

## UNDERSTANDING RIBA: A NEW APPROACH

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### Abstract

*Islamic banking has grown immensely during the last decade. As more and more banks are showing up, more and more people are getting critical on the nature of Islamic banking. Within the foundations of Islamic economics, lot of confusion still persists as diverse views come up from different schools of thought. Similarly there is a need to revisit the basic concept of Riba specially on the perspective of deferred sales transaction and to analyse in the light of shariah both in letter as well as in spirit and to come up with the precise definition of the concept, that not only satisfies all objectives of the shariah and its conditions so as to help develop financial products that could be Islamic in true spirit.*

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Of all the sins, Riba is one of the greatest sins after Kufr. Allah and the Prophet (s.a.w.) have explicitly waged war against those who are engaged in this evil. However at the same time it is now considered as a necessity in western as well as majority of Muslim countries since there financial system is built on this very evil. Those who refrain from this cannot compete as fast as those who are engaged in this. As a result, Islamic financial system still lacks a proper theoretical groundwork that is robust to modern economic challenges. This has not only caused a large number of people to suffer and to pay a cost of being Muslim but also huge sum of wealth is left unutilized instead of being invested in real sectors. It is because of this sheer need that lead to the establishment of Islamic banking industry. Islamic banks and financial institutions are comparatively a new phenomenon, and lack theoretical groundwork. Every financial product in existence as of today has come through major economic refinement over the years. These are end result of development of economic theories that is why it suits there economic framework. With regards to Islamic products, no such efforts are being made in their development, as to what the true concept is behind and why Riba is being prohibited. On the contrary these products are based on the western theological framework as their counterparts, with following implications: Firstly these products could satisfy shariah's conditions but not its objectives because Islamic perspective to achieve economic objectives is different from conventional theories. And secondly the very nature of Islamic products is viewed critically and their genuineness is disputed. There is a dire need to develop a unified theory of Islamic financial systems and institutions that could be applied in the development of Islamic financial products. This paper is an early attempt to clarify some of the basic concepts of Riba with the perspective of sales that could serve as a small contribution towards the development of a unified Islamic economic framework.

### **Defining Riba**

The word "Riba" in Arabic means excess, increase or addition to a thing<sup>1</sup>. One can find many definitions given by many people in the context of Shariah, Some of them are given below.

- This excess originates either in the thing itself, or an increase in an exchange or sale of money as the sale of one dirham for two dirham, or of commodities as in cases of barter of a measure for more of the same merchandise<sup>2</sup>
- Riba is excess whether it is in the commodity itself or in money (Ibn Hajar al Asqalani)<sup>3</sup>
- Riba is every excess in return of which no reward is paid (Abu Bakr Ibn al Arabi)<sup>4</sup>
- Riba is a predetermined excess or surplus over and above the loan received by the creditor conditionally in relation to a specified period (Abu al A'la Mawdudi)<sup>5</sup>

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<sup>1</sup> Abd. Al Mun'im Mahmud al Qusi. "Riba, Islamic law and Interest," a Ph.D. dissertation, Temple University, 1982, p.121

<sup>2</sup> Ibid. pp.121-122

<sup>3</sup> Quoted by Afzal ur Rahman, "Economic Doctrine of Islam." Islamic Publication Ltd. Lahore, 3<sup>rd</sup> Ed., 1986, Vol 3, p.69.

<sup>4</sup> Ibid.

- Riba is that increase in one's material wealth or possessions, which one unjustly gets, during any transaction, by usurping what rightly should belong to others<sup>6</sup>.
- Unjustified increase of capital, of which no compensation is given.<sup>7</sup>
- As narrated by Saeed (1995)<sup>8</sup>  
*"Islamic Jurists divided riba into riba al fadl and riba al nasiah. Riba al fadl involves excess in hand to hand transaction. There is an excess in one of the countervalues belonging to the same genus and they are both weighable or measurable (Hanafi); either both are currency or both storable nourishment (Maliki); either both are currency or food stuffs (Shafis); and either both are currency or both are measurable or weighable (Hanbali)<sup>9</sup> Riba al nasiah occurs when, in a sale transaction involving counter values susceptible of Riba, delivery of one counter-value is deferred. The counter value should be either of same genus of both weighable or measurable (Hanafi); storable human nourishment or currency (Maliki); both food stuff or currency (Shafis), either both measurable or weighable or both currency (Hanbali)<sup>10</sup>"*

Riba in shariah stems from some practices with regards to lending as the practice of Usury was rampant at that time, which is interest according to Christian belief. Usury defined as charging a fee for the use of money<sup>11</sup>. It covers the following situation in a lending transaction<sup>12</sup>

- any excess amount in exchange of a loan at an agreed rate
- additional amount over the principal in a contract of loan or debt
- Predetermined payment over and above the actual amount of principal.
- Every loan that draws profit

### **Riba as people understood at the Prophet (s.a.w.) time**

The *riba* which was known to and practiced by the Arabs was that they used to advance loan in the form of Dirham (silver coin) or Dinar (gold coin) for a certain term with an agreed increase on the amount of the principal advanced.

Riba *An-Nasiah*, it was a transaction well-known and recognized in the days of Jahiliyyah i.e. they used to give money with a condition that they will charge a particular amount

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<sup>5</sup> Abu al A'la al Mawdudi, "Interest," Vol.1, p.33; Afzal ur Rahman, Ibid. p. 71.

<sup>6</sup> See Iqbal (2002)

<sup>7</sup> Chapra, M. U., 1984. The Nature of Riba in Islam, Hamdard Islamicus Vol. 7, No. 1, p.1

<sup>8</sup> Saeed Abdullah, 1995. 'The Moral Context of the Prohibition of Riba in Islam Revisited'. American Journal of Islamic Social Sciences, Vol.12(4):pp.496-517.

<sup>9</sup> Al Jaziri, Kitab al Fiqh, 2:250 ff; Saleh, Unlawful Gain, pp.19-26

<sup>10</sup> Saleh, Nabil A., "Unlawful Gain and Legitimate Profit in Islamic Law." pp. 19-26 2nd. Edition Graham & Trotman: London [Dordrecht] Boston.

<sup>11</sup> The American Heritage Dictionary of the English Language, Fourth Edition by Houghton Mifflin Company. First published in 2000 Updated in 2009.

<sup>12</sup> Wayne A.M. Visser and Alastair McIntosh. 1998. "A Short Review of the Historical Critique of Usury." Accounting, Business & Financial History Vol 8(2):pp.175-189 London: Routledge

monthly and the principal will remain due as it is. Then on the maturity date they demanded the debtor to pay the principal. If he could not pay, they would increase the term and the payable amount. As expressed by Ibn Zayd, on the authority of his father<sup>13</sup>, it clearly shows that the claim of an increased amount over the principal had different forms in the days of Jahiliyyah. Firstly, while advancing a loan the creditor used to claim an increased amount over the principal and would advance loan on this clearly stipulated condition.

Secondly, the creditor used to charge a monthly return from the debtor while the principal amount would remain intact up to the day of maturity.

The same explanation has been given by al-Suyuti on the authority of Faryabi in the following words: "They used to purchase a commodity on the basis of deferred payment, then on the date of maturity the sellers used to increase the due amount and increase the time of payment." It was these practises that led to its prohibition by Quran.

Riba has being mentioned in Quran in Various Suras and verses. They can be conveniently divided into following statements about *riba*.

1. *Riba* is a type of increase in a loan. (Surah Aal e Imran, verse 130)
2. *Riba* often involved doubling and redoubling of the debt. (Surah Aal e Imran, verse 130)
3. Charity is an alternative or an opposite to *riba*. (Surah al Rum, verse 39)
4. *Riba* is not like sale. (Surah al Baqarah, verse (275-278))
5. *Riba* leads to destruction and *sadaqah* to growth. (Surah al Rum verse 39)
6. Dealing in *riba* is gaining through the wealth of other people. (Surah al Rum verse 39)
7. Taking *riba* is a very serious sin. (Surah al Baqarah, verse (275-278))

Riba is Further Explained in Hadith in following Words "Every loan that derives a benefit (to the creditor) is *riba*." This Hadith is reported by Hadith ibn Abi Usamah in his Musnad.

But after the revelations of the *riba* verses in Quran, the Holy Prophet, (s.a.w.), prohibited some other transactions as well, which were not known previously as *Riba*. The Holy Prophet (s.a.w.), felt that, given the commercial atmosphere at that time, certain barter transactions might lead the people to indulge in *Riba*. The Arabs used certain commodities like wheat, barley and dates etc. as a medium of exchange to purchase other things. The Holy Prophet (s.a.w.), treated these commodities as a medium of exchange like money

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<sup>13</sup> Al Tabari, Jami, Ch. 4, p.59.

Hence Riba can be divided into two categories

1. Riba in Debt (usury), which is also explained in Quran
2. Riba in Exchange Transaction- this is known as Riba Al Fadl and is the main focus of this study.

Riba Al Fadl actually means that excess which is taken in exchange of specific homogenous commodities and encountered in their hand-to-hand purchase and sale.

The Arabs used certain commodities like wheat, barley, dates etc., as a medium of exchange to purchase other things. The Holy Prophet, SAW, treating these commodities as a medium of exchange like money. The Holy Prophet, (s.a.w.) has termed the following transactions as riba.<sup>14</sup>

- A transaction of money for money of the same denomination where the quantity on both sides is not equal, either in a spot transaction or in a transaction based on deferred payment.
- A barter transaction between two weighable or measurable commodities of the same kind, where the quantity on both sides is not equal, or where the delivery from any one side is deferred.
- A barter transaction between two different weighable or measurable commodities where delivery from one side is deferred.

It was Riba Al Fadl which Umer R.A has mentioned in his words, wishing if Prophet (s.a.w.) had given some more clarification on three topics, it was this that lead to misconception that prophet didn't explain Riba fully. In the Prophet's (s.a.w.) time, there was an economic system, very much similar to ours<sup>15</sup>.

To summarize various Hadith, following themes can be inferred.

Theme 1 - "No *riba* in spot transactions" or No *riba* except in deferment/credit

Theme 2 - In case of loans, no excess is to be accepted by the lender

Theme 3 - Barter/Trade except spot transactions or alike (in quality or quantity) of certain commodities is prohibited

### **Riba in deferred sales: Analysis of Money**

The Prophet (s.a.w.) prohibited the deferred sales on six commodities namely wheat, rice, dates, barley, gold, silver as mentioned by the Prophet (s.a.w.) in Hadith on which only spot sales are permitted. One can infer that whatever is not prohibited is allowed, we can

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<sup>14</sup> Ahmad, Ziauddin.,1978 "The Theory of Riba" Islamic Studies Vol. 17, No. 4, pp. 171-85; and Mawdudi, Sayyid A.A., 1977 Interest (Sood) Islamic Publications, Lahore (Pakistan).

<sup>15</sup> See Appendix 1 at the end of this article

use any other commodity apart from the above six in deferred payment. On this subject, almost all the religious scholars agree that spot transactions are not confined to just six commodities<sup>16</sup> and anything which possesses similar property can have the possibility of Riba if not exchanged in spot. As said by Mufti Taqi Usmani<sup>17</sup> “any commodity which is sold by weighing or measuring falls within this category and is subject to the same rule”. Another misconception that requires clarification is present money, which we called Fiat money, cannot be included in this prohibited list, as it does not have weight or intrinsic value and cannot be redeemed for specie or any commodity, but is made legal tender through government decree. It’s just a paper backed by nothing. And because those six commodities mentioned were used because of intrinsic value, and paper money has no intrinsic value, hence forward sales are allowed.

One logical conclusion that could arise from such inference is that since money is not considered to be wealth, so it is no harm in stealing money, since no intrinsic value is lost from the person from whom it is stolen. If this was the case, then it would lead to the destruction of entire economic and social system and render the law useless. So the correct interpretation of measurability or weight would not be in accordance to intrinsic value but to the property of medium of exchange and unit of account which is the property of money and present money or any commodity that has the property of money can be included in the prohibited list. This is further signified by ruling given below

Fiat money is same as commodity money: Resolution No. 9 3<sup>rd</sup> session Council of Fiqh Academy OIC 1989.

And apart from this, Dirham and Dinars used at the Prophet (s.a.w.) time (which was synonymously said in Hadith as gold and silver) do have some intrinsic value but no intrinsic utility, hence it is used as money in the same sense it is used now.

Perhaps the most compelling evidence was given by Imam Al-Ghazzali (d.505 A.H.) about 1000 years ago<sup>18</sup>. He said:

*The creation of dirhams and dinars (money) is one of the blessings of Allah.... They are stones having no intrinsic usufruct or utility, but all human beings need them, because every body needs a large number of commodities for his eating, wearing etc, and often he does not have what he needs and does have what he needs not.. Therefore, the transactions of exchange are inevitable. But there must be a measure on the basis of which price can be determined, because the exchanged commodities are neither of the same type, nor of the same measure which can determine how much quantity of one commodity is a just price for another. Therefore, all these commodities need a mediator to judge their exact value.... Allah Almighty has, therefore, created dirham and dinars (money) as judges and mediators between all commodities so that all objects of wealth are*

<sup>16</sup> Chapra, M. U., op.cit., pp.3-24

<sup>17</sup> Usmani, Mufti Taqi, 1999, Judgment on Riba, the Shariah Appellate Bench of the Supreme Court of Pakistan, dated: 14 Ramadan 1420, <[http://www.meezanbank.com/docs/riba\\_judgement.pdf](http://www.meezanbank.com/docs/riba_judgement.pdf)> p. 23.

<sup>18</sup> Usmani, Mufti Taqi, op.cit. pp-59-60

*measured through them... and their being the measure of the value of all commodities is based on the fact that they are not an objective in themselves. Had they been an objective in themselves, one could have a specific purpose for keeping them which might have given them more importance according to his intention while the one who had no such purpose would have not given them such importance and thus the whole system would have been disturbed. That is why Allah has created them, so that they may be circulated between hands and act as a fair judge between different commodities and work as a medium to acquire other things.... So, the one who owns them is as he owns everything, unlike the one who owns a cloth, because he owns only a cloth, therefore, if he needs food, the owner of the food may not be interested in exchanging his food for cloth, because he may need an animal for example. Therefore, there was needed a thing which in its appearance is nothing, but in its essence is everything. The thing which has no particular form may have different forms in relation to other things like a mirror which has no color, but it reflects every color. The same is the case of money. It is not an objective in itself, but it is an instrument to lead to all objectives...*

*So, the one who is using money in a manner contrary to its basic purpose is, in fact, disregarding the blessings of Allah. Consequently, whoever hoards money is doing injustice to it and is defeating their actual purpose. He is like the one who detains a ruler in a prison.*

*And whoever effects the transactions of interest on money is, in fact, discarding the blessing of Allah and is committing injustice, because money is created for some other things, not for itself. So, the one who has started trading in money itself has made it an objective contrary to the original wisdom behind its creation, because it is injustice to use money for a purpose other than what it was created for. If it is allowed for him to trade in money itself, money will become his ultimate goal and will remain detained with him like hoarded money. And imprisoning a ruler or restricting a postman from conveying messages is nothing but injustice.*

This brief, yet comprehensive analysis of the nature of money, undertaken by Imam Al-Ghazzali, is admitted to be true by the economists who came centuries after him. Hence it is clear as to what money was and by mentioning gold and silver, the Prophet (s.a.w.) not only meant Dirham and Dinars but also meant all the money that would be coming in future. On account of pure reasoning, when Prophet (s.a.w.) said sell gold for gold, silver for silver, salt for salt etc, this means that these kind of transactions actually do happen which can only be the case when one of the commodity is used as a medium of exchange and other used as commodity or intrinsic value like exchanging gold jewellery with Dinars, both made up of gold but with differing quantities. A hadith on the event of Khyber is the explanation of this account<sup>19</sup>.

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<sup>19</sup> From Fadalah ibn 'Ubayd al-Ansari : On the day of Khaybar he bought a necklace of gold and pearls for twelve dinars. On separating the two, he found that the gold itself was equal to more than twelve dinars. So he mentioned this to the Prophet, who replied, "It [jewellery] must not be sold until the contents have been valued

### **A New Approach of Defining Riba Understanding Money**

Anything that qualifies money has to carry three properties. First, it has to be a medium of exchange i.e. it is used to intermediate the exchange of goods and services. It lowers transaction cost i.e. the time spent trying to exchange goods or services. In barter economies transaction costs are high because people have to find who has a good or service and who also wants the good or service they have to offer. Secondly, it serves as a unit of account. A *unit of account* is a standard numerical unit of measurement of the market value of goods, services, and other transactions. To function as a 'unit of account', it must be: 1) Divisible into smaller units without loss of value. 2) Fungible that is, one unit or piece must be perceived as equivalent to any other. 3) A specific weight, or measure of value of goods or services. Thirdly, it serves as a store of value i.e. it must be able to be reliably saved, stored, and retrieved.

It is quite clear that fiat money used now satisfies all the above mentioned properties and hence can be equivalent to the six commodities mentioned in the Hadith. However one need to see whether money is the only commodity which now exists or are there others. On further analysis, it is found that despite the existence of Dirham and Dinars also included other commodities. If Dirham or Dinar were all meant, then Prophet (s.a.w.) just mentioned gold and silver, why has he mentioned other commodities. Two conclusions can be derived on the subject. First because they were also used with varied degree and moneyness<sup>20</sup>, second, any other commodity or asset having property of being medium of exchange will also be considered as money in terms of the Hadith.

Only fiat money is medium of exchange and unit of account now as they have a fixed value with respect to other commodities. i.e. a person's salary paid in money is fix despite the currency depreciation. Thus one might consider that the logic behind confining the trading of six commodities to spot transactions comes from the fact that all those commodities' value was fixed with respect to others, so there is a chance of predetermined return.

To put it another way, money or other asset or commodity having property of money can be combined to be called money asset, on which only spot sales are allowed. One might define money asset as any exhaustible (which is consumed or loose its value when is used) asset, which can be used in a production or investment process (directly or through purchasing of those assets that are used directly), and new but same asset is produced. In this way one can calculate return or profit e.g. in a hypothetical situation if one ton of wheat is used production and as a result 1.5 tons are produced, So return is 50%. Here wheat is money asset and only spot transaction is allow if exchanged with other money asset. And in present time this property is only reserve to fiat money.

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separately." (Muslim, Kitab al-Musaqat, Bab bay'i al-qiladah fiha khara-zun wa dhahab; also in Tirmidhi and Nasa'i)

<sup>20</sup> Chapra, M. U., op.cit., p.7

Any exchange transaction can be of three types.

1. Money asset exchanged against another money asset.
2. Money asset exchanged against a non-money asset
3. Non-money asset is exchanged against non-money asset

And only first type comes in the ambit of exchanging among six commodities hence only spot trade is allowed, whereas in the other two types, transaction with deferred payment are allowed.

Imam Ghazali<sup>21</sup> in account of explaining the prohibition of Riba clarified that

*Riba, is prohibited because it prevents people from undertaking real economic activities. This is because when a person having money is allowed to earn more money either in spot or in deferred transactions, it becomes easy for him to earn without bothering himself to take pains in real economic activities. This leads to hampering the real interests of the humanity, because the interests of the humanity cannot be safeguarded without real trade skills, industry and construction.*

As explained previously, Riba derived from two sources, one is in form on interest in lending and other from few deferred transaction, furthermore the basis cause of Riba is Injustice or Zulm, this means the element of Zulm is present in both there sources, and also there might be some commonality in between them. The economic implication of interest as explained by Imam Ghazali is, a person determines return or profit before getting into the transaction, and as a result the other person shares his risk of loss but also of the others. And this can happen in those deferred transactions that are prohibited, since one can predetermined the profit in combination of those transactions hence estimate return before investment. That is why commodities that have property of money asset can only be traded at spot. Since it is said "There is no riba except in Nasiah (waiting)"- Bukhari, i.e. spot transaction could not contain riba. Hence a formal one line definition would be "Any predetermined return on Money asset that is exchanged and any change (after returning back) in any asset that is loaned is *Riba*".

Here predetermined mean, the return set before investment or the reward is set before undertaking the challenge. Thus any return that is predetermined at the time of contract before investing involving money assets means unlawful gain of wealth through the element of force or Zulm is Riba.

If money asset is exchanged against other money asset then there will be predetermined return<sup>22</sup> but if money asset is exchanged against non-money asset whether cash deferred (murabaha) or asset deferred (salam), then there is no predetermined return<sup>23</sup>. Here non-

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<sup>21</sup> Usmani, Mufti Taqi, op.cit. p. 63.

<sup>22</sup> Like if going exchange rate of PKR/USD is Rs.60 and if one sold \$1, one month deferred at Rs.70 then the other person who gets \$1 now can sell it in open market at Rs 60, as a result he borrowed Rs 60 and pays Rs.70, Rs.10 being interest. Similarly other person can take an interest free loan of Rs. 60, and after paying back that loan, he still have Rs.10, hence predetermined return

<sup>23</sup> There can be cases of predetermined returns if linked with some clauses.

money asset could both be productive or consumptive asset. Productive asset is such, when it is used; it retains its original form like house, car, machine or human (as when the service of human is used, human remains in the previous form). Whereas consumptive asset is such which loses its form when used. Like salt when used in food, loses its form, here money too is considered to be consumptive asset as money when used in investment, it loses its form from paper asset to other investment asset. Salary or rent is a murabaha (cash deferred) sale from productive asset<sup>24</sup>. Similarly there is no predetermined return in advanced payments or deferred payments against consumptive asset like apples etc. Here a thing to note is that services can only be purchased of a productive asset<sup>25</sup>. There are chances where of fixed return if certain clauses are put in deferred sale contract like in case binding contract that person should work for certain period at this pay like some contract says person have to work three months before deciding to quit can have the element of predetermined return hence riba under conditions like market value of salary against that specific work is fixed. Similarly some house contract<sup>26</sup> may also contain elements of riba if market value or rent is fixed. In case of non serviced transaction whether in productive or consumptive asset like before cash deferred sales, the seller put in a condition before sale that the buyer will purchase this asset at all cost may contain predetermined return hence Riba<sup>27</sup>.

No better explanation can be given then what is given by Justice Taqi Usmani in his historical Judgement Usmani<sup>28</sup>. He said,

*And since money can only be traded in at par value, as explained earlier, any excess claimed in a credit transaction (of money in exchange of money ) is against nothing but time. Conversely, in a credit sale of a commodity, time is not the exclusive consideration while fixing the price. Time of payment may act as an ancillary factor to determine the price of a commodity, but it cannot act as an exclusive basis for and the whole consideration of an excess claimed in exchange of money for money.*

### **Its Economic Implications**

Allah says in Quran, "God deprives interest of all blessing but blesses charity; He loves not the ungrateful sinner."<sup>29</sup> In other words, Allah destroys *riba* and nourishes charities. Here Charity is placed as a direct opposite of riba, and this can be seen as Riba is increase of ones wealth because of injustice and charity is decrease of ones wealth to remove

<sup>24</sup> In case of salary, you perform a day or hour or minute or a second work which you will be paid after a month as monthly salary. Similarly in rent the payer utilizes the services of the house or car or machine or any productive asset and pay for it at the end of the month.

<sup>25</sup> Consumptive asset because it changes its form, cannot provide service with its original form.

<sup>26</sup> which says house owner cannot claims the house without giving advance notices and tenants can fixed their rent in advance by not giving up house, for another month, tenants are fixing another month rent in advance.

<sup>27</sup> If price of a car is \$ 1000 which the seller promises to sell at \$ 1200 payment made after year, and if the seller bounds the buyer to purchase the car from him when it is available to him, this way he buys the car at \$1000, at the same time sells back on deferred payment at \$ 1200 and making \$ 200 predetermined return.

<sup>28</sup> Usmani, Mufti Taqi, op.cit. p. 94.

<sup>29</sup> Al-Quran, Surah Al-Baqarah, 2:276

sufferings from the society. Some philosophers and thinkers, not belonging to Islam, on the bases of pure reasoning, were also able to deduce severe consequences of this curse.

St. Thomas Aquinas, the leading theologian of the Catholic Church, argued charging of interest is wrong because it amounts to "double charging", charging for both the thing and the use of the thing. Aquinas said this would be morally wrong in the same way as if one sold a bottle of wine, charged for the bottle of wine, and then charged for the person using the wine to actually drink it. Similarly, one cannot charge for a piece of cake and for the eating of the piece too. Yet this, said Aquinas, is what usury does. Money is exchange-medium. It is used up when it is spent. To charge for the money and for its use (by spending) is to charge for the money twice as if one were to charge for a piece of cake and then make a further charge for eating it.<sup>30</sup> And within the modern economic prospective, an Ultimate Economic goal of any nation is to insure adequate distribution of income and wealth among its citizens. Riba provides redistribution of income and wealth from poorer to richer,<sup>31</sup> while zakat and sadaqat redistribute income and wealth from richer to poorer. This Exploitation of poor is not limited to lending on interest; the same kind of devastating results would take place even in deferred mode if predetermined return could be earned from it.<sup>32</sup>

### **Analyses of Islamic products in the light of Definition**

#### **They say "sale is similar to Riba" (Murabah vs. Riba)**

This same question was asked by the Mushriks at the time of the Prophet (s.a.w.), this has been mentioned in Quran in the following verses.

"The non-believers say that sale is very similar to Riba."<sup>33</sup>

This saying of the non-believers clearly refers to the particular transaction of cash deferred sale also called murabaha. Their objection was that when we increase the price of commodity in the original transaction of sale because of its being based on deferred payment, it is treated as a valid sale. But when we want to increase the due amount after the maturity date, when the debtor is not able to pay, it is termed as *Riba* while the increase in both cases seems to be similar. This objection of the non-believers of Makkah has been specifically mentioned by the famous commentator Ibn Abi Hatim on the authority of Said ibn Juba: "They used to say that it is all equal whether we increase the price in the beginning of the sale, or we increase it at the time of maturity.

In answer to this argument of theirs, the Holy Quran could, by pure logic have explained how profit in a sale is different from Riba. But this line of argument was intentionally

<sup>30</sup> Page Harry, 1985. In *Restraint of Usury: the Lending of Money at Interest*, The Chartered Institute of Public Finance and Accounts, London

<sup>31</sup> Siddiqi, M. Nejatullah., 2004. *Riba, Bank Interest, and the Rationale of Its Prohibition*, Islamic Development Bank, Visiting Scholars Research Series; and Haque, Ziaul (1993) "The Nature and Significance of the Medieval and Modern Interpretations of Riba" *The Pakistan Development Review* Winter, 32:4 Part II, p.937.

<sup>32</sup> Nabil Saleh, 1992. *Unlawful gain and Legitimate Profit in Islamic Law*, Graham and Trotman, London.

<sup>33</sup> Al-Quran, Al-Baqarah 2:275

avoided, and the brief and simple answer given by the Holy Quran was: Allah has allowed the sale and has prohibited interest."<sup>34</sup>

If we look at the transaction with the perspective of the definition, that we developed so far, i.e. any predetermined return on money asset through exchange is Riba. In Murabaha, return on investment at the time of investment cannot be calculated. E.g. if we invested some money in a process to buy something, at that point we don't know how at what price it is sold. But after a commodity is made, whether it will be sold on spot or deferred with a predetermined increase in price which can be equivalent to prevalent or benchmark interest rates<sup>35</sup> is up to the seller and is allowed. In that case, the return cannot be calculated at the time you made investment or purchase<sup>36</sup>. However in certain type of murabaha transactions where profit is predetermined that is mostly followed by Islamic banks could contain element of Riba.<sup>37</sup> This can be the only logic behind what unbelievers said that Trade is like riba as jurist haven't yet found a conclusive answer.<sup>38</sup>

Similarly by purchasing on deferred payment and selling that commodity on spot simultaneously could also be riba<sup>39</sup>. However the condition of a murabah buyer, and selling at spot simultaneously can be relaxed in those commodities, with large liquidity premium of ample product differentiation, like antiques, animals or product with unique attributes. In other words of those products, whose market price cannot be ascertained.

Now a days there are serious reservation of wide spread use of murabah technique as a mode of finance, where the bank purchases the commodity only after the customer agrees in principal to purchase it from the bank. Justice Taqi Usmani writes about Murabah<sup>40</sup>:

*There should be a gap between purchasing the commodity and selling to the customer and the risk of owing a commodity during the period should be borne with all its basic components and all its essential consequences.*

Another Interesting observation is given in The Economist (1994).<sup>41</sup> It states:

*Muslim theoreticians and bankers have between them devised ingenious ways of coping with the interest problem. One is murabaha. The Koran says you cannot borrow \$100m from the bank for a year, at 5% interest, to buy the new machinery your factory needs? Fine. You get the bank to buy the machinery for*

<sup>34</sup> Al-Quran, Surah Al-Baqarah 2:275

<sup>35</sup> Like sale at Rs100 on spot or Rs 110 with deferred payment after 1 year, this could be derived from KIBOR rate of 10% for year.

<sup>36</sup> A product market price at that time is Rs 100 and if one put a price tag of Rs. 200 on deferred payment, there is no guarantee that this product can be sold for Rs 200 so cannot calculate return before investment

<sup>37</sup> If before investing Rs 100 the buyer promises to buy at Rs. 200. Here return can be calculated before investment which is 100%. And this could only happens when buying and reselling is done in single contract.

<sup>38</sup> Tahir, Sayyid (1994) "What is Riba?" Hikmat-e-Quran, Nov. Issue. 13 , English section, pp.1-6

<sup>39</sup> If price of A is Rs 50 spot and Rs 60 deferred payment, and if a buyer buys at Rs 60 and then sell back at Rs 50 on spot, here he can calculate return before investment.

<sup>40</sup> Usmani, Mufti Taqi. "An Introduction to Islamic Finance." Pp. 74-75 Idaratul Ma'arif:Karachi

<sup>41</sup> The Economist (1994) "The cash-flow of God." 4th August issue (online version)

<[http://www.economist.com/displayStory.cfm?Story\\_id=812830](http://www.economist.com/displayStory.cfm?Story_id=812830)>

*you -- cost, \$100m -- and then you buy the stuff from the bank, paying it \$105m a year from now. The difference is that the extra \$5m is not interest on loan, which the Koran (perhaps) forbids, but your thanks to the bank for the risk it takes of losing money while it is the owner of the machinery: this is honest trading, okay with the Koran. Since with modern communications the bank's ownership may last about half a second, its risk is not great, but the transaction is pure. It is not surprising that some Muslims uneasily sniff logic-chopping here.*

Islamic banks are predetermining the return on money asset through buying and reselling in one contract.

The conventional murabaha offered by Islamic banks can also be proved wrong in 'conventional Islamic context'. There is a wide consensus in our ulema that murabah can only be done when the seller (bank) has full possession of the asset sold, and also it assumes full risks of that asset from the time in is bought by the bank, to the time it is sold. Property possession and ownership do remains with the bank, until it is sold, however banks doesn't bear all the risk regarding that assets, as one of the risk is liquidity risk which the bank transfers to the buyer through a promissory note signed by the buyer to buy the asset from the bank even before it is purchased by the bank.

#### **Other Islamic mode of financing**

Similarly Ijarah and diminishing Musharka offered by Islamic bank can also be illegal if they designed in such a way, that there is a predetermined return on money asset which in our context is riba. Like Ijarah offered by bank normally contain a clause that bounds the bank to sell the vehicle (asset) after all the rentals (installments) are being paid, at a predetermined price usually equal to the security deposited at the beginning. It is a kind of option contract, writer being the bank. Options are allowed 'only without price' Ulema allowed it by virtue of their ruling on options, however what they fail to recognize is that the customer is actually paying a price of that option not in form of cash but in a form of the rental difference between the bank and the market. So these financing should also be overlooked, to minimize the possibility of riba.

#### **Conclusion**

The conclusion reached from the above analysis, helps in defining what Riba really is not only from the prospective of various sharia scholars and Fiqh literature, but also as identified in the context of Islamic economic principles conveyed by Quran and Sunnah based on justice. This will also remove confusion on the way Islamic banking is practiced as Islamic banks in devising products, may make it shariah applicable but probably not in the true shariah spirit. It is this in clarity that led even a common man to ask questions whether Islamic banking is really Islamic or not.

## Appendix 1

To give you the account of what the economic system was, and how riba was treated in the Prophet saw's time, a brief discussion on the topic is followed. Even in the days closer to the advent of Islam in Arabia, all kinds of commercial, industrial and agricultural loans advanced on the basis of interest were prevalent in the Byzantine Empire ruling in Syria, to the extent that Justinian, the Byzantine emperor (527-565 A.D) had to promulgate a law determining the rates of interest which could be charged from different types of borrowers. Gibbon has detailed the contents of the Code of Justinian and that it allowed the rate of 4% charged as interest from illustrious people, 6% charged from general people as ordinary rate of interest, 8% from the manufacturers and merchants and 12% from nautical insurers. The exact words of Gibbon are as follows:

*Persons of illustrious rank were confined to the moderate profit of Four Per Cent; six was pronounced to be the ordinary and legal standard of interest; eight was allowed for the convenience of manufacturers and merchants; twelve was granted to nautical insurers.*

This law of Justinian was promulgated in Byzantine Empire shortly before the birth of the Holy Prophet, (s.a.w.) in Arabia (Justinian died in 565 CE while the Holy Prophet, SAW, was born in 570 CE) and obviously the law remained in force for quite a long time after its promulgation. On the other hand the Arabs, especially of Makkah, had constant business relations with Syria, one of the most civilized provinces of the Byzantine Empire. The Arabs trade caravans used to export goods to and import other goods from Syria. Their economic and financial relations with the Byzantine Empire were so prominent that the currency used throughout the Arabian Peninsula was the dirhams (of silver) and dinars (of gold) coined by the Byzantine Empire, so much so that the poets have referred to the Dinars as Ceazarians. Rather, some contemporary writers have claimed that the nomenclature of the Arabic coins (dirham, diner and fals) is originally derived from the Greece or Latin words which are very similar to these names. These Byzantine coins remained in use throughout the Muslim world till the year 76 A.H., when Abdul Malik ibn Marwan started coining his own dinars.\*

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\* For further detail, please refer to the books of political economy of Islam in Arabic, Urdu, Persian and English.