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### CRITICAL ANALYSIS OF ISLAMIC CONCEPT OF INTEREST

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#### ABSTRACT

*Traditionally there is a consensus among Muslim thinkers on the definition of interest in the Muslim perspective interest is that excess amount which a creditor receives from the debtor on expiry of loan, subject to the condition this increment is pre-decided and part of the agreement. This definition restricts the concept of interest just to debt and gives special status to costs as compare to other assets. It restricts the rent of cash and legitimates the rent of all other assets. Different reasons are given for this artificial bifurcation. But the critical analysis of all of these arguments shows that all of them are unable to come up any standard of reasoning. Hence this concept is just baseless.*

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**Keywords:** Interest, Rent, Depreciation, Cash, Assets

#### INTRODUCTION

It is a well known fact that, interest is prohibited in Islam. Quran has used the term *al-riba* for interest which is normally used as *riba*. The Arabic word *riba* is used in the meaning of to increase, expand, swell, fatten and exult etc. (Parwaiz, 1987) in different verses of Quran it is used in the same meanings e.g. chapter 22 verse 5, chapter 13, verse 10, chapter 69, verse 11 and chapter 23, verse 51 etc. But when this term is used in its specific economic background, it is divided in two types one is called as *riba-al-nasia* and the second is *riba-al-fadal*. Whereas the former is concerned it represents excess amount on debt which creditor receives from the debtor. There is almost a consensus between Muslim thinkers on its definition, which is normally defined in these

words “interest (*riba*) is that increment on debt which is pre-decided and part of the agreement , received by the creditor from the debtor on expiry of loan” (Abu Bakar, 1935).

The Arabic word *nasia* is derived from *nasa* which has the meaning of to post-pond, delay or to wait etc. in this sense it represents that time or delay which creditor provides to debtor to take his loan with pre-decided increment (Chapra, 2005). Whereas the *riba al-fadal* is concerned it represents excess quantity on some particular items in this paper the discussion is concentrated only on *riba al-nasia*. Whereas the terms and conditions of this type of *riba* are concerned following matters are normally considered as decided.

- i. Amount of increment whether it is small or large will be considered as *riba*(interest). Siddiqui (1968a).
- ii. Purpose of loan will not matter, it does not matter whether it was taken for consumer goods or for trading or commercial objectives.
- iii. During the duration of loan no weight will be given to the value of currency. The main reason is that, factors which affect the value of currency are completely beyond the range of debtor; hence he cannot be liable for those factors. Moreover, it is the order of Quran that only principal amount can be taken back and no excess amount can be charged on it.
- iv. According to this definition simple and compound interest both are prohibited. (Maududi, 1997).
- v. Gold, silver or currency cannot be treated as means of production; hence their rent is also not possible.
- vi. Between two Muslims and a Muslim and non-Muslim state any economic transaction is completely prohibited on the basis of interest.

Hence it can be said that there are three components of interest, first increment in debt, second increment with subject to time and third transaction is conditional with this increment. (PLD, 1992).

It is assumed that, from Quranic point of view interest (*riba*) is just restricted to debt. It means this concept gives a special status to cash/ currency as compare to all other assets. According to this concept rent of former is unlawful and reward of the latter is legitimate. Definitely this situation raises a fundamental question about the basis of this bifurcation. In the other words why the rent of cash / currency is unlawful and rent of other assets is lawful?

Moreover this definition also creates confusion in this regard e.g. it may be proved that prevalent interest on financial assets and loans is not that *riba* which is prohibited by Quran (Ahmed, 1995). On the other hand it I also proved that, interest of commercial banks is *riba* (Ayub, 1993). From another point of view interest and *riba* are not identical, whereas interest can not contain an element of *riba* but whole of its cannot be termed as *riba* (Ali, 1989).

## **Reasons of Bifurcation Between cash and All other Assets**

Following four reasons are presented by Muslim thinkers in this regard.

### **Depreciation**

Depreciation is counted as the first and the main reason of rent. It is claimed that due to depreciation rent of all assets becomes lawful. Basic reasoning in this regard is that, the items which are depreciated with the passage of time can be given on rent. Whereas, the consumable goods cannot be given on rent [Siddiqui \(1968b\)](#). It means that only durable things like houses, offices, shops, machines, equipmentsetc, can be given on rent and perishable items like raw material etc. cannot be given on rent.

### **Change in Ownership**

Rent of all those things considered as lawful whose ownership does not change during the transaction. Normally the ownership of durable assets e.g. houses, machines and offices etc., does not change during letting process, hence their rent is valid. On the other hand in case of debt ownership of cash is immediately changed hence its rent is not lawful [\(Kilani, 1991\)](#).

### **Change of Nature**

It is assumed that rent of those things is lawful which maintain their nature intact during the process of letting. In this regard again examples of durable assets can be given like buildings, machines and equipments etc. During the transaction no change take place in their nature, hence their rent is lawful. On the other hand in case of debt, cash cannot be used in the same form, to use it, its form must be changed, and hence its rent is not lawful.

### **Concept of Badal (Exchange)**

It is another important reason to justify the bifurcation of cash and other assets. Under this argument it is argued that, in case of letting durable assets process of exchange is completed. In this case the person who takes assets on rent pay the reward of that asset in the form rent. Same as the person who lets it received cash against his asset, hence the process of exchange (*badal*) is completed and this transaction is lawful. On the other hand it is not same as in the case of debt. Creditor loses the possession of his cash but did not get anything. Whereas debtor receives the cash without any thing in exchange.

### **Element of Risk**

According to this argument it is said that since in the process of letting element of risk is involved. Owner of the asset takes the risk of damage or destruction of his asset. Hence due to presence of risk rent is lawful. [\(Usmani, 1999a,b\)](#). Element of risk has a special importance in the eyes of Muslim economist and from their point of view risk is the fundamental base of profit. Since in the case of rent owner of the asset takes the risk hence on the basis of this fundamental principle rent is lawful.

### **Critical Analysis of the prevailing Concept of interest**

As it is mentioned above under prevailing concept a boundary line is drawn between cash and other assets and then reasons are given to justify it. On this basis critical analysis is divided in two parts. In the first part this artificial bifurcation is challenged and in the second part refutation of these arguments is given which are presented in this regard.

### **Artificial bifurcation Between Cash and other Assets**

The concept through which cash is separated from other assets in completely baseless due to the following reasoning:

First of all this fact is not admitted throughout the world neither in theory nor in practice. All subjects which are directly related to assets e.g. accounting, economics and commerce none of them recognized it. Even in ordinary life it is not so, same treatment is given to cash and all other assets throughout the world in theory as well as in practice. Hence this artificial bifurcation does not exist in this world.

The above mentioned definition of interest is self-contradictory. On one hand it is said that, all those assets can be given on rent which are depreciated with the passage of time. But this rule does not admitted in case of cash / currency, because currency is also depreciated with the passage of time. Hence it is a completely self- contradictory concept.

The most important point is that, Quran is also not ready to accept this baseless concept. The simple proof of this fact is that, Quran has used the term *mal* for all assets including cash. Quran has used this at almost 86 times but at any place it is not used just for cash. The analysis of all 86 verses clearly shows that Quran has used this term for assets at all places. Hence it is proved that Quran also does not verify this strange concept.

### **Rebuttal of Arguments Given in Favour of this Division**

All arguments which are given in this concept do not have any logical base, their individual critical analysis is as follows:

### **Negation of Depreciation as the Base of Rent**

Due to the following reasons depreciation can not be accepted as the fundamental base of rent.

First and the most important point is that, depreciation as the base of rent cannot be proved from any verse of Quran and neither from any Hadith. Any proof from these two basic sources is not available with which it can be claimed that due to depreciation rent of assets can be taken. On the other hand Quran strictly restricts the reward of any asset, in any form and quantity ([Aziz and Abbas, 2011](#)). Hence on this bases depreciation as the base of rent cannot be acceptable.

Another big hindrance in this regard is that, Quran has allowed the *al-bay* (the trade) and strictly prohibited *al-riba* (The reward of capital). The main difference between these two terms is, in the case of former three conditions must be satisfied i.e. a) a buyer b) a seller and c) a commodity which is to be sold by the seller and purchased by the buyer. In case of rent none of these conditions are satisfied. On the other hand this act has a complete resemblance with *al-riba* which is not allowed by Quran. Hence on this basis also concept of rent is not possible.

If the concept of depreciation is accepted as the base of depreciation then on this basis rent of all assets should be decreased with the passage of time. It is due to the reason that, because of wear & tear in the assets their depreciation gradually decreases, hence rent of assets must have a declining tendency. But in real life it is not so, rent of all assets gradually increases with the passage of time. It is an open contrast between theory and practice, and shows that rent is not charged on the basis of depreciation but simply based on market value of assets. It is a simple proof that, rent is not charged on the basis of depreciation.

It is an interesting point that, still in accounting any exact method of calculation of depreciation is not yet discovered. All methods which are used in this regard are just based on estimations, even on the balance sheets of the companies depreciation of assets is shown under the title of provisions. In such a situation when exact calculation of depreciation is not possible how rent can be charged on this basis? Definitely it is not possible.

Another big contrast between theory and practice is that different rent is charged for the same thing which is not possible in any way. It may be cleared with an example of rent of a building. A building which is constructed with the same material, will depreciate definitely with a uniform rate. On this basis same rent should be charged for all parts of the building. But in real life practice is not so, it is an open observation that, different rent is charged for the different parts of the building. It is another open contrast of theory and practice and shows that rent is not charged on the basis of depreciation.

Another point is that depreciation of assets is a natural process, regardless of the fact who is using that asset. It is up-to that extent that an asset will also be depreciated even if anyone do not use it. In this background how a person who takes an asset on rent can be liable for the depreciation of that particular asset? Definitely no logical reason can be given to take the amount of rent due to a completely natural process. Hence on this ground also depreciation cannot be presented as the base of rent.

This argument is totally meaningless in the period of inflation, because in inflationary time period creditor takes more loss as compare to debtor. This point may be explained with a simple example. Assume that a person has one million dollars, in an inflationary time period it will be more beneficial for that person that he will purchase a house and gives it on rent as compare to give this

amount on debt. If it is assumed that rate of inflation is 15% and rate of interest is 10%, then that particular person will receive \$100000 after one year in the form of interest if he gives this amount as debt, but with that his currency is also depreciated by \$1,50,000, hence his net loss will be \$50,000 at the end of year. But if the same amount is invested in the purchase of a house and he rented it at \$100,000 per year then at the end of year he will receive this net amount of rent with that, value of the house will also increases due to inflation. Point of consideration is that both situations are some, from the income point of view, but he is getting more advantages in latter form. Hence this claim do not have any weight that due to depreciation owner of asset gets loss and due to this loss he claims compensation in the form of rent. On the other hand he gets more advantages in this form. This is another example where any reconciliation between theory and practice is absolutely impossible. (Aziz, 2004) On the basis of these arguments it can be concluded that, due to vast contrasts in theory & practice and due to the lack of applicability of this concept depreciation cannot be a base of rent.

### **Denial of Change in Ownership as the 2<sup>nd</sup> Reason of Rent**

On the basis of following two reasons this concept is not valid

Like depreciation any justification from Quran or Hadith cannot be presented with which it can be proved that due to change in ownership rent becomes lawful.

This argument is completely based on delusion under this reason it is claimed that in the case of rent of durable assets nature of ownership is not changed and in case of currency it is so. It is not the fact, both cases are completely same in their nature. In both cases owner of asset temporarily loose the rights of ownership of his asset, sooner or later it will return back to him. In both cases owner has the right to claim his assets whether it is currency or any other asset. Then how it can be said that in case of currency creditor loose the right of ownership and in case of other assets it remains intact. It is completely wrong, both cases are same and there is no difference between these two.

### **Refutation of change in Nature as the 3<sup>rd</sup> Reason of Rent**

Like the first two arguments it is also based on misconception and can easily be refused due to the following facts.

This argument is also barefoot from any logical reasoning from Quran and Hadith. It is a self created argument without any rational.

It is a self contradictory argument because if it is admitted then on this basis interest of commercial banks becomes lawful. It is due to the fact that, under this reason it is claimed that rent of those items is lawful which remains intact during the whole transaction. On this ground consider the case of a commercial bank. A depositor of that bank deposits cash in the bank and receives interest in the form of cash also. During this whole process nature of commodity i.e. cash remains intact.

Hence on this basis bank interest automatically becomes lawful, hence this argument is self-contradictory because it is presented to prevent bank interest and on its basis it becomes lawful.

### **Rebuttal of Concept of Badal as the 4<sup>th</sup> Argument of Rent**

There is also no change in this case like the previous three reasons it is also build on a fallacy which is based on the lack of knowledge of accounting. It is proved from the following facts.

This argument claims that in case of debt, process of exchange is not completed. It is not true, in-fact there is a concept of *badal* or exchange. The simple proof is that, when a creditor gives the credit to a debtor on one hand he gives cash then on the other hand this credit creates another asset i.e. receivable. The situation is quite same as in the case of debtor. When a debtor receives the cash in the form of debt a liability i.e. loan payable is created at the same time. It means creditor on one hand loose one asset i.e. cash then another asset i.e. receivable is created. In case of debtor a liability is created against his debt. Hence in both cases the process of exchange is completed. Hence the concept of lack of exchange is just the result of lack of knowledge of accounting as a subject.

Regarding the proof from Quran and *Hadith* the situation is quite same, this argument is also free from any base from these two basic sources. It is just a self created argument not more than that.

### **Venial of Element of Risk as 5<sup>th</sup> Base of Rent**

Whereas this argument is concerned it is simply based on an open contradiction of teachings of Quran. Its detail is as follows:

According to this claim any income is lawful which is subject to risk. It is a completely wrong notion. Quran has categorically prohibited any income which is based on gambling (Chapter 5, verse 90). Then on what grounds it can be claimed that income on the basis of risk is lawful? Definitely it is not possible. It is important to note that highest degree of risk is involved in gambling. If it is recognized that, on the basis of risk income may be legitimate then no meaning will be left of this verse. Hence this reason cannot be accepted in any way. (Aziz, 2004).

## **CONCLUSION**

Prevailing concept of interest in Islamic perspective gives a very limited concept of Quranic term *al-riba*. It is not just a limited concept but also self-contradictory. It restricts the interest just on debt and allows the rent of rest of the assets, but also fails to give the reasons of this artificial bifurcation. The five reasons which are presented to justify this meaningless division are also baseless and can be refused just on the basis of common sense. These reasons do not have any base from Quran and Hadith but also move just in opposite direction of Quranic teachings. Hence the

present concept of interest (*riba*) in Islamic perspective is completely baseless, and cannot come up to the any standard of reasoning.

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