THE PROHIBITION OF RIBA (USURY)

DEFINITION

✧ The basic principle of Islamic financial system is the prohibition of riba (Usury).
✧ The Arabic word, *riba*, literally means growth, excess, addition, expansion, surplus or increase.
✧ *Riba*, from *Shari'a* perspective, refers to any predetermined and conditional extra amount, big or small, that must be paid by the borrower to the lender above and over the principal, for the loan to be materialized or for an extension in its maturity.
✧ *Riba* is categorically prohibited by *Qur'an* and *Sunna* regardless of whether the loan is taken for the purpose of consumption or for some production activity.
✧ The prohibition of *riba* implies that the predetermined positive return on a loan as a reward for waiting is not permitted by *Shari'a*, regardless whether the return is a fix or variable percentage of the principal, an absolute amount to be paid in advance or on maturity, or received in the form of a gift or prize or a service.
✧ The prohibition of *riba* applies equally to the loans obtained from or extended to Muslims as well as non-Muslims. There is no distinction between Muslims and non-Muslims, or between individuals and states with respect to the receipt and payment of interest. Therefore, the prohibition of *riba* has universal application. This is consistent with Islam being a universal religion that preaches the unity of mankind and the equality of all individuals, irrespective of their sex, color, nationality or faith.
✧ The prohibition is explicitly mentioned in four different revelations (*Surah*) of *Qur’an* (2:275-76, 2:278-279, 3:130, 4:161 and 30:39) expressing the following ideas:
   1. *Riba* deprives wealth from Allah’s blessings.
   2. *Riba* is equated with wrongful appropriation of property belonging to others
3. Muslim should stay away from riba for the sake of their own welfare.
4. When lending money, Muslims are asked to take only the principal and forgo even that sum if the borrower is unable to repay.
5. Despite the apparent similarity of profits from trade and profits from riba, only profits from trade are allowed.

TYPES OF RIBA

Shari’a scholars have differentiated between two types of riba.

1. Riba Al-Duyoon (Riba on Debts)
   - This is what the Qur’an prohibited and refers to as a war against Allah and his prophet. Riba al-Duyoon is known in Islamic Shari’a as riba Al-Nasi’ah.
   - Riba Al-Nasi’ah
     - Nasi’ah means delay, defer or wait. It is applied to “money-money exchange”; money is exchanged for money with deferment.
     - Since the verses of Qur’an has directly rendered this type of riba as haram, it is called riba al-Qur’an.
     - Similarly, since only this type was considered riba in pre-Islamic era it has earned the name of riba al-jahiliyya
     - Riba al-nasi’ah is the real and primary form of riba that represents predetermined extra amount on deferred payments due to the inability of the borrower to pay its debt on time; i.e., extending the period for payment by charging more than the principal value.
     - Riba al-nasi’ah underlies most of conventional financial products and services.

2. Riba Al-Buyu’ (Riba on Sales)
   - This type of riba is specifically prohibited by the Prophet (pbuh). It gives a more comprehensive implication to riba and is not merely restricted to loans.
   - Riba Al-Buyu’ applies to certain types of sales transactions, both immediate
exchanges as well as credit exchanges. It is commodity specific and results in what is known as *riba Al-Fadhl*.

- **Riba Al-Fadhl (Riba on Increase).**
  - Also known as *riba al-Sunna* or *riba alhadeeth*
  - *Riba al-Fadhl* is described as an unlawful excess in the exchange of two counter-values where the excess is measurable through weight or measure.
  - The basis for the prohibition of *riba* in the exchange of commodities is the famous *hadeeth* of the Prophet on six commodities: 
    
    “Sell gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt – like for like, equal for equal, and hand-to-hand (spot); if the commodities differ, then you may sell as you wish, provided that the exchange is hand-to-hand or a spot transaction.”
  - This hadeeth created a lot of confusion and many scholars in the past or in recent days expressed their inability to appreciate the reasons and the logic behind the concept of *Riba al-Fadhl* and its alleged prohibition.
  - Economically speaking it would be irrational and unacceptable to imagine that a person would knowingly commit himself to a bargain whereby he is required to give a superior quality of his commodity to another person for inferior quality of the same commodity. It would indeed be unfair to expect the former to agree to any such deal in spot exchange.
  - Furthermore, there *ahadeeth* shows that the Prophet (pbuh) categorically stated that the question of *riba* relates to exchanges involving credit and has nothing to do with spot exchanges.
  - What I believe now is that the *Ahadeeth* of *riba al-Fadhl*, if properly interpreted, serve to clarify two important aspects relevant to the prohibition of *riba*: one that *riba* is only applicable to credit dealings and, two, that while dealing with loan transactions, it is absolutely essential that what is returned by the borrower should be identical to the item he
If you give on credit gold, then receive back the same gold: the same weight and the same quality; and if you give silver [on credit], then receive back the same silver: the same weight and the same quality, because the one who gives more or expects more, then [he should know that,] that is exactly Riba.’

Likewise, if you will sell gold for silver on credit then there is a danger of interest in it.

**ADDRESSING SOME MISCONCEPTIONS ABOUT RIBA**

✧ As mentioned in the definition of *riba* given above, anything, big or small, stipulated in the contract of loan to be paid in addition to the principal is *riba*.

✧ However, there have been a number of misconceptions about *riba* and its prohibition. The main misconceptions include:

1. **Modern day interest is not riba**
   
   **Argument**
   
   o Interest-based commercial transactions were invented by modern day business thus not covered by the *riba* referred to in the Qur’an. The prohibition of *riba* cannot be extended to modern day banking
   
   o Interest is based on the premise “money is a commodity”.

   **Addressing this misconception**
   
   o Interest is the rent paid for the use of money. The lender rents you the money at a rental rate called interest. In a legal sense, “interest” implies that excess amount which a creditor settles to receive or recover from his debtor in consideration of giving time to the debtor for repayment of his loan.
   
   o Thus, *riba* and interest are the same. The equivalence of *riba* to interest has been recognized by the majority of Muslim scholars. They explicitly and clearly equate *riba* to interest.
2. **There is no difference between Interest and Profit**

   **Argument**
   - Bank interest resembles profit in *murabaha*

   **Addressing this misconception**
   - *Allah* (swt) states in the *Qur’an* that some people might raise the issue of the apparent similarity of profits from trade and profits from *riba*; however, only profits from trade are allowed.
   - Generally, trade means exchange of any goods for money. You can buy or sell goods for money at any price.
   - In *murabaha*, you buy an item at one price and sell it to someone at a higher price, allowing him to pay you for it over time. In *riba*, you lend someone some money and require him to pay back a greater value of money than what he borrowed.
   - *Murabaha* prevents you from being caught in a spiral of debt, as the amount that you pay fixed before hand. You cannot get a situation where you have large debts that you cannot pay off and which rise every year due to interest.
   - Several types of risks are associated with trade while charging *riba* (interest) is risk free. There are other legal means to avoid *risk of default*.
   - Conventional economy today is *debt-based* that transfer risk to others, while Islamic economy is *asset-based* that emphasizes risk sharing. Great emphasis is placed in Islam on the distinction between trade and *riba*. *Riba*, which represents unjustified monetary benefits, is different from trade, which promotes partnership and exchange in a just and fair way, which leads to a more equitable distribution of income, and a more just economic system.

3. **Riba is only relevant to consumption loans, not commercial loans**

   **Argument**
   - The common practice of *riba* during the time of its prohibition was the charging of interest on consumption loans taken by poor people to finance their basic needs. This form of exploitation is not present in production loans
whereby in many cases, the debtor is economically well-off and loans taken are used to generate profit. Therefore, the basic cause of the prohibition of *riba*, exploitation and injustice, is absent.

**Addressing this misconception**

- First, the prohibition of *riba* concerns the unjustified excess, not the use of funds. The *Qur’anic* prohibition of *riba* includes all forms of it without any specifications of whether it is for consumption or production and regardless of the financial status of a party (whether rich and poor).
- Since *riba* is equal to interest, it makes no difference whether the loan is for consumption or business purposes, and whether the loan is given (or taken) by a commercial bank, government, corporation, or an individual.
- There are evidences that interest-based commercial or productive loans were in existence since the beginning of human civilizations. In addition, a number of *Ahadeeth* reporting on the practice of *riba*-based commercial loans.
- Nevertheless, lending in Islam is considered as "a benevolent act with a view to helping someone in need. If someone needs capital for commercial purposes, then capital should be given in a risk-sharing basis and if someone needs funds to overcome some short term need, then such need should not be exploited and the borrower should not be put under undue burden."

**4. Inflation justifies interest**

**Argument**

- It is argued that a debt when repaid at a later date may have lower purchasing power due to persistent increase in the general prices of goods and services (inflation). Hence, the borrower, in essence, repays less, which would be unfair to the lender if he is not compensated for the loss of purchasing power.
- With the issue of inflationary nature of the contemporary economy, the prohibition of *riba* would be applied to only real interest rate (the nominal interest rate minus the rate of inflation). Otherwise, the absence of interest in
an inflationary period would amount to negative real interest, which would penalize lenders and rewards borrowers.

- Indexation is needed to adjust the value of the loan to compensate for the change in the value of money due to inflationary pressure so that there is no injustice to the lender.

- **Indexation** refers to the price adjustment, which allows capital or income to take account of, or benefit from, inflation. The purpose of indexation is to keep the purchasing power after inflation as before inflation.

### Addressing this misconception

- First, rates of interest are not based on rates of inflation, although there may be some kind of correlation. Actually, several studies have illustrated that interest is one of the causes of inflation. A better way to reduce inflation is to stop charging interest to begin with.

- If surplus on loan amount is only attributable to actual value loss due to inflation, there will be no commercial incentives to banks.

- With regard to indexation, it is justifiable from *Shari'a* perspective for wages to face the inflationary rise in prices. But the majority of scholars oppose indexation of financial assets based on the following arguments:
  
  1. Islam considers any excess of the loan’s principal as *riba*. So only the original amount lent should be repaid.
  2. The presence of inflation will result in the decline in the purchasing power of lender’s money whether it is given to the borrower or not.
  3. The factors that lead to inflation are beyond the borrower’s control, so why the borrower should be held responsible.
  4. Even if indexation is allowed there is no perfect index to fully and fairly capture the loss of the value.

- However, one solution to protect the purchasing power of money lent, the lender and borrowers can agree that the loan can be denominated in terms of some relatively stable commodities such as gold or diamond, or a strong
currency. Thus, the lender can lend a certain quantity of gold to the borrower who is obligated to return the same quantity when it is due.

For example, suppose an individual borrow 50,000 Yemeni Rial from his friend when the exchange rate between USD and YR was 1: 4, which means the YR50000 equals to $12,500. After several years, the borrower decides to return the amount of debt to his friend, but the exchange rate between USD and YR is now equal to 1: 200, which means the YR50000 equals only to $250. What do you think? To me, it is unfair to return the original amount with its value now equal to $250 instead of the original value of $12500.

The above example results in a big loss to the lender and a large gain to the borrower. Denominating the loan in terms of a relatively stable commodity is a reasonable and fair solution to both parties.

Another solution to overcome the decline of the value of money is the Islamic way of profit-and-loss sharing partnership, so both parties share the risk.

5. **If it is not excessive, it is not riba**

**Argument**

It has been stated in Surat Aal-Imran (3:130) - “O those who believe do not eat up riba doubled and redoubled”. Thus, if the rate of interest is not excessive (e.g. doubled) then it does not constitute riba and therefore not prohibited.

**Addressing this misconception**

Verses of the Qur’an on the same subject matter must be studied in relation to each other; e.g., Al-Baqarah (2:278) – “O those who believe fear Allah and give up whatever remains of riba, if you are believers”

Every amount, regardless of magnitude, over and above principal is riba

We must understand the Qur’an as a book of guidance that directs us to the core of values; otherwise, Qur’an will be misinterpreted. For example, verse 41 in Surat Al-Baqarah (2:41) states “Do not sell My verses for a little price”. Does this imply that one can sell verses for a high price?
The expression “doubled” only meant to show how bad the practice of *riba*, and emphasize the added severity of the sin due to its excessiveness.

6. **Riba is Allowed under Dharura (Necessity)**

   **Argument**
   - Under *dharura* circumstances, the *haram* is permissible. If it is permissible to consume pork to save one’s life from dying of hunger, *riba* is allowed under *dharura* too.

   **Addressing this misconception**
   - First, there is a misunderstanding of *dharura*. *Dharura* is applied only to life-threatening circumstances. To identify *dharura* that necessitate *riba* the individual debtor must answer the following two questions with absolute sincerity: Is the purpose of the *riba*-based loan to protect an absolute necessity? Have all other permissible alternatives been exhausted?
   - At the institutional level, removal of *riba* from the economy does not imply that financial institutions will have to give charitable (interest-free) loans. The role of loan giving and taking in Islam must be well understood.
   - While giving a benevolent loan is highly commendable, the taking of a loan is discouraged and limited to cases of absolute necessity. Islam provides means of financial intermediation in the form of profit and loss sharing.

7. **Interest represents an opportunity cost which cannot be denied**

   **Argument**
   - Interest rate is just a compensation for the opportunity cost of the lender during the time of loan. According to this argument, the lender could use his money to consume goods or services or could benefit from investing this amount today. Therefore, the postponement of consumption or investment involves sacrifice and hence, the individual deserves compensation for giving up the satisfaction he would get from consumption today or the return he would get from investment.
Addressing this misconception

- The notion of interest as a reward for deferring consumption is rejected in Islam. Saving by itself should not be rewarded by an increase in capital. The ability to save is a reward by itself.
- There may be some alternative uses to the loaned fund but there is no guarantee that these uses would guarantee a return.
- Furthermore, as Muslims, we should not consider only the material aspects but also the non-material dimensions such as the rewards in the hereafter.

8. **Interest as a compensation for risk element**

**Argument**

- Lender faces different economic risks including the default of the borrower, unanticipated changes in economic circumstances such as rapidly rising inflation. Taking all these risks should be compensated.

**Addressing this misconception**

- It is always true that lenders may face different types of risks whether he lend his money or not.
- *Shari’a*-based contracts provide rules and regulations that protect both lenders and borrowers in ways other than charging interest.

9. **Interest is a reward for money as a commodity**

**Argument**

- The advent of interest-based lending has introduced a fourth function of money: “money as a commodity”
- It is argued that, just as a merchant can sell his commodity for a higher price than his cost, he can also sell his money for a higher price than its face value
- Similarly, just as a person can lease his property and can charge a rent against it, he can also lend his money and can claim interest on it
Addressing this misconception

- Islam rejects the notion that money is a commodity
- The prohibition of *riba* dictates that money should never be treated as a commodity
- There are differences between money and commodities
  - Money is not an objective in itself. Treating money as a commodity (trading in money) goes against the original wisdom behind its creation (medium of exchange).
  - Money has no intrinsic value, it, in itself, cannot be used for direct fulfillment of human needs.
  - Commodities can have different qualities while money is perfectly homogeneous.
  - In a commercial transaction, specific commodities are identified for exchange whereas money is generic.
- Treating money as commodity directs economic activities towards money out of money, and against providing real goods and services. In the contemporary world economic setting, most of the money that is transferred around the world in daily basis is for purely financial transactions, and has no link to transactions in the real economy.
- Another critical repercussion of the prevailing monetary system (which treats money as a commodity) is that the system, by design, promotes inflation

10. **Time Value of Money**

Argument

- Time value of money (time preference) is an important concept of modern conventional financial system. In simple terms, it means that money has a time value. Having money now is more valuable than having it at some future time. A rational person would prefer to have BD1000 today rather than having it later because the BD1000 today may not be same as BD1000 tomorrow.
Sacrificing present consumption for future consumption must be compensated.

**Addressing this misconception**

- Islam does not permit the reward for time but allows reward for efforts and risk-taking activity in business. Because money in Islam is just a medium of exchange, it cannot earn more money by itself without putting it into real productive actions such as sale, lease, investment.
- Time value of money is recognized by *Shari’a* but only on sales contracts not in debt contracts. There is a great distinction in *Shari’a* between investment and lending. Since time by itself, without any economic activity does not yield any return, it is actually the economic activity that is undertaken during the time, which creates the yield.
- Lending does not constitute, by itself, a productive economic activity. But, investment is an economic activity that needed to be compensated for any profit or loss received during the time.
- Investment is different from pure *riba*-based risk-free debt. A seller in a trade, whether on spot or deferred payment basis, is free to charge any price and the profit that accrues to him is legitimate (halal). There is a possibility that his “spot” price may be lower than his “deferred” price. Such price differential is obviously due to deferment and is recognized as the time value of money. Such time value of money is acceptable in the Islamic framework. What is not permissible is the time value of money in the context of debt.
- Nevertheless, when the buyer in a deferred-payment sale decides to defer his payment beyond the due date for payment, neither he nor the seller is allowed to increase the price. Price is now in the nature of debt and a debt cannot be replaced by a higher or lower debt. A higher debt replacing a lower debt results in *riba* on the old debt.
- *Shari’a* applies Islamic time value of money in such a way that exists in *mudharaba contacts* where *rabbul-mal* has the right to a share of the
venture’s profits because he has given up current consumption or the ability to invest the funds elsewhere (but at the same time rabbul-mal may suffer loss too).

THE RATIONALE BEHIND PROHIBITION OF RIBA (INTEREST)

✧ For Muslims, the prohibition of riba as evidenced in the Qur’an and Sunna should be sufficient. However we can attempt to articulate some rationale or reasons for its prohibition to better appreciate the wisdom behind the injunction.

✧ Although the responses to the misconceptions stated in the previous section constitute important rationales, some of the additional rationales for the prohibition of riba are provided as the following:

1. Riba is a cause of injustice and exploitation
   - Riba is considered a form of injustice and exploitation, which contradicts the core Islamic teachings of social justice.
   - It is unjust for lenders to guarantee return with no involvement in risk.
   - Because riba entails taking advantage of a man’s inferior economic position it breeds hatred, jealousy and ill-will towards the rich.
   - This behavior kills the spirit of cooperation in the society and discourages people from doing good to each other.

2. Riba leads to the creation of materialistic society
   - In Islam, incurring debt is discouraged. The Prophet (pbuh) refused to offer salat-ul janazah of a person who died indebted. Lending is a charitable act. Borrowing money should be limited to cases of dire needs.
   - On the other hand, permitting riba enables lending to become a viable business. Banks are motivated to lend as much as possible. They exploit man’s inherent greed to spend beyond their means by offering credit which will result in negative repercussions.
o Easy availability of credit cultivates a materialistic society. People have to work harder and harder for longer hours, and may exercise unethical business practices in order to repay bank debt. All this leads to less emphasis on the family, negative effect on social relations amongst the people which leads to social ills

o The banks in essence exercise “control” over people who become “enslaved” to the banks.

3. **Riba discourage productive work**

o Interest-based financing results more wealth collected by lenders without exerting much effort or contributing to productive activity.

o Money by itself is not part of capital in economic definition and hence, is not a productive resource.

o From an Islamic point of view, money should not be rewarded. Money functions as a medium of exchange or a store of value and cannot be utilized for fulfilling human needs directly. It can only be used for acquiring goods or services, which have a fundamental use.

o Managerial and entrepreneurial skills along with the productive use of money are the essential factors in converting it into capital. The lenders of the money have no input in the conversion process and thus, they do not deserve a reward. *Riba* encourages the creation of wealth with no effort from its provider at the cost of borrower. The value of work is reduced.

4. **Riba impedes healthy economic development**

o *Riba* generates negative effects on production since it is security oriented rather than growth oriented.

o Lending is confined to established businesses with known creditworthiness and adequate security (collateral) not profitability. Banks are not willing to experiment new and unproven methods of production, especially for small-scale enterprises and agriculture.
o Utility of certain projects is with reference to criteria other than profitability and benefit to society, like financing of luxurious or wasteful consumption and/or production
o Lenders preferred to finance large-scale businesses, which results in domination of big businesses over smaller entrepreneurs. This behavior will curtail competition and in turn will affect product variety.
o *Riba* discourages innovation since potential entrepreneurs without security to pledge are denied credit.

5. **Riba increases the disparities in income and wealth**

o The rich (who are most likely to be the lender) take advantage of the need of the poor (the borrower) for money by charging interest, which adds to the burden of the borrower. As a result, the rich becomes richer and the poor becomes poorer. Thus, *riba* increase wealth inequality among the members of the society.

o Lacking collateral and established economic standing, poorer segments of the economy are at an economic disadvantage when competing for credit to finance economic activities. As a result, wealth and income disparities increase among the society members, which generate envy and hatred among the society.

6. **Riba discourages partnership**

o A loan provides a fixed return to the lender regardless of the outcome of the borrower’s course of action. From an Islamic point of view, it is much fairer to share in the profits and the losses.

o The supplier of capital has the right to a return, but this return should be equivalent to the risk and effort involved in the project for which the finances are supplied. Therefore, *Shari’a* promotes profit and risk sharing.