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***Riba* in Islamic finance: Some fresh insights**

By Muhammad Akram KHAN [†]

Abstract. In present-day Islamic finance, all forms of interest are considered *riba*, which is prohibited in the Qur'an. However, this definition of *riba* creates several problems in everyday business transactions. The Islamic financial institutions are obliged to adopt such operational procedures that closely resemble interest, the while they claim to be operating on interest-free basis. The paper delves into the Qur'anic text relating to *riba* and suggests an alternative understanding which can help resolve various controversies relating to *riba* and interest. It attempts to formulate a contemporary definition of *riba* which accommodates the current practice of Islamic financial institutions.

Keywords. *Riba* in Qur'an, *Riba* and interest, Cash and credit prices, Time value of money, *Riba* and inflation, Definition of *riba*, Islamic financial institutions.

JEL. D64, E40, G21, Z12.



1. Introduction

The Qur'an prohibits dealings in *riba*, which, literally means 'an increase' but in common parlance refers to 'an increase to be paid by a debtor on principal sum of a loan'. *Riba* is commonly translated in English as 'interest' or 'usury'. However, as this paper would discuss in detail, the term '*riba*' has several dimensions. It is difficult to find one word that can translate it precisely. We have, therefore, chosen to retain the term '*riba*' as it is, without translating it.

2. The problem

The Qur'an forbids dealings in *riba* (Q. 30:39, 3:130, 2:275-280)¹. Historically, the Islamic law explained *riba* as an increment on a loan to be paid by a debtor besides the principal sum borrowed. However, with the advent of modern financial institutions during the last three centuries, the question of interest on bank finance came for discussion among Muslim scholars. The overwhelming response by the scholars was that all forms of interest are *riba* and illegal under the Islamic law². That created a sort of abhorrence among Muslims in dealing with interest-based financial institutions. In the wake of independence from colonial powers and the flood of oil money in the last quarter of 20th century, many Islamic financial Institutions (IFIs) came up with the aim of providing an alternative platform for financial dealings, avoiding interest in all its forms. Since 1975,

[†] House 138, D-Block, Valancia Town, 54770 Lahore, Pakistan.

 +0092-42-35210433  .makram1000@gmail.com

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when the first Islamic commercial bank (Dubai Islamic Bank) was established, these institutions have made significant progress in terms of geographical spread, branch numbers, capital invested, and assets managed. Besides banks, Islamic insurance companies (*Takaful* companies, included in the generic term IFIs) have also been established. The dominant view remains that all types of interest are *riba*. This is the main justification for establishing these institutions³.

In early days of Islamic banking, Muslim scholars propagated profit-loss sharing (PLS) or dual-*mudaraba* as alternatives for interest-based banking. However, soon the newly established IFI realized that these alternatives were not practicable. With the help of religious scholars, they commissioned other modes of finance such as mark-up (*murabaha*), leasing (*ijara*), sale on deferred delivery (*bai'salam*), sale on deferred payment (*bai'mu'ajjal*), manufacturing on deferred delivery (*istisna'*) and their various permutations. These modes ensure fixed returns to Islamic banks but are not considered *riba*. At present most of the IFIs deal in these new modes of finance in preference to PLS or dual-*mudaraba*.

A strict adherence to the above interpretation that equates all forms of interest with *riba* raises several questions:

(a) If all types of interest are *riba*, why religious scholars allow difference between cash and credit prices of the same products? The difference in these two prices is clearly interest, although it is included in the credit price. Implicitly, the religious scholars exclude this interest from the definition of *riba*.

(b) Getting cash for bills receivable before due date is a real-life business need. Financiers pay cash but deduct an amount as discount from the maturity value of the bill. The discount is nothing but interest on the cash provided. If we treat all types of interest as *riba*, how do we arrange discounting of bills receivables?

(c) If we disallow all types of interest on deposits, how do we protect the value of money when it is depleted by inflation? Similarly, how do we compensate creditor of an interest-free loan if principal sum depreciates by the time of repayment?

(d) How to protect the vulnerable segments of society like pensioners, widows and orphans who cannot do any business with their savings, if they have. How to ensure that they do not expend their principal sums (savings) and become destitute? Investment schemes such as mutual funds are not risk-free, and these segments of society cannot afford to take risk with their minimal savings.

(e) How to arrange finance for homeless people for buying a house? Schemes of rent-sharing practiced by IFIs are only bad ruses to conceal interest and are, in some cases, more expensive, more exploitative and riskier than interest-based finance.

(f) How to ensure that micro-finance required by the poor people comes without any cost? The present-day cost of microfinance can, in some cases, go up to 100 percent.

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(g) How to develop a capital market for inter-bank finance for short periods like a day or so, if interest is not allowed on such funds?

(h) Standard project appraisal techniques use benefit-cost analysis that uses interest rate for discounting cash flows. How to appraise projects if interest is prohibited?

(i) How to punish deliberate defaulters of utility bills, credit card users, and members of voluntary organizations etc., who default willfully on their obligations? The organizations that provide these facilities charge penal interest on outstanding payments after due dates. If we disallow this mechanism, how do we discipline the deliberate defaulters?

The IFI were unable to find satisfactory answers to the above or similar questions. They adopted various modes of finance prescribed by jurists. These modes of finance had strict conditions to be followed as safeguard against slipping into the domain of interest. Being unequal to implement these conditions, the IFIs have adopted various short-cuts. For appearing to be *riba*-free they devised many tricks and ruses (*hiyal*) which brought to them fixed returns without getting the blame for earning interest. We have tried to catalogue these tricks in our earlier publication (Khan, 2013, 337-401; also see Azhar, 2010, 310; Abedifar, 2019; Alshubaily, 2019). These tricks are so numerous that it is difficult to keep track, since new ones are being added almost daily⁴.

While many Islamic economists have protested on the practice of IFIs, and others are persuading IFIs to return to PLS, the IFIs are doing their daily business in a manner that suits them. At the end, the whole exercise of Islamic banking has become less than enviable.

The days when the religious scholars decided the Islamic position on interest in modern financial institutions, majority of them, under nationalist emotions, were against colonial powers and capitalist system. They saw commercial banks as institutions of exploitation in capitalism. The definition of *riba* was spelt before any real-life experience in Islamic finance in modern economic environment. Actual practice has brought out contradictions in the theory. It is time for taking a second look on the definition of *riba*. The present paper aims to do that. For this purpose, first we shall enumerate limitations of the prevalent definition of *riba* and then try to delve deeper into text of the Qur'an for a possible contemporary definition of *riba*.

3. Limitations of the prevalent definition of *Riba*

The prevalent definition that treats all forms of interest as *riba* has several limitations as stated below:

(a) The Qur'anic rationale (*hikma*) for the prohibition of *riba* is justice (Q. 2:279). However, the dominant view treats all interest as *riba* even though there is no injustice involved. For example, when a widow receives interest on her deposit from a bank, it is treated as *riba*, even though there is no injustice by any twist to the definition of

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justice. At the same time, it does not care if injustice takes place when a debt loses its real value in real terms due to inflation and the creditor receives back a lower real value of money as compared to the time when the loan was extended. Obviously, it is a situation of injustice to the creditor. But the definition does not consider such situations.

(b) The Qur'an relates *riba* with borrowing of a person who is financially hard-pressed. (Q.2:280). However, the dominant view treats all interest as *riba*, even though there is no hardship for the debtor. For example, when government of the USA sells a \$100 bond at interest, there is little likelihood that it will be financially hard-pressed to pay interest on the bond. However, the definition treats interest on such bonds as *riba*.

(c) The Qur'an mentions prohibition of *riba* in the context of charity (Q. 2:277, 30:39). It implies that the context of *riba* is lending to poor people who deserve charity. But the definition does not specify this factor. [Abedifar 2019]

(d) The Qur'anic reference (Q: 3:130) to doubling and re-doubling of the principal sum provides another justification for the prohibition of *riba*. The doubling and re-doubling of the principal sum could be due to either *inability of the debtor* or *willful avoidance to repay*. The prohibition of *riba* should apply to the former situation but not the latter. However, a blanket equation between interest and *riba* ignores this distinction.

(e) The definition does not cover relationship of *riba* and trade – situations where capital is required for *financing* of trade and where it is required *as debt*. The Qur'an says that these are two different contexts (Q. 2: 275). However, the definition does not distinguish between the two. When the IFIs faced practical difficulties, the religious scholars made room for them by commissioning concepts of markup on cost (*murabaha*), delayed payment (*mua'jjal*), delayed delivery (*salam*) and manufacturing with delayed delivery (*istisna'*). They immediately recalled that the definition should not apply to the above-mentioned contracts of sale. Despite this accommodation, they did not formally review the definition of *riba*.

(f) The definition does not cover situations where a debtor may earn profit by investing borrowed funds and is comfortable in paying interest. Interestingly, the definition also does not cover situations where the debtor suffers a loss. The idea of PLS is an add-on to the definition of *riba*. The definition does not say that the lender should share the loss, if any.

The above discussion suggests that we need to take a fresh look into the prevalent definition of *riba*. For this purpose, we should revert to text of the Qur'an dealing with *riba*. In the following discussion we shall undertake this task.

4. Understanding the Qur'anic verses on *Riba*

The Qur'an discusses the concept of *riba* at four places as follows:

(a) Verse Q. 4:161 refers to behavior of the Jews and does not deal with any injunction for Muslims. It is only a historical mention. We shall, therefore, not discuss it in this paper as it does not pertain to the subject under discussion.

(b) Verse Q. 30:39 is the earliest revelation in chronological order, revealed about 6 or 7 years before emigration of the Prophet (pbuh) to Medina. However, it does not deal with a situation where a debtor takes loan and pays interest on principal sum.

(c) Verse Q. 3: 130 is primary order for the prohibition of *riba*. It was revealed during or after the battle of Uhud in 3 A H.

(d) Verses Q. 2:275-280, where the Qur'an uses the word "prohibited (*haram*)" explicitly were revealed in the 10 A H, shortly before death of the Prophet (pbuh). The common perception that these verses are the primary order for the prohibition of *riba*, is not correct. These verses reply to an objection of the non-believers on the prohibition of *riba* and elaborate verse Q. 3:130. Similarly, the common perception that *riba* was prohibited shortly before death of the Prophet (pbuh) is also not well-founded. We shall discuss below these verses in detail.

4.1. Giving *riba* so that it increases wealth of other people

The Qur'an (Q. 30:39) says:

And whatever you give out as *riba* so that it might increase other people's wealth does not increase in the sight of God – whereas all that you give out as *zakah* (charity), seeking God's countenance [will be blessed by Him]. It is they (those who pay *zakah*) (whose wealth) will increase manifold.

For understanding this verse, we need to keep following points in view:

(a) Other verses on *riba*, use the verbal form for eating, gorging, or devouring ('*akla ya'kulu'*) of *riba* except the above verse which uses the verbal form for giving or offering (*ata' ya'ti*). It means the condemnation here is not for eating or gorging of *riba* but for giving or offering *riba*. What could be the nature of transaction where *riba* was given and not taken?

(b) In this verse, giving of *riba* is mentioned in a context where the giver aims to increase wealth of others. Generally, no debtor *aims* to increase wealth of the creditor by paying *riba*. It is an unavoidable payment and cannot have the good intention of enriching others. What could be the situation where a person giving *riba* also *intends* to enrich the other person?

(c) Giving of *riba* is stated here as an act for seeking the pleasure of God, about which He says that this perception is not well-founded. What could be a situation where a person seeks God's pleasure by paying *riba*?

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(d) The verse indicates *zakah* as an alternative for giving of *riba*. What could be a situation where giving of *riba* can be replaced by paying of *zakah*?

Azhar (2010, 291) has discussed this verse at length and has provided a unique explanation which answers the above questions. The following explanation is based on inspiration from Azhar's explanation. He thinks that the situation discussed in the verse, most probably, was as follows.

The poor in the then Makkah used to deposit their savings with the rich for safe custody. The rich would use these funds in trade and earn profit. While returning the principal sums to the depositors, the rich would give something extra (*riba*) believing that they are doing a charitable act and helping the poor, as it increases the wealth of the latter. On this act of avowed 'righteousness', they expected some reward from God. In this background, God has clarified that the extra sum that the rich pay to the poor (i.e. *riba*), thinking that it is a righteous act, is not actually so. They had already benefitted from these funds and whatever increase (*riba*) they gave was not charity. It was part of the profit they had earned from funds of the poor. If they wanted to perform a righteous deed they should give something to the poor as charity (*sadaqah*) without getting a reciprocal benefit from them. The charity should not be conditional on deposit of the poor. It should be selfless, altruistic and with the intention of getting a reward from God. There should not be any intention of getting a benefit from the poor people's funds. If they neglected this consideration, it would not be charity.

This is the only verse, where debtors have been criticized by the Qur'an for giving something as *riba*. At all other places, the Qur'an criticizes creditors for getting benefit from debtors in the form of *riba*. This verse seems to be a precursor of modern finance where the banks get benefit from poor people's money and give interest as portion of the profit earned with that money. In this case also, the banks do not deserve a reward from God. They do something as a matter of business. For helping the poor, they should assist the poor without any *quid pro quo*.

4.2. Doubling and re-doubling of loan due to *riba*

The Qur'an (Q. 3:130) says:

O you who have attained to faith! Do not gorge yourselves on *riba*, doubling and redoubling it, but remain conscious of God, so that you might attain to a happy state.

In this verse the key phrase is 'doubling and re-doubling'. What are the exact meanings of this phrase? It has been a source of debate, confusion and ambiguity among Muslim scholars. Should we say that interest on loan is permissible if the amount to be repaid by the debtor is not a multiple of the principal sum? Is that the Qur'an prohibits only compound interest and not simple interest? Is that only an excessive rate of interest is prohibited but not the market rate of interest, usually charged by banks and financial institutions?

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The verse obviously refers to a situation where a person borrows a sum on interest and keeps paying interest, yet his principal is never repaid fully and even residuals of interest payments keep accumulating. This is a situation of grave injustice and illustrates exploitative nature of interest-based loans. The term 'doubling and re-doubling' points to this type of situation. The situation of doubling and re-doubling can emerge even when the rate of interest is low if it is for a long period. It means, whatever the rate of interest, it can lead to 'doubling and re-doubling' situation. Based on this understanding, the prevalent definition of the term '*riba*' is that all increments on principal sum are *riba*, whatever the rate, because they have the potential of leading to a situation of 'doubling and redoubling.'

This simple situation gets blurred when we notice that in some cases interest-free loans can become a source of injustice for creditor if repayment is delayed voluntarily for a long time. The point became obvious to me when a friend of mine approached me with a question that he lent a sum of Rs 200 in 1952 to a friend (obviously on interest-free basis). The friend never repaid the loan. In 1992, forty years after the loan, he suddenly appeared said that he was approaching last days of life. He came with Rs 200 to repay his debt. The creditor asked me: The Qur'an says that 'you are entitled to your principal sum' (Q. 2: 279). But is this the sum that I lent him 40 years ago? His obvious reference was to the purchasing power of money that had gone down by over 100 times during these 40 years. Now getting back the same amount in nominal terms is an obvious injustice to the creditor. What is the Qur'anic position on such situations?

My understanding is that the creditor is entitled to the real value of money that he lent. The Qur'an itself explained it in Q. 2:279 when it allowed the creditors to get back their principal sums. The principal sum, in this case, must be value of the money in terms of its purchasing power. For this purpose, the principal sum should be adjusted for inflation during the period. In the above case, if for example the prices have gone up 100 times, the value to be repaid would be Rs 20,000 and not Rs 200. The sum of Rs 20,000 is several multiples of the principal and attracts the warning against 'doubling and re-doubling'. Yet, it would be allowed since the creditor is getting only the sum lent and no increment over it in real terms. In brief, if the rate of interest is equal or less than the rate of inflation during the period of the loan, the increment would not be prohibited under the law of 'doubling and re-doubling'.

4.3. Qur'anic explanation of the term '*riba*'.

The verses of the Qur'an (Q. 2: 275-80) say:

Those who gorge themselves on *riba* behave but as he might behave whom Satan has confounded with his touch; for they say, 'Trade is like *riba* – the while God has made trade lawful and *riba* unlawful. Hence, whoever becomes aware of the Sustainer's admonition, and thereupon desists [from *riba*], may keep his past gains, and it will be for God to judge him; but as for those who return to it – they are destined for the fire, therein to abide. God

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deprives *riba* of all blessings whereas He blesses charities (*sadaqaat*) with manifold increase. And God does not love anyone who is stubbornly ingrate and persists in sinful ways. Verily, those who have attained to faith and do good works, and are constant in prayer, and pay *zakah* – they shall have their reward with their Sustainer, and no fear need they have, and neither shall they grieve. O you who have attained to faith! Remain conscious of God, and give up all outstanding *riba*, if you are [truly] believers; for if you do it not, then know that you are at war with God and His Apostle. But if you repent, then you shall be entitled to your principal: you will do no wrong, and neither will you be wronged. If, however, [the debtor] is in straitened circumstances, [grant him] a delay until a time of ease; and it would be for your own good – if you but knew it – to remit [the debt entirely] by way of charity.

4.4. Meaning of “one who has been confounded by touch of Satan”

Those who gorge themselves on *riba* behave but as he might behave whom Satan has confounded with his touch... (2:275)

The verse means that those who gorge *riba* are confused people. They do not distinguish between *social responsibility* of caring for others and *greed* for accumulating wealth. They exploit their fellow-men, an evil state, where the Satan has led them by his inspiration (touch). Their confusion is evident from the statement: “Trade is like *riba*”. They are unable to distinguish between the two.

4.5. Meaning of the statement: “Trade is like *riba*.”

The Qur’an illustrates confusion of the non-believers when they say: ‘Trade is like *riba*; (why then God has forbidden *riba*)?’ The Qur’an does not give a direct reply to this statement. However, it becomes obvious from the way the Qur’an deals with it, as explained below:

The non-believers did not say ‘*Riba* is like trade’. Instead, they said: ‘Trade is like *riba*’. It means they made *riba* as the primary legitimate activity and considered trade like that. Most of the Islamic scholars, while explaining this verse, made trade as the primary legitimate activity and mentioned its distinguishing features as compared to an interest-bearing loan. For example, they mentioned that trade involves profit as well as loss, while interest-based loans do not involve any risk of loss. This was an unnecessary discussion. The point to be explained was: in what sense the non-believers thought that trade is like *riba*. The religious scholar got into the discussion of main features of trade but still did not explain in what sense the non-believers thought the trade was like *riba*.

The main point of the non-believers was a similarity between interest-bearing cash loans and trade credit. How did they consider the two as similar? Their argument was as follows:

Riba involves providing *money on credit* and getting a return on that. Trade consists of providing *goods on credit* and getting a return (over and

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above the cash price) on that. What is the difference, they wondered? It is only substituting *money* for *goods*.

They did not see any difference in the two activities. For understanding the above verse, we need to imagine the state of premodern economy. It was *similar, stable* and *static* in all parts of the world. Harari (2014, 2011, 345) gives a graphic description of the premodern economy. Because of lack of trust in future that the money will grow, the practice of credit as a mode of financing business was rare. Wherever it was practiced, the amounts were *small*, the periods were *short*, and interest rates were *high*. It did not make much business sense, therefore, to finance business through borrowed funds. The most prevalent forms of participation in others' business were *commenda (qirad)* and partnership (*shirka*) (Koehler, 2014). The most common method of credit in trade was sale on deferred payment basis at a price higher than the cash price. The Qur'an did not prohibit this activity. On this the non-believers raised an objection: why do you allow increase in price of goods sold on credit as legitimate, the while you treat increase in the principal sum of a cash loan as *riba* and illegitimate? The Qur'anic reply can be interpreted as follows:

It is evident from verse Q. 2:280 that *riba*-based loan transactions took place between wealthy money lenders and poor borrowers. The Qur'an says that if the borrower is hard-pressed, give respite and forgiveness is even better. It means the practice of 'providing money on credit and getting a return' (*riba*) was for personal loans to the poor. It was a social activity. Compared to that, 'providing goods on credit and getting a return (over and above the cash sale price)' was a commercial activity. The two could not be compared. God made lawful increase in the credit sale price of goods, being a commercial activity, and prohibited increase on cash loans to poor people, being a social activity. The latter were personal loans, mostly obtained by the poor and needy from the wealthy. Interest on these loans was prohibited and termed '*riba*'. Sale of goods on credit at a price higher than the cash price was a commercial activity and interest included in the sale price was made lawful. From among Muslim scholars, Kahf (2014) has also made a similar argument.

In brief, the prohibition of *riba* is related to either *context* of a loan or *state of borrower*. In social context, when a person gets loan from members of family or friends for meeting personal needs, an increase on principal sum of the loan is *riba* and prohibited. This is treated as against norms of civilized social behavior. If the debtor is poor, it is even inhuman and cruel⁵ and a means for increasing poverty⁶. In business context, however, the two parties deal for mutual gain. Sale of goods or services on credit is one form of debt. But in business context, there could be other forms as well. For example, one party may require loan for working capital needs. In that case also, increase in the principal sum will not be *riba*. This is, strictly speaking, a type of debt arisen from financing of business needs. The transaction is potentially a mechanism to *create, enhance, or maintain* earning ability of one party by the other. By any definition of business operations, this transaction

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is a trading activity and covered by the Qur'anic permission of increase in context of trade through loans or debts. In brief, the Qur'anic permission of trade covers all types of financing transactions by financial institutions. It does not require any further legal support. It is already covered by the Qur'anic permission of trade.

Incidentally, the above explanation takes care of a long-standing controversy in Islamic finance about legal status of differential in cash and credit prices. In this verse, God has categorically allowed trade which in this context is 'credit sale'. Credit sale has always been in vogue in human history and in most cases prices of goods and services sold on credit are higher than cash prices. By implication, this verse permits the differential between cash and credit prices.

The above explanation also settles the question about time value of money. By allowing credit trade, where prices are usually higher than cash prices, God has recognized time value of money. That also simplifies the question relating to project appraisal in this age which uses the methodology of discounted cash flows⁷.

The questions relating to permissibility or otherwise of trade bill discounting, sale and purchase of bonds and other negotiable instruments in the Islamic framework are also answered. The trade bills or accounts receivables are financial assets, which arise through business transactions and not through loan transactions. Because of their commercial origin, their sale and purchase at going market price or discounted price at a certain rate of interest is like sale and purchase of other business assets. Interest rate only simplifies determination of market price. It means, the prevalent practices of bill discounting and floatation of bonds at certain rates of interest and their discounting, etc. should be permissible in the Islamic framework.

4.6. Do no wrong and you will not be wronged (Q. 2: 279)

The situation where a creditor can inflict wrong on poor debtor is obvious and needs no explanation. However, the question arises: how can a debtor commit wrong to a creditor? The following discussion tries to answer this question.

A borrower can cause loss to a creditor in following ways:

- (a) Non-repayment of loan or funds in full
- (b) Delay in repayment of loan
- (c) On long-term loans, the principal sum is not indexed to inflation that has taken place and returning only the principal sum in nominal terms
- (d) For commodity loans, returning the commodity of lower quality or of lower value in market terms than the one borrowed

The Qur'an prohibits all such behaviors and insists that the creditor should also not be wronged.

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4.7. *Riba* and war against God and His Apostle

Ahmad (2013, 139) has touched upon the question whether the Qur'anic threat of war against God and His Apostle (Q. 2: 279) falls within the category of criminal law of Islam. His conclusion is that the verse does not unambiguously declare a criminal law against those who indulge in *riba*. Accordingly, neither the Prophet (pbuh) nor the first four caliphs issued a legal injunction against those who indulged in *riba* as criminals who took up arms against the state.

Ahmed (2013, 140) thinks that the Caliph Umar forced the Christians of Najran (Yemen) to migrate to Iraq because they were involved in *riba*-taking. However, he does not give any evidence for that because this could be Umar's political decision. Moreover, even Iraq was part of the Islamic state, how could this be treated as a means of exile for *riba*-taking? Besides, there is no other example of any punishment by any Islamic state throughout history where *riba*-taking was treated as a legal offence.

The Qur'anic expression of "*biharbin min Allah wa Rasulihi*" (2:279) is also mentioned in Q. 5:33 with slight verbal variation for those who spread corruption. We reproduce the two verses as follows:

"O you who have attained to faith! Remain conscious of God, and give up all outstanding gains from *riba*, if you are [truly] believers; for if you do it not, then know *that you are at war with God and His Apostle*. But if you repent, then you shall be entitled to the return] of your principal: you will do no wrong, and neither will you be wronged. [Q. 2:278-79].

"It is but a just recompense for those *who make war on God and His apostle*, and endeavor to spread corruption on earth, that they are being slain in great numbers, or crucified in great numbers, or have, in result of their perverseness, their hands and feet cut off in great numbers or are being [entirely] banished from the face of earth: such is their ignominy in this world. But in the life to come [yet more] awesome suffering awaits them. [Q. 5:33].

Asad (1980) explains Q. 5:33 as follows:

"The term 'apostle' is evidently generic in this context. By "making war on God and His apostle" is meant a hostile opposition to, and willful disregard of, the ethical precepts ordained by God, and explained by all His apostles, combined with conscious endeavor to destroy or undermine other people's belief in God as well." [Note 43 on Q. 5:33]

From the above explanation it is evident that the expression 'war against God and His Apostle' refers to willful disregard of the ethical precepts ordained by God. In Q. 2: 279, the ethical precepts under discussion pertain to charging of *riba* from debtors. *It means if the believers continue dealing in riba, they would be guilty of willful disregard of God's ordinance*. It does not mean that they are guilty of treason as some scholars of the present age have tried to infer from this verse. Fallacy of their inference is also evident from the fact that throughout Muslim history never taking of *riba* was

treated as an act of treason and never people indulging in *riba* were given a sentence for treason.

5. Towards a contemporary definition of *Riba*

The above discussion on the limitations and problems in the prevalent definition of *riba* takes us to a stage where we can attempt to rethink and reinterpret the term '*riba*' suitable for the present age. Need for such a redefinition has been felt by some scholars earlier also. For example, Asad (1980, note 35 on Q. 30:39) says:

...we realize that the question as to what kinds of financial transactions fall within the category of *riba* is, in the last resort, a moral one, closely connected with the socio-economic motivations underlying the mutual relationship of borrower and lender...Hence, while the Qur'anic prohibition of *riba* is unequivocal and final, every successive generation is faced with the challenge of giving new dimensions and a fresh economic meaning to this term...

Interestingly, Uthmani (1999, 34), as Shari'ah Court Judge in Pakistan while announcing decision on a petition about prohibition of *riba*, has mentioned in his judgment that Khalid Ishaq, a leading contemporary jurist of Pakistan, held a similar view about the definition of *riba*. He (Khalid Ishaq) thought that *riba* should be defined in each age according to parameters of injustice prevalent in the society. Uthmani quotes Khalid Ishaq: "The deliberate omission of a rigid definition would propel Muslims to come up with their own guiding and evolving principles of identifying injustice (*zulm*) in space-time situations. Economic conditions are not static and nor are human situations."

Encouraged by such opinions and compelled by our above analysis we attempt to present below a new definition of *riba* suitable for the present age.

Riba is an increment on principal sum of a loan (a) given to a poor person deserving *zakah*⁸ or (b) a loan given in a social context to relatives or friends⁹ or (c) when it is a penalty compounded over time for non-compliance with contractual obligations¹⁰.

5.1. Explanation of the above definition

The above definition restricts *riba* to only three situations:

(a) Interest on loans given to such poor people who otherwise would deserve assistance from *zakah* funds. The reason for prohibition of interest on such loans is gross inhumanity, bordering cruelty.

(b) Interest on loans given in a social context. 'Social context' means loans given to friends, relatives, neighbors, colleagues or other socially acquainted persons. The reason for prohibition of interest on such loans is to ensure solidarity and cohesion among members of a community or society.

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(c) On compounding of interest as a penalty such as on default of commercial loans, utility bills or credits cards as it attracts the Qur'anic prohibition of 'doubling and re-doubling'. The reason for this prohibition, again, is injustice, inhumanity and cruelty.

5.2. When interest is not *riba*?

Interest on loans would not be *riba* in following cases:

- I. *Riba* is an increase in principal sum of a loan or debt¹¹ except when:
 - a) in a sale transaction, such an increase is due to differential in cash and credit prices;
 - b) it is a one-time penalty for delaying payment for a financial obligation;
 - c) the creditor had provided the loan for *maintaining, enhancing* or *creating* earning ability of the debtor;
 - d) a financial institution pays interest on deposits¹²
 - e) increase in the principal sum is less or equal to the rate of inflation during the period the loan was outstanding;
 - f) a debtor repays more than the principal sum voluntarily as a gesture of goodwill or expression of gratitude or as gift¹³.
 - g) interest is used as a discounting tool for project evaluation and capital budgeting.
- II. *Riba* is a reduction in the principal sum of a loan or debt except when:
 - a) a creditor voluntarily accepts a reduction in a financial claim as compensation for payment by debtor on a financial obligation before due date (cash discount);
 - b) it is a reduction in face value of a financial paper as compensation for its encashment before due date (discounting of financial papers);
 - c) reduction in the principal is equal or less than the rate of deflation during the period the loan was outstanding;
 - d) a creditor reduces the principal sum of loan as a gesture of goodwill or expression of forgiveness.
- III. In case of commodity or foreign exchange loans any increase on the quantity of the commodity or nominal value of the foreign exchange will be *riba* except when:
 - a) quality of the commodity presented for repayment of the loan is lower/higher than the commodity borrowed, and the debtor and creditor agree to increase/decrease the quantity of the commodity to compensate for variation in quality;
 - b) market price of commodity or foreign exchange has varied during the period the loan was outstanding and debtor and creditor agree on a neutral benchmark for valuation of the principal to be settled by the debtor.

The neutral benchmark for determining value of the principal could be any of the following:

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- a) Any one or combination of price indices for consumer/wholesale prices of commodities, precious metals like gold or silver;
- b) Foreign exchange rate determined by international foreign exchange market;
- c) Average value of a basket of currencies;
- d) Any other benchmark mutually agreed

The central bank of the country can also play a role in regulating values of commodities and foreign exchange for settling debts and loans.

6. Concluding remarks

The Qur'an prohibits *riba*, which is an increase on principal sum of a loan. The prevalent opinion is that all forms of interest on loans are *riba* and hence prohibited. This one-line definition of *riba* has several limitations. The paper argues for rethinking on the subject. It presents fresh interpretation of the Qur'anic text dealing with *riba*. That takes the paper to next level of discussion where it attempts to redefine the concept of *riba* as a first-degree draft for consideration of scholars and for further refinement.

The IFIs have developed during the last four decades at a rapid pace. It is a good omen for Muslims. The definition of *riba* presented in this paper distills the actual practice of the IFIs. They are already practicing what has been presented in this definition. Similarly, most of the practice of conventional financial institutions is also *riba*-free according to the definition presented in this paper. Only a small segment of total business both in IFIs and conventional banks would need some reform to bring it into the fold of *riba*-free business.

An implication of the above definition is to recognize need for fresh appraisal of the business of conventional financial institutions for identifying those transactions which contain an element of *riba*. It would help bring the two types of banking closer to each other. The slogan of IFIs that they are in a *halal* (permissible) business while conventional banks are doing a *haram* (prohibited) business may be a good marketing gimmick but has weak intellectual foundations.

The IFIs should remain in business and grow as they are already doing. They should compete with conventional banks not on being in *halal* or *haram* business but on grounds of efficiency, profitability, customer services and other management practices. They should present themselves as an alternative method of financing business and not on basis of *Shari'ah* support.

The above discussion does not condone the negative aspects in the practice of conventional banking. An extensive body of scholarly literature highlights role of conventional financial institutions in fanning fires of financial instability every few years. There is a need to manage and control that. But that subject does not concern us in this paper.

Notes

- ¹ References to the Qur'anic verses in this paper start with 'Q.' followed by chapter number before colon and verse number after the colon. For example: Q. 30:39 means: Chapter 30 and verse 39 of the Qur'an.
- ² For a summary of the debate on the subject see: Ahmad & d Kabir (2007). Also See Razi (2014, 10).
- ³ There are exceptions, though. A recent one is by Suharto (2018).
- ⁴ Khan (1929) describes that the jurists of *Hanafite* and *Shafi'ite* schools legalized tricks in social and business dealings, particularly, in matter of *riba*, to evade strict conditions of the law, when they could not follow them. They did not show the acumen or originality for reviewing interpretations of the laws (which were a human effort). However, the Malikiite jurists were opposed to these tricks. The contemporary jurists take comfort from the relaxation given by early Hanafite and Shafi'ite jurists and allow various tricks without any qualm of conscience.
- ⁵ Because of the inhuman nature of *riba*, all religions prohibited it. Razi (2014, 5) quotes Jewish and Christian sources to illustrate this point.
- ⁶ For an exhaustive and persuasive elucidation of this point, see (Abbasi, 2016; Abedifar, 2019).
- ⁷ For an elaborate discussion see, Ahmad & Hassan (2006).
- ⁸ This based on Q. 2:277, Q. 2:280.
- ⁹ This is based on the general instructions about kindness and benevolence toward members of family and friends. For example: Q. 2:83, 2:177, 2:195, 4:36, 16:90, 24:22, 28:77, etc.
- ¹⁰ This is based on Q. 3:130.
- ¹¹ Islamic jurisprudence distinguishes between debt (*dayn*) and loan (*qard*). The debt is created by a contract, expenditure or sale and has a definite term fixed for repayment as distinguished from loan (*al-qar.,d*), which is created by lending cash and does not have a fixed term for maturity.
- ¹² This is exactly in line with the spirit of prohibition of *riba*, which aims at protecting and empowering the weaker sections of the society. Also, it is in consonance with justice. When wealthy people get finance from bank for enhancing their earning ability, they are using money of depositors. It is only fair that the depositors get something in return for providing this money.
- ¹³ It is based on the following *hadith*: Abu Rafi' reported that Allah's Messenger (pbuh) took from a person a loan of a young camel (below six years). Then the camels of *sadaqa* were brought to him. He ordered Abu Rafi' to return to that person the young camel (as a return of the loan). Abu Rafi' came back and said: I do not find but better camels above the age of six. He (the Messenger of Allah (pbuh)) said: Give that to him for the best of men are those who are best in paying off the debt. [Muslim, Abu al-Husayn bin al- Hajjaj. *al-Jami al-Sahih*. Beirut. Kitab al-Muzara'h. 142].

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