

Riba, its definitions and the relative Islamic rulings

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In the Name of Allah, the Extremely Gracious, the Very Merciful.

All praise and thanks are due to Allah, and peace and blessings be upon His Messenger.

Introduction

Borrowers are prepared to pay interest on loans either because

1. The absence of interest free loans.
2. The non-availability of credit from suppliers of material goods and services.

The material goods may be of a consumptional nature or be for re-sale. Where the goods are for re-sale, expected net profits are supposed to finance the capital + interest of the loans taken. Thus, the cost of borrowing is weighed against the possible greater expected net returns.

3. The expectation of higher net-returns through investing interest-bearing loans.

Though businesses may present clear and legitimate business plans to justify their need for interest-bearing loans through financial institutions, the reality is that there are many cases where such finance is not used for the purposes outlaid and defined. Where the loans are to be used in specific projects or purchases it is possible for the financing party to gain securities over those very projects/purchases.

Lenders or financiers are prepared to extend loans because of the expected returns on capital extended. The rates of interest are generally at a level equal to that which the lenders can receive from other and alternative opportunities in the same risk class. Interest rates are also governed by State departments in order to regulate macro economic variables. In a rather reverse format, it is also true that inflation and other economic variables also govern the rates of interest. The need to market the idea of borrowing on an interest basis is also prompted by, especially in the case of private lenders, economic variables which increase inflation rates that in turn results in the loss of the real value of stagnant fiat currencies. The global money markets which determine currency rates also significantly impacts the avenues where finance is channeled since investing in a foreign currency, though speculative at times, can provide greater returns in comparison to lending that capital on interest to borrowers. In fact, the protection of currency value is now integrated with the politics and economic variables of national states.

In the same manner that banks and other financiers re-cycle loans (plus received interest) to maximize the return on investor and deposited capital, borrowers who use the loans for non-consumptional reasons also attempt to maximize the return on such capital in order to make re-payments and profit. In certain cases, e.g. loans taken for fixed property, borrowers expect the capital appreciation of their investments to ultimately be equivalent of the capital + interest that they are to pay.

The principles of supply and demand dictate the premium at which borrowers are willing to seek loans or at which lenders are willing to provide loans. In the case of

banks and financial institutions, these rates are regulated through State organs. Policies of central banks are subject to the economic objectives of States, except in some rare cases where such banks have been authorized to self-regulate their own institutions. The latter allowance, as we have witnessed with the Sept to Nov 2008 economic crises in the US, has been to the detriment of the economy and international offshore investors.

The fact that currencies are regulated in international markets, a state can lose total control of the exchange rate of its own currency due to political and economic factors. Devaluation of a national currency due to foreign intervention or issues relative to monetary economics and methodologies of backing a currency also determine the worth of a specific currency.

In a rather strange turn of events, the paper currency which acts as a store of value for human effort and production has become the very weapon or victim of circumstances and has in the case of some countries become the very reason why an entire nation can overnight be turned into a bankrupt community whose paper money has no value or monetary worth. The truth of the matter is that in the growing global political turmoil, paper currency has indeed, justifiably or unjustifiably, lost its virtue as the absolute mechanism to store the rewards of human labour.

It is very significant, on an Islamic level, to note, that classical Islam has never acknowledged the fractional reserve monetary system nor sanctioned the storage of human effort in a paper currency whose worth can be eliminated by external variables.

It is high time that a new international currency be created which can defend private capital against political and economic variables.

Islam recognizes that lending capital can be risky. It does not deny the need for returns on capital. Rather, it regulates the methodologies through which profit is earned on capital. Thus, though lending capital to borrowers is a means for the latter to earn and gain profits, such profits are not guaranteed and repayment of capital with interest in the case of investment losses is detrimental to the active economic agents of society. It is thus that Islam demands the spread of economic risks between the providers of capital and those who utilize it so that an equilibrium is achieved in regard to the financial positions of every one in society. Capital providers who refuse to share economic risks ensure their own enhancement and economic protection to the detriment of others.

Contemporary fiat currencies differ from the primary Islamic currencies of gold and silver where the inherent metallic value could not be seriously destroyed by external economic and political factors. There is no denial that floatation of actual metallic currencies of such metals have its own problems in contemporary markets. Growth in Islamic economic markets demanded that a copper currency “fulloos” was introduced as a metal of less economic worth to serve for the purchases of goods that were much less in value than the silver coins. This is indicative of some degree of flexibility in economic engineering to serve the monetary requirements of society.

The definition of interest

The amount of money charged¹ after a specified term on the principal amount that is given as a loan is referred to as interest.

Sometimes, a sum of money is charged on the principal amount that is given as a loan without a clearly stating the period after which the loan becomes due.

e.g.

Where A lends B a \$1000 in return for a 20% interest per annum, then any \$200 paid by B to A in addition to the capital loan would be an interest payment.

Even if B had earned his money on a totally Islamically acceptable basis, then also the provision of the additional \$200 to the lender would be an interest amount.

Borrowing or lending on an interest-based manner is the process that allows for the creation of interest and interest-debt.

The definition of compound interest

AF Ebrahim definition

When the amount of money charged² on the principal amount, which is given as a loan, after a specified term, is re-loaned together with the principal (or the principal + any previously accrued interest) in order to continue the cycle of the loan to a specific date, then the aggregate interest charged over the term of loan is referred to as compound interest.

Notes

1. This definition is appropriate because interest has not only been charged on the original principal amount but also on every interest amount, except the last interest payment, which was periodically paid upon the principal and all other interest earnings.
2. The principal loan could be a deposit into a banking account in which it has to be left for a fixed term in order to qualify for the specified interest-return. In this case, the money is considered as a loan that is forwarded to the bank. The bank then either invests the money or lends it to others and charges them an interest amount relative to the term of usage.

More simply

¹ Interest is very often classified in financial writings and statements as “Interest Earned”. Islamically, earning is different from charging, and since the lender has not toiled for the interest-return, it would be better to classify the interest as “Interest charged”. Thus, a person who has deposited his money into a banking account that pays interest is actually forwarding a loan on which he demands interest.

In common terms, interest-earned or interest charged would both have the same connotations.

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The difference between the total interest gain on the principal including any interest gains on other accumulated interest gains and the original principal is called compound interest.

Another definition: A compound interest contract is like a series of simple-interest contracts that are connected. The length of each simple-interest contract is equal to one compounding period. At the end of each period, the interest earned on each simple-interest contract is added to the principal.³

e.g. \$100 invested at a rate of 10 % compounded annually:

Year	Principal	Interest	Year End Total
1 st	100	10	110
2 nd	110 (Principal + interest of year one)	11 (110 x 10%) Interest on principal + interest on the interest of the first year	121
3 rd	121	12,10	133,10

In the above example, the original principal (100) + interest accrued at the end of year one (10), is also be regarded in conventional finance as the new principal for the next period of the loan.

Equation for compound interest

Equation 1⁴: $S = P (1+r)^n$

S = Compound amount or principal + accumulated interest on principal and interest.

P = Principal amount of the loan

r = rate of interest

n = number of years or number of periods over which the compound interest is forwarded.

1 = the integer one and not the alphabet **I**.

The same formula is represented in the many manuals of financial calculators as

$$FV = PV (1+r)^n$$

where

³ HP 10bll Financial calculator's User's guide.

⁴ Introductory Mathematical Analysis – For Business, Economics, and the Life and Social Sciences. Ernest F. Haeussler, Jr. /Richard S. Paul. Prentice Hall. USA. 1990. 6th Edition, p159. ISBN 0-13-501438-7

FV = Future Value = S (as specified here above)

PV = Present Value = P (as specified here above)

Example 1

Suppose \$1000 is invested for 10 years at 6% compounded annually.

Using Equation 1, the calculation of S or FV would be

When $P = 1000$, $r = 0,06$ and $n = 10$

$$FV = 1000 (1+0,06)^{10} = 1000 (1,06)^{10}$$

In the early years, the values of $(1,06)^{10}$ was taken from compound interest tables in which (n) was shown progressively in a vertical column in the table that gave the specific exponential values for 0.06 or 6% (or any other respective percentage) as the compound interest rate.

However, this exponential value is very easily obtained via scientific and financial calculators using the y^x function which is often activated through the 2nd Function $2^{nd} F$ key.

Thus $1,06 \setminus 2^{nd} F$ key \ then the y^x followed by the positive integer 10 = 1,79

$$\begin{aligned} \text{Therefore } S \text{ or } FV &= 1000 \times 1,79085 \\ &= 1790,85 \end{aligned}$$

See Calculators:

1. Sharp EL-738 Business /Financial Calculator
2. Casio FC-100 manual p38 + calculator
3. Texas Instruments BA II Plus – p28 of manual + calculator

Therefore, the compound interest in the above case is

S (or FV) - P (or PV) = Compound Interest

$$\begin{aligned} 1790,85 &- 1000 \\ &= 790,85 \end{aligned}$$

Example 2

1. A principal of \$2000 is invested for 10 years.
2. Compounding takes place every 3 months (i.e., quarterly) at a rate of 1½ % per quarter. Thus, there are 4 interest periods or conversion periods per year. In ten years there are $10 \times 4 = 40$ interest periods.

$$\begin{aligned} FV &= PV (1+r)^n & \text{and} & & 1\frac{1}{2} \% \text{ is equal to } 0,015 \\ &= 2000 (1 + 0,015)^{40} \\ &= 3628,03 \end{aligned}$$

FV- PV = Compound Interest

$$3628,03 - 2000 = 1628,03$$

Calculator usage

We can do the above more simply with Financial Calculators.

Calculator 1. Here we use the FN Aurora Financial Manager⁵:

After correctly setting the calculator		
40 \boxed{N}		
1.5 \boxed{i}		Note: The interest key \boxed{i} is not shown as $\boxed{I/Y}$. This is similar to the same key on the Sharp EL-733 calculator.
-2000 PV		
\boxed{COM} key	3628,04	Answer appears after few seconds due to the level of the calculators processor

Notes

1. Usually, the interest rate per conversion period is stated as an annual rate.⁶
2. In example two, we would say that the annual rate of 6% is compounded quarterly. Thus, **the rate per interest period**, or the **periodic rate** is $6\% \div 4 = 1,5\%$. The quoted annual rate of 6% is called the **nominal rate** or the **annual percentage rate (A.P.R.)**.
3. Unless otherwise stated, all interest rates will be assumed to be annual (nominal) rates.
4. Thus a rate of 15% compounded monthly corresponds to a periodic rate of $15\%/12 = 1,25\%$.

⁵ This was the best priced budget Financial calculator but lacks processing speed and certain functions of higher end financial calculators.

⁶ [for footnotes 1-4] Introductory Mathematical Analysis – For Business, Economics, and the Life and Social Sciences. Ernest F. Haeussler, Jr. /Richard S. Paul. Prentice Hall. USA. 1990. 6th Edition, p159. ISBN 0-13-501438-7

5. The convention in FV calculations is to regard the PV as a negative quantity. Payments to the bank or to a supplier will appear as negative in the display.⁷
6. Generally, for a given nominal rate of interest, the compound interest amount increases due to an increase in the frequency of the compounding. However, this increase becomes less meaningful when the number of interest periods become closer to each other.⁸

Calculator 2: Sharp **EL-738** Business Financial Calculator

Note: The $\boxed{I/Y}$ “Interest per year” key is functional as $\boxed{i/p}$ “interest per period” as well. Thus it would have been better if the key had \boxed{i} printed on it instead of $\boxed{I/Y}$. The \boxed{i} is found to be printed on the Sharp **EL-733** Financial Calculator

After correctly setting the calculator and entering the appropriate mode		
	$\boxed{ON/C}$ 40 \boxed{N}	
The down pointing cursor is to be used to insert all subsequent or other variables	-2000 \boxed{PV}	
Quarterly interest rate	1.5 (or key in $6 \div 4$) $\boxed{I/Y}$	
Skip the (PMT) variable		
\boxed{COMP} = (compute answer)	\boxed{COMP} \boxed{FV}	Answer: 3628,04

Calculator 3. BA II Texas Instruments Business Analyst Calc.

See p 28 of the manual. In this calculator, the \boxed{CPT} key is used to for \boxed{COMP} = (compute answer).

Calculator 4. HP 10bll

⁷ Sharp EL-733 Financial Calculator Manual p15.

⁸ Introductory Mathematical Analysis – For Business, Economics, and the Life and Social Sciences. Ernest F. Haeussler, Jr. /Richard S. Paul. Prentice Hall. USA. 1990. 6th Edition, p159. ISBN 0-13-501438-7



See the manual p60 for doing the \boxed{FV} calculation. Follow the example but do not insert the FV value. Rather enter a value for \boxed{N} . Then, finally press the \boxed{FV} key.

Calculator 5. Sharp EL-733

See manual which provides clear details on the \boxed{FV} calculation.

Islamic prohibitions relative to interest

THE PERSON WHO TAKES OR GIVES INTEREST

Abdullah bin Masūd narrates from his father who stated: "Rasūlullāh (S.A.W.) cursed the person who ate Ribaa (interest), the person who fed another with interest, he who is "Shaahid - witness" to it (i.e. the transaction) and also the person who records it." [Refer to Abu Da'ud, chapter four, hadith 3317].

The hadith uses the word "eater" despite that the prohibition equally applies to the person who has taken the interest without actually having eaten or utilised the proceeds for any of his needs.

The above hadith is narrated through different narrations by Tirmidhi, ibn Mājah and Muslim. Part of it is also found in Bukhāri.

Imām Nawawi, a Shafi scholar, expresses that the hadith prohibits the recording of interest related transactions as well as being witness to it. It thus prohibits a Muslim to aid "Bāṭil - Islamically invalid activity".

CANCELLATION OF RIBAA

On the occasion of "Hijjatul-Widaa - the Farewell Hajj", Rasulullah (S.A.W.) said: "Know well, Every bit of Ribaa (interest) which has been contracted into during the period of "Jaahiliyyah - pre-Islamic ignorance" is now cancelled. You will have the capital (output) of your wealth. Do not oppress and you will not be oppressed." [Refer Abu Da'ud, chapter no.5, part of hadith 3318].

Any non-Muslim who accepts Islam and to whom others are obligated to by interest payments will have to relinquish such interest gains and accept his capital outlay of the loan only.

However, a Muslim who has taken interest from any other person, will be obligated to return the interest as ignorance or violation of the Shari'ah does not permit him any prohibited gain.

Non-Muslims who accept Islam will be forgiven for all their previous interest accumulations. They will only forfeit the outstanding interest debt at the instance of accepting Islam.

Munzari states that the above hadith is also quoted by Tirmizi, Nasaa'ie, ibn Majah and Muslim.

الفتاوى الإسلامية
الكتاب : فتاوى دار الإفتاء لمدة مائة عام
الباب : من أحكام المعاملات

الموضوع (4) التعامل بالربا مع غير المسلمين .
المفتي : فضيلة الشيخ عطية صقر .
مايو 1997 المبدأ : القرآن والسنة .
سئل : أنا أعيش في بلد غير إسلامي ، ولا يمكنني أن أقضى مصالحي
إلا عن طريق البنوك التي تتعامل بالربا ، ففكيف لي : إن الربا معهم ليس بحرام
، فهل هذا صحيح ؟
أجاب : تحدث العلماء عن الكفار هل هم مخاطبون بفروع الشريعة - أم
لا ، واختلفوا في ذلك ، وبناء على هذا الاختلاف ، قالوا : إن المقيمين في
البلاد الإسلامية يلتزمون بالأحكام الشرعية ، سواء كان المقيم مسلماً أو ذمياً
، لأن تطبيق الأحكام الشرعية ممكن في البلاد الإسلامية فإذا سافر المسلم
أو الذمى إلى دار الحرب وحدثت منه مخالفة لأحكام الشريعة ، أو حدثت
من شخص كان يقيم في دار الحرب ثم عاد بعد ذلك إلى دار الإسلام ، فلا
تطبق عليه أحكام الشريعة الإسلامية ، لأن القاضي المسلم لا تمتد ولايته
إلى المحل الذي ارتكبت فيه الجريمة ، ومن هنا نقل عن أبي حنيفة أنه أجاز
للمسلم والذمى من أهل دار الإسلام إذا دخل دار الحرب مستأمنين - أن
يتعاقدا بالربا مع الحربي أو المسلم من أهل دار الحرب الذي يهاجر إلى
دار الإسلام ، لأن أخذ الربا في هذه الحال يكون في معنى إتلاف المال
بالرضا ، وإتلاف مال الحربي وبرضاه مباح ، لأنه لا عصمة لدمه ولا لماله
، وقد نقل أبو يوسف عن أبي حنيفة قوله : إن وجوب الشرائع يعتمد على
العلم بها ، فمن لم يعلمها ولم يبلغه فإن هذا لم تقم عليه حجة حكومية . وبهذا
، إذا دخل المسلم أو الذمى دار حرب بأمان فتعاقد مع حربي على الربا
أو على غيره من العقود الفاسدة في نظر الإسلام جاز عند أبي حنيفة ومحمد
وقد أفتى بذلك الشيخ محمد نجيب المطيعي مفتي الديار المصرية الأسبق
ونشره في رسالته عن أحكام التأمين " السكورتاه " ص 7 مطبعة النيل
" بمصر سنة 1906 م ونقله الشيخ جاد الحق على جاد الحق في كتابه
فتاوى معاصرة ص 86 " . هذا ما قاله أبو حنيفة ، أما صاحبه أبو يوسف
فقال : لا يجوز للمسلم في دار الحرب إلا ما يجوز له في دار الإسلام ،
لأن حرمة الربا ثابتة في حق العقادين ، أما في حق المسلم فبإسلامه وأما
في حق الحربي فلأن الكفار مخاطبون بفروع الشريعة قال تعالى { وأخذهم

الربا وقد نهوا عنه { النساء : 161، والأئمة الثلاثة قالوا : تطبق أحكام الشريعة الإسلامية على كل من هو في دار الإسلام من المسلمين والذميين والمستأمنين ، كما يعاقب المسلم والذمي على ما يرتكبانه في دار الحرب ولو كان الفعل مباحا فيها كالربا والقمار، تنفيذاً لأحكام الشريعة. وقد استظهر

الشيخ جاد الحق على جاد الحق أن الخلاف بين فقهاء الحنفية إنما هو في إمكان توقيع العقوبة على التعامل المحرم إذا وقع من المسلم في دار الحرب ، ومال إلى رأى جمهور الفقهاء من حرمة التعامل بالربا على المسلم أيا كان موقعه في دار الإسلام أو في دار الحرب ، وذلك بمقتضى إسلامه ، اللهم إلا إذا كان مقتضاً لضرورة ، أما أن يكون مقرضاً فلا محل ، لأنه لا ضرورة فيه . وبهذا الفهم والتحليل يكون تصرف المسلم في دار لا يحكم فيها بالإسلام مساوياً لتصرفه في دار يحكم فيها بالإسلام ، من جهة الحل والحرمة ، أما القضاء الدنيوى المعتبر فيه ميدان تطبيقه فلا يغير من حكم الله شيئاً .

SECOND FIQH SEMINAR – NEW DELHI Dec. 8-11, 1989

The Second Fiqh Seminar was held by the Academy with the co-operation of the Institute of Objective Studies in New Delhi from the 8th to the 11th of December, 1989 and was inaugurated by the eminent Fiqh scholar of the Arab World, Dr. Jamaluddin Atiah (Cairo). More than seventy jurists, intellectuals and Ulama from all parts of the country participated in this Seminar. Many eminent persons and representatives of great seats of Islamic learning in India also attended it.

CONCLUSIONS:

Commercial Interest and the Islamic Shariah

After taking into account all the relevant facts and after comprehensive discussions, the Seminar arrived at the following conclusion regarding consumptional and productive loans and reasonable and unreasonable rates of interest.

The Shariah has categorically prohibited interest on all types of loans, consumptional as well as productive. It is sheer misunderstanding that the *Shariah* prohibits interest only against consumptional loans and allows it on productive loans. It is entirely incorrect that productive loans did not exist during the period of revelation of the Quran. It has been established historically that the Arabs of the *Jahiliyah* period as well as the nations who had commercial relations with pre-Islam Arabs had well established practices of receiving and paying extra on productive loans. Moreover, even if the practice of obtaining productive loans and extra payment thereupon is not to be found during the period of revelation of the Quran, it could not be made to mean that the *Shariah* permitted interest on productive loans because several independent proofs of the prohibition of interest on such loans do exist. The Quran, the Sunnah, the *Ijma*, the *Qiyas* and the precedents of unbroken chain of practice of the Ummah, each one of them, declares in unequivocal terms that the motives behind receiving or advancing a loan is entirely irrelevant to the prohibition of interest.

Further, the prohibition is in no way affected positively or negatively, by the rate of interest being reasonable or unreasonable (moderate or excessive). The Shariah does never admit that interest may be permissible if the rate of interest is reasonably low and prohibits only when it is unreasonable high. The Shariah refuses to make any such distinction. Both are equally prohibited according to Islamic Law.

Question on ibf

how might a country convert a Riba based central bank into a Halal compliant system, or at the very least, make the Central Bank halal- compliant? Certainly, a model must exist. Should we not advocate such a transformation?

This seems especially relevant in light of the Pakistani Supreme Court's decision regarding the prohibition of Riba in the economy in the near future. Less argument- more advocacy!