,”

or “debt.” “Equity” and “debt” are not things with descriptive characteristics, as observed in Table 1. Rather, “finance” is a verb describing a relationship taking place in the ever-changing present. The finance we observe is always an intermediary artifact created midstream as financial relationships are interpreted, negotiated, (im)perfectly enacted, contested—or pro-socially avoided and thereby voided (Emirbayer 1997; Lépinay 2011).

The observation that “debt” and “equity” are variously interpreted cultural objects suggests that we should have humility when using financial statistics. Much of our understanding of debt and equity derive from government and for-profit databases that derive their data from companies’ published financial statements and from public disclosure statements. To the degree that these statistical and accounting categories (such as the IASB 2018b definition) do not represent the social, moral, political, or economic relationships that concern us, our inferences from this data will not be sound (see Fargher et al. 2019: 26). For example, consider arguments that observe the growth in total debt (relative to equity or relative to GNP) and infer that this signifies a shift in economic life (e.g., Robbins 2020: 26–27). First, this argument assumes that what financial contracts are categorized as “debt” is constant over time. However, this article demonstrates that, partly as a consequence of the growing influence of agency theory (Shapiro 2005), the accounting definition of “equity” has become increasingly narrow and particular, and, conversely, the category of what is categorized as debt is growing increasingly heterogeneous (e.g., IASB 2018b). The net effect is that the goalposts are moving—the proliferation of debt instruments is in part explained by the increasingly broad definition of what financial instruments are understood as debt. Second, this article’s argument would suggest that, because financial instruments categorized as “debt” are so heterogeneous, there is very little that we can surmise about how the economy is changing simply by observing more so-called

“debt.” For example, the kinds of relationships described in the overnight commercial paper market (which is better described as a relationship between liquidity providers and liquidity takers than lenders and borrowers) is entirely different than the relationships in the convertible bond market (where borrowers have the right to become future owners), and yet both of these large markets in financial instruments are categorized as “debt.”

We can put the matter simply by comparing financial instruments to marriages. Human relationships and financial instruments can be complex and surprising, and they change over time. It is self-evident that if we learn that person X and person Y are “married,” then this only tells us a little about the kind of relationship that they are in. Similarly, social scientists should not assume that simply because something is described (or categorized, or counted) as a “debt” or as an “equity” that we therefore know the relationship between the issuer and investors. When studying financial instruments or marriages, we must always take the next empirical step of observing the nature of the relationship and anticipate that different parties involved are likely to have multiple interpretations of these relationships.

Beyond debt and equity?

If financial instruments are material and relational cultural objects that intrinsically describe social relationships, and if “equity” and “debt” are cultural and cognitive schemas that remain socially consequential while also growing increasingly contested and illegible, where does this leave social scientific and normative arguments against “debt” or in favor of “equity”? As Rudnyckj (2018), Bill Maurer (2005, 2006, 2008), and others have documented, numerous theologians, Islamic economists, and public intellectuals are advocating for an “interest-free” financial system that moves away from debt-based instruments and moves toward equity-based instruments.

This article’s line of argumentation suggests that social scientists and public intellectuals should avoid entering into the debate as to whether equity is superior to debt and whether debt is inherently problematic. What constitutes “debt” and what constitutes “equity” have become increasingly illegible, with no common understanding even among practitioners as to their essential characteristics (Clor-Proell et al. 2016). Many financial instruments are “hybrids” that may be categorized legally and in statistical databases as “debts” but which have substantive “equity-like” characteristics. Moreover, due to the heterogeneity of financial instruments categorized as “debt,” there is little that we can normatively summarize about “debt” relationships. By adopting the terms of this debate, we inadvertently create a “red herring,” a literary device that misleads and distracts from the fundamental question of distinguishing salubrious from odious finance.

Instead, social scientists could learn from Shariah scholars such as Mohd Daud Bakar (2016: 47–61), who argues that whether a financial arrangement is well described as “debt” or “equity” is religiously (if not morally) moot. As this article has argued, many financial arrangements can be well-interpreted as either debt or equity. Moreover, as numerous critics of Islamic banking and finance have pointed out (e.g., El-Gamal 2006), to create financial products that are interpreted by Shariah scholars as Shariah-compliant, financial engineers are creating equity-like financial instruments that are less debt-like, but that replicate the former financial instruments’ contractual characteristics. On one hand, this can be understood as conventional financial innovation that seeks regulatory or tax arbitrage by creating an incrementally different financial instrument that is not subject to a tax or regulatory prohibition. On the other hand, such financial innovation is particularly simple to achieve in Islamic banking and finance because the putative categories of “debt” and “equity” are so contested and overlapping. One lesson that the case of Islamic banking and finance teaches us is that expending magnifi-

cent efforts to transform banks, financial institutions, or even capitalism from debt-based to equity-based is unlikely in itself to lead to “good” finance (however defined). If social movements and Shariah scholars focus their efforts on this red herring, it can potentially lead to no substantive change at all.

In the normative conversation of humankind on what constitutes good finance, we should focus instead on what constitutes a good financial arrangement that is “good” for all contractual parties and that minimizes negative effects on third parties (e.g., Asutay 2012; Daud Bakar 2016; Dusuki 2009; El-Gamal 2006; Laldin et al. 2015). If we focus on the fact that financial instruments always and everywhere describe social relationships, we can achieve “good” finance by focusing on what makes a “good” social relationship. “Debt” and “equity” are weak and simplistic normative values relative to richer, well-established normative values such as fairness, freedom, efficiency, and prosperity.

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Notes

1. The distinction between ordinary shares and non-voting shares is a rather unreal distinction, given that minority shareholders in practice rarely have any control in a general meeting (Fargher et al. 2019: 905) and that they are generally uninterested in such control (Pitluck 2012).
2. It may be useful at this point in the argument to briefly pause and contrast this argument with the debt and equity distinction in *Beyond Debt*. Rudnykyj (2018: 15) makes the following remarks on the equity–debt binary: “While these binaries were useful heuristic devices for my interlocutors and produced a grid of intelligibility through which they understood and represented Islamic financial forms and practice, like virtually all binaries they deteriorate when subjected to rigorous interrogation.” In contrast, this article’s position is that many binaries in social life are persistent and socially consequential cultural objects; however, the debt and equity binary has eroded over the past four decades due to long-term social changes in capitalism and strategic behavior by financial engineers.

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