

Are All Forms of Interest Prohibited?

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ABSTRACT. The claim advanced by jurists of Islamic banks (represented by Shari'ah Supervisory/Control Boards, Fiqh Academy of the Organization of the Islamic Conference and the Makkah Academy) that interest on deferred sale transactions is a profit, or a profit margin, and the claim advanced by the jurists of conventional banks (Muhammad Sayyed Tantawi, the legal opinion issued by Al Azhar Research Academy, Egypt, in 1923H) that calls interest on loans or deposits a profit leads to unlimited profit, for profit has no limit neither in Islamic Shari'ah nor in western capitalism. Calling things by their true name, including interest, would lead to a limited interest rate, a rate that would be determined by the central banks, even in liberal capitalist countries. Interest rates are subject to pricing on two grounds: the first is related to the monetary and credit policy, the second is related to the man-made laws prevailing in the world, which distinguish between interest and usury (where usury here means exorbitant and unfair interest rate). Thus interest is limited and is determined by the central bank, whereas profit rates are unlimited. Dissociating the issue from interest and linking it to profit would delight the greedy financiers to a high degree; the victims would of course be the weak borrowers. Some jurists of Islamic banks are searching for an indicator, a yardstick other than the interest rate, but their search would be a waste of time and effort; victims will increase in number and those searching for this alternative yardstick will ultimately discover how futile their search has been, for they will never find an alternative indicator to interest.

Jurists of Islamic banks and members of Shari'ah Supervisory Boards appointed by these banks claim, consistent with the claim of the by-laws of these banks, that Islam prohibits all forms and types of interest (*riba*). They claim as well that Muslims' markets have no place for an interest rate. I will first attempt to refute this claim from both the juristic and economic perspectives, secondly I will explain how such a claim results in exorbitant interest rates and to the exploitation of weak borrowers by their creditors by imposition of such exorbitant interest rates.

When a Muslim extends an interest-free loan (*qard hasan*), Allah rewards him for such deed. Had he not foregone the 'interest rate', he would have not been eligible for such a divine reward. A clearer case is that of a Muslim selling a commodity on credit, he can obtain a higher price for the commodity sold on credit than its immediate cash

price. Thus there is interest involved in return for the factor of time or deferment, which is permissible, and which is also the exact definition of interest. Thus interest on a loan is money paid over and above the capital sum of the loan, and interest on a deferred sale is the increase of the deferred price over the spot price. It is on these grounds that jurists mentioned that time has a share in the price or; in other words, it is permissible to increase the price (of an article of trade) in return for postponement of the time of payment, which means that there is a share in the price for the time factor.

Among other evidences permitting this type of interest in deferred sales is the fact that payment of 100 Riyals now in return for 100 Riyals to be paid after a year is not permissible in a sale transaction, but permissible in a loan transaction, for a loan is an act of benevolence (*ihsan*), in which the lender foregoes his right as a benevolent person, whereas sale contracts are based on equity not on benevolence. Therefore, jurists are of the opinion that a party to a sale transaction who receives 100 Riyals now would have charged interest to his partner who receives a 100 Riyals after a year. This type of interest is known in Shari'ah as (*riba nasa'* - delay usury), for 100 Riyals today are better than 100 Riyals after a year. It is for this reason that jurists said that an immediate payment is better than a deferred one, provided that the payment amount involved is the same. This is in regard to interest-based sale contracts, or sales commingled vaguely with loans. Regarding ordinary sale contracts, the rules that govern them are different.

If a person has an article of trade having an immediate cash price of 100 Riyals, he would not accept selling it for the same price, 100 Riyals, to be paid after a year; he would prefer to sell it today for an immediate cash price of 100 Riyals. Should the buyer raise the deferred price to 105 Riyals, the seller might continue to reject selling it at such a deferred price. Should the deferred price of the commodity be increased to 110 Riyals, the seller might abstain from selling it at an immediate cash price of 100 pounds and opt for selling it at a deferred price of 110 pounds.

This is known in Economics as "time value". Thus the more distant the date fixed for payment of the price, the higher the price, and vice versa. The time value is the basis on which the interest rate is based. The reader may notice that the seller agreed to sell his commodity at a deferred price that is 10 Riyals higher, which constitutes an interest of 10 per cent per annum. This is the time value and the interest rate it leads to, both from the Shari'ah and the economic perspectives.

This issue is not only confirmed from a juristic and a scientific point of view, but is of great importance and benefit to people in their real life. Its negligence would lead to exorbitant interest rates that would be taken as profit, which is unlimited. Claiming that all forms of interest are categorically prohibited and that an interest rate whatsoever is likewise prohibited, would lead to severing all relations with the literature on interest, central banks control authorities, interest rate tables, the scientific criteria for calculating interest rates and the control of central banks over such rates. Creditors would exploit the severance of all such relations to charge exorbitant interest rates from the public and the weak among them on the pretext that all interest and interest rates are prohibited, although this is not a confirmed issue, neither from the Shari'ah nor the economic perspective, let alone the exploitation, blackmail and inequity this leads to. This is so because the increase in debt balances (whether in the form of a loan or an installment or any of the other names given to it) would not be based on a scientific yardstick or

criteria. In other words, such increase would be chaotic and uncontrollable. Religious people should pay attention to this fact to protect themselves against ignorance and inequity.

Thus there is still in Islam an interest rate, which is legitimate in my opinion and better than an arbitrary increase that is determined without recourse to an indicator or yardstick. What happens in real life nowadays is that when an employee of limited income borrows money from the bank, the bank would grant him limited credit in the form of installment or securitization or hire-purchase, if the bank is an Islamic one, or in the form of a loan if the bank is a conventional one.

In all the above forms of financing, there is a credit of a specific amount, repaid in equal monthly installments of known number and amount. The bank calculates these installments on the basis of a specific interest rate, where the cash price of the commodity is the current value of the periodic installments calculated on the basis of the said rate. To bring the meaning of the 'current value' closer to the mind of the non-specialist, we say that the spot or immediate price of the commodity is the current value of the price deferred one year, based on the interest rate adopted. In other words, the current value of the commodity is 100 Riyals and its value after a year from now is 110 Riyals, based on a 10 per cent interest rate per annum.

It is in the interest of the borrower to calculate by himself, or through a trusted expert, the annual interest rate, whether the bank declares it or not, which is often the case. The bank is normally content to mention the number of installments and their amounts only. Even when such rate is quoted to the customer, it is not quoted correctly. Once the borrower determines the exact interest rate the bank is charging, he would compare it with the prevailing interest rate. If it is similar to, or slightly higher than the prevailing rate due to certain expenses or risks involved, the borrower would go ahead and take the loan, otherwise he would look for another alternative financier or postpone purchase of the commodity until he is able to buy it in cash.

The interest rate could be calculated on the basis of the present value formula of the equal periodic installments:

$$PV = I \frac{1 - (1 + r)^{-n}}{r}$$

where:

- PV = Present Value
- I = Installment Value
- r = Rate of Interest
- n = Number of Installments

Ascertaining the interest rate by a person who wants to borrow money is similar to his verification of the price when he wants to buy commodities. It is not sufficient for the seller alone to know the unit of measurement being used; the buyer has to know it too so that each one's unit of measurement could be used, as some traditions have mentioned.

What is important is that calculating the interest rate in such a scientific manner, by adopting interest rate tables that are prepared on meticulously accurate mathematical

basis and that are known to both parties involved, the borrower and the lender, is far better than hiding such rate from the borrower and than giving the flimsy pretext that interest and interest rates are prohibited even in sale contracts. Ignorance of the interest rate on which the transaction is based and the giving of such pretexts will automatically lead to exorbitant and hidden interest rates, of which the majority of the unwary borrowing public would be defrauded.

Interest is prohibited in loans, but not in deferred sale contracts. The difference between the immediate cash price and the deferred price is the increase of the latter over the former in return for the time value. This has been expressed by Shari'ah scholars, who say that time has a share in the price. This means that interest appears in Muslims' markets in the form of the difference between an immediate cash price and a deferred price. This interest rate is not only permissible in sale transactions, but it is a duty as well. For to ignore the interest rate or to call interest a profit leads to the borrower falling a prey to gross inequality as a result of an unproven and, therefore unrecognized, claim, a claim that Shari'ah and science oppose, and which lenders manipulate and exploit to charge exorbitant and arbitrary interest rates that are not governed by any specific criteria.

Finally, the claim advanced by jurists of Islamic banks (represented by Shari'ah Supervisory/Control Boards, Fiqh Academy of the Organization of the Islamic Conference and the Makkah Academy) that interest in deferred sale transactions is a profit, or a profit margin, and the claim advanced by the jurists of conventional banks (Muhammad Sayyed Tantawi, the legal opinion issued by Al Azhar Research Academy, Egypt, in 1923H) that calls interest in loans or deposits a profit leads to unlimited profit, for profit has no limit neither in Islamic Shari'ah nor in western capitalism. Calling things by their true name, including interest, would lead to a limited interest rate, a rate that would be determined by the central banks, even by liberal capitalist countries. Interest rates are subject to pricing on two grounds: the first is related to the monetary and credit policy, the second is related to the man-made laws prevailing in the world, which distinguish between interest and usury (where usury here means exorbitant and unfair interest rate). Thus interest is limited and is determined by the central bank, whereas profit rates are unlimited. Dissociating the issue from interest and linking it to profit would delight the greedy financiers to a high degree; the victims would of course be the weak borrowers. Some jurists of Islamic banks are searching for an indicator, a yardstick other than the interest rate, but their search would be a waste of time and effort; victims will increase in number and those searching for this alternative yardstick will ultimately discover how futile their search has been, for they will never find an alternative indicator to interest.

هل الفائدة حرام بجميع أشكالها ؟

رفيق يونس المصري

باحث في مركز أبحاث الاقتصاد الإسلامي

جامعة الملك عبدالعزيز - جدة - المملكة العربية السعودية

المستخلص : إن لجوء فقهاء المصارف الإسلامية (لهيئات الشرعية، ومجمع جدة، ومجمع مكة) إلى تسمية الفائدة في البيوع المؤجلة ربحاً، أو هامش ربح، وكذلك لجوء فقهاء البنوك التقليدية (محمد سيد طنطاوي، وفتوى مجمع بحوث الأزهر بمصر في رمضان ١٤٢٣هـ) إلى تسمية الفائدة في القروض أو الودائع ربحاً، إنما يؤدي إلى ربح غير محدود، لأن الربح لا حد له في الإسلام وفي الرأسمالية أيضاً. أما تسمية الفائدة باسمها فهذا يؤدي إلى فائدة محدودة، ومحددة من قبل البنوك المركزية، حتى في الدول الرأسمالية الليبرالية. فالفوائد خاضعة للتسعير لسببين: الأول يتعلق بالسياسة النقدية والائتمانية، والثاني يتعلق بالقوانين الوضعية السائدة في العالم، والتي تميز بين الفائدة والربا. وعلى هذا فإن الفائدة محدودة وخاضعة لتسعيرة البنك المركزي، والربح غير محدود، وفك العملية عن الفائدة، وربطها بالربح، يطير به فرحاً الممولون الجشعون، ويكون ضحاياهم المدينون الضعفاء. ويبحث بعض الفقهاء في البنوك الإسلامية عن مؤشر آخر غير الفائدة، ولكنهم سيضيعون الوقت، وستزداد الضحايا، وسيجهدون أنفسهم بلا طائل، ولن يعثروا على مؤشر آخر.