

ETHICA

INSTITUTE OF ISLAMIC FINANCE

THE FASTEST WAY TO LEARN ISLAMIC FINANCE GUARANTEED



Historic Judgment on Interest (Part 1 of 5)
Is the Definition of Riba Ambiguous?

Is the Definition of Riba Ambiguous?

This is part 1 of 5 of our series highlighting key arguments and refutations from Mufti Taqi Usmani and others in the "Historic Judgment on Interest" delivered at the Supreme Court of Pakistan in 1999.

What is Riba?

Any excess charged in exchange for a due consideration.

"The *riba* known to and practiced by the Arabs was that they advanced a loan in dirhams (silver coins) or dinars (gold coins) for a certain term with an agreed increase on the principal." – Imam Abubakr Al-Jassas

"...*Riba an-nasihah* (riba al jahiliyya) was a transaction well-known and recognized in the days of Jahiliyya - they lent money on the condition that they would charge a particular monthly amount and the principal would remain due as it was at maturity. If the debtor couldn't pay at maturity, they would increase the term and the payable amount." – Imam Fakhruddin al-Raazi

Argument

"The verses of the Quran prohibiting riba were revealed in the last days of the Prophet's (Allah bless him and give him peace) life - he did not have an opportunity to interpret them properly. No hard and fast definition of the term riba is found in the Quran or in the Sunnah. The term remains ambiguous in nature and its correct meaning unknown. Based on this, the prohibition of riba should be restricted to the transactions expressly mentioned in the Hadith literature - its principle cannot be extended to the modern banking system which was not conceivable at the time of the revelation of the verses."

This argument is based on two points:

(i) The statement of the Caliph Umar (Allah be pleased with him) that verses of *riba* were among the "...last verses of the Quran and the Prophet (Allah bless

him and give him peace) passed away before he could explain them to us, therefore avoid *riba* and everything which is doubtful.”

(ii) The verses on *riba* are ambiguous and the Quran requires us to follow only that which is clear.

Refutation

(i) It is important to note that the Quran prohibits *riba* of Jahiliyya in all its forms. All these forms relate to all transactions of loans or debts – however after the revelation of these verses, the Prophet (Allah bless him and give him peace) prohibited some other transactions as well which were not known previously as *riba*. The Arabs used certain commodities like wheat, barley and dates as mediums of exchange to purchase other things. The Prophet (Allah bless him and give him peace) felt that given the commercial atmosphere at the time, certain barter transactions would lead the people to deal in *riba*.

The Prophet (Allah bless him and give him peace) treated these commodities as mediums of exchange and issued the following injunction:

“Gold for gold, silver for silver, wheat for wheat, barley for barley, date for date, salt for salt, must be equal on both sides and hand to hand. Whoever pays more or demands more (on either side) indulges in *riba*.”

It is in this background that the Caliph Umar (Allah be pleased with him) stated that the Prophet (Allah bless him and give him peace) passed away before giving any specific direction with regard to this particular form of *riba*. A deeper study of the statement of Sayyidina Umar (Allah be pleased with him), reveals that he was doubtful only about the *riba al-fadal* mentioned in the hadith cited above, and not about the original *riba* prohibited by the Quran and practiced by the Arabs of Jahiliyya in their transactions of loan and non-barter sales.

(ii) As for terming the verses on *riba* ambiguous – Allah declares war against those engaging in *riba* making it incumbent on them to avoid it – Allah would not declare war against a practice the true nature of which is unknown.

The verses of Surah al-Baqarah pronounce *riba* a grave sin – the enormity of which is incomparably emphasized by the fact that if the Muslims do not leave its practice they face a declaration of war from Allah and His Messenger.

In the upcoming part in this series we examine the next Argument:

“The word 'riba' refers only to usurious loans against which creditors charged excessive rates of interest entailing exploitation. Modern banking interest cannot be termed 'riba' if interest rates are not excessive or exploitative.”

Source: The Historic Judgment on Interest, Mufti Taqi Usmani, et al., Supreme Court of Pakistan

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Historic Judgment on Interest (Part 2 of 5)
Does the Word 'Riba' Only Refer to Excessive Interest?

Does the Word 'Riba' Only Refer to Excessive Interest?

This is part 2 of 5 of our series highlighting key arguments and refutations from Mufti Taqi Usmani and others in the "Historic Judgment on Interest" delivered at the Supreme Court of Pakistan in 1999.

Argument

“The word 'riba' refers only to usurious loans against which creditors charged excessive rates of interest entailing exploitation. Modern banking interest cannot be termed 'riba' if interest rates are not excessive or exploitative.”

Refutation

This argument seeks support in the verse:

“O ye who believe! Devour not usury, doubled and multiplied; but fear Allah; that ye may (really) prosper.” [Al-Imran 3:130]

It inaccurately purports that riba is prohibited only when the rate is excessive and not otherwise.

The argument neglects the fact that the verses of the Quran on the subject are to be studied in juxtaposition with one another. The Quran deals with riba in four different chapters and no verse contradicts another on the same subject. From the verses mentioned earlier in the series:

“O those who believe fear Allah and give up what remains of riba, if you are believers.” [Al-Baqarah 2:278]

Based on this verse, any and every amount above the principal is to be given up.

Further based on the following verse:

“And if you repent (from the practice of riba) then you are entitled to get back your principal.”

Repentance from practicing riba is only possible if all the extra amount is given up where the lender is entitled only to the principal amount lent.

The study of the verses of Al-Imran and Al-Baqarah together show that the words “doubled and multiplied” are not restrictive in their meaning or considered as the only conditions for the prohibition of riba but rather these words are used to refer to the worst form of riba widespread at the time.

The Quran interpreted in the light of the Prophetic ahadith sheds further light.

Ibn Abi Hatim reports from the Prophet (Allah bless him and give him peace):

“Listen, every amount of interest that was due in Jahiliyya is now declared void for you in its entirety. You are entitled only to your principal whereby neither you wrong nor be wronged. And the first liability of interest declared to be void is the interest of Abbas ibn Abd-ul-Muttalib which is hereby declared void in its entirety.”

The Prophet (Allah bless him and give him peace) declares the entire amount exceeding the principal invalid – clarifying in no uncertain terms that creditors are entitled to no more than the principal.

Sayyidina Abu Hurairah reports from the Prophet (Allah bless him and give him peace):

“If the creditor received a goat as mortgage from the debtor, the creditor may use its milk to the extent he has spent in providing fodder to the goat. However, if the milk is more than the price of the fodder, the excess is riba.”

Sayyidina Anas Ibn Maalik reports from the Prophet (Allah bless him and give him peace):

"If one of you has advanced a loan and the debtors offer the creditor a bowl (of food), he should not accept it, or if the debtor offers him a ride of his animal (cattle) the debtor must not take the ride unless this type of gift has been a usual practice between them before advancing the loan."

Sayyidina Ali (Allah be pleased with him) reports from the Prophet (Allah bless him and give him peace):

"Every loan which derives a benefit is a kind of riba."

The directives of the Quran and Sunnah address this second erroneous contention by making explicitly clear that any amount over and above the principal – be it little or much - is riba and clearly prohibited.

In the upcoming part in this series we examine the next Argument:

"The third argument differentiates between consumption loans and commercial loans. It contends that "riba" used in the Quran is restricted to the increased amount charged on consumption loans extended to the poor for their day to day needs. As far as modern commercial loans go, they were not practiced in the days of the Prophet (Allah bless him and give him peace), nor has the Quran addressed them when prohibiting 'riba'. Even the basic philosophy underlying the prohibition of 'riba' cannot be applied to these commercial and productive loans where the debtors are not poor people. In most cases they are wealthy and use loans to generate profits. Any increase charged from them cannot be termed injustice which was the basic cause of the prohibition of 'riba'."

Source: The Historic Judgment on Interest, Mufti Taqi Usmani, et al., Supreme Court of Pakistan

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Historic Judgment on Interest (Part 3 of 5)
Does the 'Riba' in the Quran Also Refer to Modern
Commercial Loans?

Does the 'Riba' in the Quran Also Refer to Modern Commercial Loans?

This is part 3 of 5 of our series highlighting key arguments and refutations from Mufti Taqi Usmani and others in the "Historic Judgment on Interest" delivered at the Supreme Court of Pakistan in 1999.

Argument

"The third argument differentiates between consumption loans and commercial loans. It contends that "riba" used in the Quran is restricted to the increased amount charged on consumption loans extended to the poor for their day to day needs. As far as modern commercial loans go, they were not practiced in the days of the Prophet (Allah bless him and give him peace), nor has the Quran addressed them when prohibiting 'riba'. Even the basic philosophy underlying the prohibition of 'riba' cannot be applied to these commercial and productive loans where the debtors are not poor people. In most cases they are wealthy and use loans to generate profits. Any increase charged from them cannot be termed injustice which was the basic cause of the prohibition of 'riba'."

Refutation

This argument is fallacious on the following grounds:

- (i) A transaction's validity is not based on a party's financial status*
- (ii) The Quran does not differentiate between consumption and commercial loans*
- (iii) Commercial loans were indeed common amongst the Arabs at the time*
- (iv) The Quran and not human reason sets the measure of injustice*

A transaction's validity is not based on a party's financial status

Whether or not a transaction is valid does not depend on the financial position of the transacting parties – rather on the nature of the transaction itself. A sale generating lawful profit or a lease of property for lawful use are valid

irrespective of whether the buyer is rich or poor. The poor buyer deserves a concession at most but it cannot be said that it is prohibited to charge him profit.

Gambling and bribery are equally prohibited for both the rich and poor based on the nature of these transactions.

Charging a debtor interest follows the same principle. It would be permissible to charge if lawful by its intrinsic nature regardless of whether the debtor was rich or poor but it is prohibited by its intrinsic nature and therefore invalid to charge the rich or poor alike.

What's more – poverty is a relative term – who determines who is rich and who is poor and thereby exempt from paying interest?

If a distinction is to be accepted based on the loan's purpose then consumption ranges from items of necessity to items of luxury. Based on this premise, a car and a home are necessities for which the rich and employed needn't pay interest on millions borrowed and an unemployed individual borrowing a small sum to set up a street stall is liable to pay interest for taking a commercial loan!

Interest is prohibited in all its forms – hence the distinction between consumption and commercial loans as the basis for the permissibility or prohibition of interest is inaccurate.

The Quran does not differentiate between consumption and commercial loans

The Quranic verses and injunctions of the Sunnah prohibiting riba do not differentiate between the riba from consumption or commercial loans even if for argument's sake one were to assume that commercial loans didn't exist at the time – just as the prohibition of liquor and gambling is not restricted to the forms existent at the time the verses were revealed and not the forms prevalent today!

The prohibition of riba encompasses all forms of excess over and above the principal amount for all times.

Commercial loans were common amongst the Arabs at the time

The portion of the argument that contends that commercial loans were not common at the time the verses were revealed is invalid. All forms of commercial, agricultural and industrial loans were common amongst the Arabs and were extended before and after the advent of Islam.

These interest-based loans were common place in the Byzantine Empire to the point that Justinian the emperor at the time established a law determining different interest rates for different borrowers.

Gibbon mentions in his book – *The Decline and Fall of the Roman Empire* – *“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 same law was enforced in Arabia after the Prophet’s (Allah bless him and peace) birth and remained in force. The Arabs had business relations with Syria which was an integral part of the Byzantine Empire as well as with Iraq, Egypt and Ethiopia. The Arabs were aware of interest in all its various forms as is also reflected in Abdullah Bin Salaam’s warning advice to Abu Burdah from Iraq to be wary of the riba practiced in his country.

The Arabs were well known traders. Trade was the mainstay of the economic activity on the peninsula and extended beyond it. There were a great deal of import and export activities with surrounding countries; trade caravans being the method of transporting goods at the time.

The Quran revealed Surah Quraysh explaining their trade during the winter and summer as a blessing. Abu Sufyan’s caravan at the time of Badr comprised 1000 camels and returned with a 100% profit.

Huge caravans such as these were funded collectively by contributions from tribe members. Hence it is inaccurate to believe that the Arabs were unfamiliar with commercial loans.

According to Quranic exegesis the background of Surah Al-Baqarah's verses dealing with riba was the interest-based loans between tribes.

Ibn Jariri narrates: *"The tribe of Banu Amr used to charge interest from the tribe of Banu al-Mughirah."*

References to commercial loans are found in many ahadith as well.

Reported by Imam Ahmad, Al-Bazzar, and Al-Tabarani from Abdurrahman ibn Abi Bakr, the Prophet (Allah bless him and give him peace) said:

"The debtor will be summoned before Allah on the Day of Judgment. Then Allah will ask him: 'O Son of Adam! Why did you incur debt and infringe on others' rights?' The man would reply: 'My Lord! You know I took it, but I neither abused nor lost it. It was stolen or fumed in a fire or lost its value.' Allah, the Almighty and Exalted, will say: 'My slave has told the truth, and I am more entitled (than anyone else) to settle his debt.' Then Allah will issue a command and something will be placed on his scales causing his good deeds to outweigh his bad ones. And so, by Allah's Grace, he will enter Paradise'."

Apart from the trade caravans, evidence that commercial loans were prevalent can also be seen from the following accounts:

Ibn Saad reports Sayyidna Umar (Allah be pleased with him) wanted to send a trade caravan to Syria for which purpose he borrowed four thousand dirhams from Sayyidna Abdurrahman ibn Awaf (Allah be pleased with him).

Al-Baihaqi reports that Sayyidna Miqdad ibn Aswad (Allah be pleased with him) borrowed seven thousand dirhams from Sayyidna Uthman (Allah be pleased with him). Sayyidna Miqdad (Allah be pleased with him) was of the affluent of the

Prophetic companions and clearly did not borrow this sum to meet his consumption needs.

When Sayyidna Umar (Allah be pleased with him) received the fatal blow from a Christian, he called his son and directed him to calculate the debt he owed his creditors. His son calculated the amount and found that it was 80,000 dirhams. Sayyidna Umar directed his sons to pay the amount from his assets. Obviously, this amount of 80,000 dirhams could not have been borrowed for personal consumption.

Based on this study it is clear – the assertion that the prohibition of riba was restricted only to “consumption and not commercial loans as they did not exist at the time” is far from accurate.

The Quran and not human reason sets the measure of injustice

The measure of injustice is what is set by the Quran as a command from Allah and not independent, individual opinion. It is in this light that the verse referring to riba as injustice must be understood.

“And if you repent (from claiming riba), then you are entitled to get your principal back. Neither you wrong nor be wronged.” [Al-Baqarah 2:279]

The Quran establishes that the one who repents from riba, withdrawing from its practice and giving it up completely – as the one entitled to the principal. If the debtor fails to pay the principal, he commits injustice against the creditor and if the creditor claims any amount over and above the loan, he commits injustice against the debtor.

The Quran does not leave the standard of justice for transacting parties to decide but in fact sets the standard for it – where anything contrary to it is injustice.

Source: The Historic Judgment on Interest, Mufti Taqi Usmani, et al., Supreme Court of Pakistan



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Historic Judgment on Interest (Part 4 of 5) Are There Interest-Based Loans the Quran Permits?

Are There Interest-Based Loans the Quran Permits?

This is part 4 of 5 of our series highlighting key arguments and refutations from Mufti Taqi Usmani and others in the "Historic

Judgment on Interest" delivered at the Supreme Court of Pakistan in 1999.

Argument

The fourth argument was that the Quran prohibits riba-al-jahiliyya which according to a number of traditions was a particular transaction of loan where no additional amount over and above the principal was stipulated but if the debtor could not pay back the loan at maturity, the creditor would grant him an extension against charging an additional amount. According to this theory, an increased amount stipulated in the initial loan agreement does not constitute riba al-Quran. It falls in the category of riba-al-fadal, prohibited by the Sunnah. Its impermissibility is of a lesser degree and may be termed disliked but not prohibited. This prohibition may be relaxed in cases of genuine need and doesn't apply to non-Muslims as it falls within the category of 'Muslim Personal Law,' which does not come under the jurisdiction of the Federal Shariah Court, as established in Article 203(B) of the Constitution of Pakistan.

This argument contends:

- Interest on bank loans is equivalent to riba al fadal which has not been prohibited by the Quran; the Quran only prohibits riba al jahiliyya where the interest amount is imposed after the loan's maturity.
- Riba al fadal is not prohibited in the Quran but is condemned by the Sunnah and so is a disliked but not an impermissible transaction. Contemporary loan transactions are transactions of riba al fadal where it is acceptable to charge an agreed amount of interest at the time of loan extension.
- An interest-free loan is also based on a riba al fadal transaction.
- The prohibition of riba al fadal does not apply to non-Muslims.

Refutation

This argument is baseless at the outset as it vies to found itself on the false theory that an increase stipulated at the time of contracting a loan is riba al fadal and not riba al Quran/riba al jahiliyya; which is only when a creditor demands an increase after loan maturity. This is not so. Riba al Quran is every transaction that entails an increase on the principal whether or not it is established at contract execution or conclusion.

The claim that interest-free loans too entail riba al fadal, as the Prophetic hadith mentioned the necessity of equal quantity on either side of the transaction and an exchange effected at spot, is inaccurate. The problem with this understanding is that it equates a sale with a loan. The reference in the Prophetic hadith is to a sale and not a transaction of loan.

The hadith states: "Do not sell gold for gold, except in equal quantities...and do not sell the deferred (gold or silver) for the (gold or silver) delivered on the spot."

A sale is different from a loan. In a deferred sale the seller is not allowed to ask the buyer for the price any time before the agreed date while in an interest-free loan the creditor is entitled to ask the buyer to return the loaned amount at any time.

To summarize, riba al fadal applies to sales and not to loans which are covered in the Quran under the subject of riba al Quran/riba al jahiliyya. The Quran clearly states that the creditor is allowed to receive only the principal amount and no more. It is erroneous to consider that a bank loan stipulating interest at the time of the transaction's execution is covered by the prohibition of riba al fadal and not riba al Quran and therefore disliked but not impermissible.

The contention that the prohibition of riba al fadal falls within "Muslim Personal Law" and does not apply to non-Muslims as it is beyond the Shariah court's jurisdiction, is inaccurate too. Statute laws

such as the one prohibiting riba al fadal even though applicable to Muslims do not fall under the category of “Muslim Personal Law” based on a revision of the mentioned article of the constitution, and apply to all.

Source: The Historic Judgment on Interest, Mufti Taqi Usmani, et al., Supreme Court of Pakistan

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Historic Judgment on Interest (Part 5 of 5)
Is Interest a 'Necessity'?

Is Interest a 'Necessity'?

This is part 5 of 5 of our series highlighting key arguments and refutations from Mufti Taqi Usmani and others in the "Historic Judgment on Interest" delivered at the Supreme Court of Pakistan in 1999. Please note that the data contained in the judgment is from 1999.

Argument

Though modern interest-based transactions are covered by the prohibition of 'riba,' yet commercial interest is the back-bone of the modern economy. Islam, being a practical religion, recognizes the principle of necessity and permits eating pork in extreme situations for survival. The same principle of necessity should be applied to interest-based transactions and the laws permitting interest should not be declared repugnant to Islamic injunctions.

Refutation

This argument asserts itself based on the doctrine of necessity. While Islam is realistic and does not demand the impossible – the doctrine of necessity is not a vague concept but in fact one founded on sound principles. It requires a certain criteria be met before it is considered applicable to a given situation. The necessity must be real; one that cannot be met with except by the impermissible.

Based on this understanding, the doctrine of necessity does not apply to interest. Let's see how.

There is a common misconception that eradicating interest is synonymous to converting banks and financial institutions to charities; no return for the bank or depositors. This is untrue. While the concept of a loan as it exists in the modern economy today has no basis in an Islamic economic system- the shift from conventional to Islamic

finance does not entail extending interest-free loans rather it is basing transactions on well worked out modes of finance which are not without return and of which profit and loss sharing is one.

Another misconception is that Islamic finance is not yet developed or practiced widely enough to be depended upon to support an entire economy.

Islamic banking and finance is not an idea in theory but in fact a system that has been worked upon by jurists and economists for the last half century. The results of these efforts started turning into a reality in the 70s – since then Islamic banks have grown in number now reaching more than 200 across 65 countries of the world with US\$90 billion capital at a growth rate of 15% per annum.

The Islamic Development Bank's views on the feasibility of a paradigm shift from conventional to Islamic banking:

"The experience accumulated by Islamic banks, in general, and the Islamic Development Bank in particular, as well as attempts made in a number of Muslim countries to apply an Islamic financial system, indicate that the application of such an Islamic system by any Muslim country, at the national level, is feasible. According to the data compiled by the International Union of Islamic Banks, there are 176 Islamic banks and institutions in the world. In terms of number, 47% of these institutions are concentrated in South and South East Asia, 27% in GCC and Middle East, 20% in Africa and 6% in the Western countries. In terms of deposits, amounting to US \$112.6 billion and total assets amounting to US \$147.7 billion. 73% of the activities of these institutions are concentrated in the GCC and the Middle East. IDB alone, since its inception from 1976 to 1999, has provided financing in the range of US \$21.0 billion. As against a growth rate of 7% per annum recorded by the global financial services industry,

Islamic banking is growing at a rate of 10-15% per annum and accounts for 50-60% of the share of the market in the GCC and Middle East."

"Islamic banking is distinctive in two respects: concentrating on the real sector of the economy, it imparts tremendous stability to the economic system by achieving an identity between monetary flows and goods and services, and by operating on a system of profit and loss sharing in its evolved state, it insulates the society from the debt-mountain on the analogy that if the economies enter into recessionary or deflationary phases, the principles of profit and loss sharing protects the states and economic operators from the evils of accumulation of interest and minimizes defaults and bankruptcies."

No doubt the Islamic finance industry is still a nascent industry dealing with a numerous issues at various levels but there is sufficient evidence to disprove that it is unable to sustain an economy.

The fact is that though the elimination of interest from an entire economy is a great deal more challenging than from an institution alone – it is possible. There are many places where abolishing interest is much easier for governments than it is for private Islamic banks. This is because many Islamic banks in various parts of the world have no support from governments or central banks at all where adherence to non-Islamic local regulatory frameworks is a necessary prerequisite to their functions.

In places where an interest-free system and regulatory framework is introduced and established by the government, Islamic banks will be unimpeded as will the government in ensuring an economy based on the equitable principles of Islam.

Without this overriding enforcement at government level, Islamic banks struggle to compete with conventional banks. When no banks offer interest-based financing – this problem is overcome.

As far as foreign debt at government level is concerned its conversion to Islamic financing modes has been elaborated upon in the IDB's reports. The thrust of the reports is that project-financing is not only a Shariah-compliant alternative but will also go a long way to curb corruption and fund misappropriation.

(To examine the features of Islamic banking in detail, please look at our modules designed on specific Islamic banking products available [here](#). To see the devastating effect of foreign debt on the economies of developing countries watch our video: [Why Islamic Finance?](#))

Many leading bankers and highly qualified international finance practitioners are unanimous that Islamic financing modes are not only feasible but in fact geared to ensuring a stable and thriving economy – there are reports based on real facts and figures to corroborate their views.

Based on this discussion, the claim that the interest-based system qualifies as permissible on the grounds of the doctrine of necessity is dismissed.

The conversion to Islamic finance may take time but as the evidence suggests, it is a practicable and viable alternative to conventional interest-based finance.

Source: The Historic Judgment on Interest, Mufti Taqi Usmani, et al., Supreme Court of Pakistan