

ISLAMIC ECONOMIC VIEWS ON INTEREST

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Abstract: According to all Islamic religious and philosophical traditions, money was invented to serve as measure, medium of exchange of goods and services and ensure just measure of values. It was never desired for itself. But the practice of lending money on interest makes the money a source of injustice and exploitation. A unique contribution of Islam to economic thought is that it envisaged occurrence of interest in certain cases of barter that involve exchanges unequal by way of quantity or time of delivery. The Quran clearly condemns what it calls by the Arabic term “riba,” which literally means an “increment’ or addition” and is usually translated “interest”. Still, attempts have been made to distinguish interest from riba, by pointing out that interest charged on consumption loans is definitely “usury”, but that on loans taken to finance trade or production is not.

Keywords: money, interest, usury, barter

1. NATURE AND FUNCTIONS OF MONEY IN ISLAMIC TRADITION

Muslim scholars discussed many aspects regarding money, such as its nature and functions, merits of bimetallic standard, consequences of bad money, debasement of currency, while accepting that money is not desired for its own sake and that it has been invented out of human need to exchange goods and out of specialization in different professions. Money was the measure of the value of various goods and services and established equality between them, which was not possible in direct exchange or barter. Moreover, money was a unit of account and store of value, not only a medium of exchange.

Many Muslim philosophers have discussed money as needed because of the difficulty of transactions in a barter economy, thus emphasizing the most obvious function of money – medium of exchange, a common denominator between producers of unlike goods. Counterfeiting and currency debasement was another issue many Muslim scholars addressed. This generally meant mixing inferior metals with gold and silver coins or mutilation of the metallic content. Circulating bad money was worse than stealing since the former affected many that used it in transactions.

In order to preserve the just and stable value of currency and avoid inflationary trends, the face value of the coins had to be equal to their intrinsic value, and the costs of minting coins should not be included in the value of the coins.

In addition to inflation and chaos, Muslim scholars also analyzed a phenomenon known nowadays as Gresham's Law. According to this law, where two different money units of the same value but varying intrinsic value (in terms of purity of metals) are circulated, the bad money drives out the good money (the flight of good money abroad, the phenomenon of hoarding or melting). According to religious and philosophic traditions, the practice of lending money on interest and extracting a higher amount over and above the sum lent, on conjectural basis, made it a source of injustice and exploitation.

Muslim scholars were even against the distinction drawn between interest on consumption and interest on production loans, because no one is entitled to any guaranteed profit irrespective of the outcome of business. Profit is to be shared with a predetermined ration, while in case of loss the capital owner is to bear the loss of capital and the working partner is to bear the loss of labor which goes unrewarded.

2. RIBA

One of the integral parts of an Islamic financial system is the prohibition of Riba from the economy. Riba happens to be one of the most difficult subjects for the last 1400 years, for Muslims as well as for the Muslim Scholars.

Riba in Arabic means excess, increase, increment or addition. The literal meaning of riba is to grow, to increase, to prosper, to rise, to swell.

In the Islamic terminology interest means effortless profit or that profit which comes free from compensation or that extra earning obtained that is free of exchange. Riba is a loan with the condition that the borrower will return to the lender more than and better than the quantity borrowed.

The definition of riba in classical Islamic jurisprudence was “surplus value without counterpart.”

In the Islamic terminology interest means effortless profit or that profit which comes free from compensation or that extra earning obtained that is free of exchange. Riba has been described as a loan with the condition that the borrower will return to the lender more than and better than the quantity borrowed. Any attempt to demonstrate the importance of the prohibition of riba in Islam ought to be based upon the two basic sources of Islam, the word of Allah and the word of the Prophet. Riba is prohibited in Islam as it appears explicitly in the Holy Quran. There is complete unanimity among all Islamic schools of thought regarding the prohibition of riba. Since the Quran is the undisputed source of guidance in Islam for all Muslims, there is unanimous agreement on the fact that Islam has forbidden the practice of riba. The debate on whether interest is riba or not has been settled and it has been made crystal clear that interest is riba.

Islam believes if one person or group is allowed to exploit people's needs and they hoard all the money for themselves, then this not only causes disruption but it is a source of great injustice that creates imbalance in society and unequal distribution of wealth. This naturally results in greed, selfishness, self centeredness, exploitation which is the source of all ills, resentments, anarchies, crime and corruption. Hence, Islam attacks at the root of this crime and corruption.

Riba (usury and interest) is perhaps one of the most difficult issues in Islamic concern for fairness in business dealings is its prohibition of business transactions. Riba, in its Quranic meaning, means paying money for the use of money. Muslims have struggled with the problem ever since the Quran categorically denounced riba. From the Islamic perspective, with its bias towards fair distribution of wealth and social justice, the Quran's strictures against riba have implications for international political economy. The issue also confronts devout Muslim business people as they struggle to make their investments religiously and morally legitimate.

Economists throughout time have presented different interpretations of interest. Samuelson states that interest is the price of rental for the use of money; J.M. Keynes mentioned the rate of interest as the percentage of excess of a sum of units of money contracted for forward units of time over the spot or cash price of the sum thus contracted for forward delivery, and so on.

The Islamic economic system promotes compassion and it discourages self-centeredness. As a direct consequence, from an economic point of view, *riba* is an unjustified increment in borrowing and lending money, above the amount of the loan, as a condition imposed by the lender and accepted by the borrower. *Riba* is a tool of oppression and a means to unjustly take the money of others by exploiting their needs and circumstances. *Riba* defined in this way is debt usury.

Riba is also perceived as a medium for hoarding money by the elite and the powerful, and there are warnings against those who accumulate wealth with this unjust way.

Allah has permitted trade and has forbidden usury. Therefore, Islam recognizes trade and commerce not only as a lawful profession but also as a moral duty. Actually, Islam has encouraged men to earn their own provision and to provide it to their families. But it has laid down a complete set of rules for trade. Any sort of transaction that does not correspond to the rules of trade will not be allowed. Interest is amongst those conditions which all dealings must be free from.

The Prophet advised all traders to avoid *riba*. *Riba* prohibition in Quran is mentioned in distinct passages. First there is a warning that *riba* earnings will be wiped out while persons giving charity will be rewarded more than they have spent. Believers are then warned not to take *riba* at compound rates. *Riba* in all forms is further condemned as being more sinful than many other sins. In fact, *Riba* is considered amongst the Seven Heinous Sins: believing in gods other than Allah, magic, murder, *riba*/usury, unlawfully taking orphans' money, fleeing the battlefield, and accusing chaste, pious women.

Quran establishes the framework for the Muslim way of living and establishes the boundaries, the four corners within which they practice all their transactions and interactions.

Since Quran explicitly prohibits *Riba*, and since Quran is an undisputed source of guidance, all Muslims unanimously agrees on prohibition of *Riba*.

The Islamic Economic System is founded on several key principles, among which the equal distribution of wealth amongst all members and the prohibition of hoarding money amongst the elite few.

3. RIBA'L-FADL AND RIBA'L-NASI-AH

A unique contribution of Islam to economic thought is that it envisaged occurrence of interest in certain cases of barter that involve exchanges unequal by way of quantity or time of delivery termed as *riba'l-fadl* and *riba'l-nasi-ah*. In short, *riba'l-fadl* (usury of trade or usury of increase or taking a superior thing of the same kind of goods by giving more of the same kind of goods of inferior quality, e.g. dates of superior quality for dates of inferior quality in great amounts) relates to trade, and *riba'l-nasi-ah* (usury of debt, usury of deference or interest on lent money) relates to loans, both being covered by the verse, "Allah has allowed trade and prohibited *riba*".

The prohibition of interest is mainly based on the Prophet's saying that gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt be exchanged, like for like, equal for equal and hand to hand; one who demanded extra or paid extra, indulged in interest.

When the commodities exchanged differ, they should be sold with a difference of quantity provided that the exchange takes place at once – on the spot delivery – the reason being that otherwise it would violate the nature and functions of money.

Essentially, *riba* relates to the possibility of cheating that existed in barter exchanges of commodities in a society that lacked standardization.

Riba al-fadl arises when a quantity of any one of five or six commodities is either bartered for a different quantity of the same type of commodity (possibly differing in quality) or the exchange is not done on the spot. These six commodities are: gold, silver, dates, wheat, barley, and salt.

There is no *riba* in what is hand to hand (on the spot).

Usury is commonly understood as the lending of money at illegally high rates of interest. But *riba* in Islam is the lending of money on interest, regardless of the rate of interest! When money is lent on interest, then money by itself, independent of any labor or effort, or the assumption of any risk, increases over time. The increase is realized through the exploitation of labor, goods or property since Allah has unambiguously declared that nothing can be had without effort or labor.

A benefit gained from a loan is also *riba*. The Prophet made it clear that the only reward for a loan should be the thanks giving along with the repayment. In other words, the capital owner is entitled to profit only if he is ready to accept possible loss. Interest paid above the money borrowed is *riba*. Hence the prohibition of certain lending arrangements, for which there seems to be no moral or logical basis.

In a *riba*-based economy the possessors of capital will not only remain permanently rich, since they eliminate the possibility of suffering losses, but they will grow constantly richer, since they will be sucking the wealth which belongs to others. They will grow richer at the expense of those who, if not already poor, will have to pay the price of becoming impoverished through the system of 'risk free investments'. Risk-free investments are legalized theft. The number of poor will constantly increase. And the level of poverty will descend lower and lower until it reaches destitution.

4. SOCIOECONOMIC CONSEQUENCES OF RIBA

Riba prohibition engenders multiple social and economic consequences in terms of economic realities such as savings and investment, rate and pattern of economic growth, allocative efficiency, stability of the banking system, and stability of the economic system as a whole.

The effects of *riba* prohibition upon production consist in creating wide discrepancies between the supply of money and the supply of real goods as a result of using money as a production good yielding daily profit rather than a medium of exchange and a measure of value. This creates an imbalance of the monetary system since money cannot become the object of profitable trade without severe trade-offs. Money is not a tradable commodity since it is neither consumption good nor a production good but merely a medium of exchange.

The effects of *riba* on banking led to the primary goal of Islamic banking being not to maximize the profit as the interest-based banking system does, but rather to render socio-economic benefits to the Muslims. Banking institutions have to integrate moral values with economic action. Money and other resources are thus social tools to achieve optimum social good and welfare.

Riba has got an impact on the stability of the economic system as a whole since Islamic banks are prepared to share in losses, which reduces the severity of business recession and enables the productive enterprises to tide over difficult periods without a shut down. Islamic banking has, therefore, to be regarded as a promoter of stability rather than instability.

5. CONCLUSIONS

In Muslim society, socio-economic justice is considered as one of the most significant characteristics for all realms of human interaction – the social, the political, and the economic as well as. The Holy Quran has emphatically instructed Muslims not to acquire each other's property wrongfully, thus insuring a socio-economic justice and equitable distribution of income and wealth.

The prohibition of riba (interest) was one of the socio-economic reforms made by Islam and continues to be a key element in the Islamic vision of a socially responsible economy, and an important element in Islamic business practice. The Quran's strictures against riba remain at the heart of the Muslim individual as well as national financial institutions in international economic activity.

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