

# Monetary Conditions of Economic Growth and the Islamic Concept of Interest

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## Is there a Solution to the Open Conflict between Law and Practice in the Muslim World?

### The Qur'anic distinction between Interest as a Surplus and Interest as a Factor in Computing the Overall Efficiency of the Economy

#### The question to answer

Do the Muslim countries, mostly looked upon as under-developed areas, face any obstacles of a religious nature in their efforts to reach the Western standard of living and, more specifically, to adopt the monetary instruments and institutions of the West?

As far as monetary conditions of economic development are concerned, the main fact to be considered is, I think, that the Qur'an prohibited usury (*ribá'*), which according to the traditional interpretation should also cover interest. For those Muslim countries that, instead of adopting a sharp separation of religious and economic (as well as political) matters as in the case of Turkey, intend to evaluate and judge modern institutions in the light of the *shari'ah*, the problem becomes a most critical one: Should Muslims as sincere Muslims still banish interest by following the old interpretation and then search possibilities elsewhere, say within an interestless economy, or try to re-interpret Islamic Law so as to confine *ribá'* to usury and then have complete freedom in accepting economic institutions based largely on interest taking.

In trying to find an adequate answer to the above questions it may well be to start reviewing the true nature of the Islamic concept of interest, and more specifically the set of conditions under which the objections against interest were born.

#### The Qur'an makes a distinction between "business" and *ribá'* or interest as a premium

As is well known, interest in the present-time economies has a variety of functions. Over and above its simplest aspect

as a premium paid to the lender, it serves as the most dependable discount factor in evaluating and comparing different investments, and plays in this capacity a major role in determining the overall structure of investment and production. We will later in this essay try to explain that the predominant role attached to the first aspect (interest as a mere premium that sometimes comes close to usury) declined in the course of economic development, while the other functions gained more importance with the rise of modern capitalistic practices.

It is needless to say that the sharp criticism of the great religions against interest was closely related to its first and simplest aspect, i.e., against interest as a premium that in many cases surpasses the paying ability of the borrower and accrues to the lender as an unearned, and therefore unjust, surplus. Hence the intolerant and even hostile attitude towards *ribá'*, a word denoting a premium or surplus which accrues to a person at an ever-growing percentage with no defensible reason. That is precisely where the interdiction starts from. So, for example, take the Qur'an, 3 : 15 :

"O ye who believe ! Devour not usury doubly doubled, but fear God, perchance ye may be prosperous ; fear the fire which is prepared for the unbelievers . . ."

or for a more elaborate statement take the Qur'an 2 : 275 :

"Those who devour usury shall not rise again, save as he riseth whom Satan hath paralysed with a touch ; and that is because they say ' trading is only like usury ', but God has made trading lawful and usury unlawful."

#### What is *ribá'*?

The distinction made in the above phrase between trade

and *ribá* deserves special attention, and is most essential in understanding the true nature of *ribá*. Following a widely accepted criterion, trade simply means the exchange of heterogeneous items such as money against wheat, and, furthermore, implies that the seller receives a benefit only by reselling in subsequent actions at higher prices the merchandise he might have bought cheaper. *Ribá*, on the other hand, denotes the surplus that arises out of a single act of exchanging homogeneous items (wheat against wheat or money against money). Thus we have a pure act of *ribá*, if a person gives a certain amount of wheat to his neighbour in need with the understanding that a surplus or addition be added on the return. This is unjust simply because the borrower will have consumed up the wheat in the meantime, so that no surplus which can be transferred to the lender would have accrued to him. In other words, consumers' goods, over and above their capacity to satisfy a need, do not have any additional value for which a price may reasonably be charged. For a long time money was also considered as a consumers' good. In fact, as long as it was spent for consumption rather than for productive purposes, no one could expect any increase or surplus. Here we see the Qur'an in perfect accordance with reality :

"That which you give in usury in order that it may increase on people's property hath no increase with God" (The Qur'an, 30 : 39).

### Why the Qur'an condemns *ribá*

Following what has been said so far, the underlying causes of the prohibition of usury by the Qur'an may be, in their logical sequence, classified as follows :

1. To start with, loans are taken and used primarily for consumption purposes. The borrower, having therefore no feasible addition to his income, is very likely to be in difficulty even in the repayment of the principal. Therefore, paying a surplus over and above the capital would easily undermine his economic well-being and force him down to a sub-marginal position where insolvency and bankruptcy are inevitable. That is why the Qur'an explicitly urges, "And if it be one in difficulties, then wait for easy circumstances" (2 : 280).

2. The lender, on the other hand, instead of acting in accordance with the above, would consider himself justified in charging the highest possible interest that would increase at a progressive rate ("doubly double," to use the words of the Qur'an), so as to make up for any loss incurred because of the insolvency of the borrower.

3. Finally, *ribá* is also being spent on consumption rather than for productive purposes, or to use again the terminology of the Qur'an, "swallowed and eaten up", so that the surplus, although apparently growing at a progressive rate, diminishes and finally disappears. And here again is the Qur'an in perfect accordance with what actually takes place : "God shall blot out usury" (2 : 275). Translated into the terminology of modern economic theory, this would read pretty much as follows : there is no addition whatsoever made by usury to the stock of wealth and to the productive capacity of the business community as a whole.

To sum up : we have been dealing with a surplus that seems to move in a circular flow the start and the end of which tend to the same stage of unproductive consumption. In other words, a surplus that, while consuming itself, causes innumerable difficulties and frictions. Therefore, it is quite understandable that, as long as the disadvantages outweigh

the prospective benefits, such a surplus should be suspended or prohibited.

The facts mentioned above suggest that the objections raised are not so much related to loans and interest, as such, as to the nature of their underlying motives and purposes. The main target of the criticism is an economy based largely on unproductive consumption and exploitation. It is worth noticing that Islam, while from the outset is more tolerant towards consumption habits as compared with many other religions, very emphatically condemns any excess of consumption and spending (The Qur'an, 17 : 26). Such an excess, one might argue, would force the individual to perpetual indebtedness, and the worst of all, to misery and mendicancy. So much for consumption from the individual's point of view. As for its social aspect, care should also be taken of a fair acquisition and consumption that would ensure the highest possible justice in distributive shares. Therefore, every surplus acquired and consumed in an unjust manner should not be tolerated in any way (The Qur'an, 17 : 27). Except the profit mutually agreed upon in a normal trading act, all kinds of surpluses are to be looked upon as unjust. *Ribá*, among other things, belongs to this category. Hence again, "God permitteth trading and forbiddeth usury" (The Qur'an, 2 : 275).

To understand and appraise the historical trend it is essential to realize that the prohibition of usury dates from the years after the Hijrah. As a matter of fact, we have no evidence of explicit interdiction in the first years of Islam, except a few remarks in the Qur'an, ch. 30, revealed at Mecca. It is not a mere accident that the chapters openly prohibiting usury were revealed after the Hijrah at Medina. In fact it was soon discovered that a minority composed of non-Muslim (specially Jewish) people was deeply engaged in usury, whereby the interest increased more than double (The Qur'an, 3 : 130). It is worth noticing that the more intricate social and economic structure of Medina brought about a set of problems (among other things also usury) awaiting immediate solutions and interference. This, at least partly, explains the fact that, while most of the chapters revealed at Mecca were rather confined to divine and moral matters, those revealed in Medina did establish concrete and explicit rules and regulations.

The reasons for this gradual change of attitude prevailed in the next few centuries and were even more accentuated by the emergence of an "intricate civilization", to use the terminology of Ibn Khaldun. More specifically, here we have to deal with an economy of large-scale consumption and spending based on estates and farms of which, to speak with Farid al-Din 'Attar, the great Persian mystic poet of the 12th century, an increasing amount of loans along with the jealousy and hostility of the outsiders, endless troubles and lots of dependants are the main features.

The development outlined has been partly responsible for the growing intensity of the criticism against usury, with the result that even matters very loosely connected with usury were looked upon as unfair and unlawful. Hence the warning of the later days, "Suspecting usury is but usury itself".

### Open conflict between practice and law

The growing intensity of the criticism did of course not provide a guarantee of a strict obedience. As is always the case, the effectiveness and operational capacity of the doctrine should clearly be distinguished from its logical content. Thus the following question arises : How far did the

interdiction succeed in abolishing the practice of paying and receiving interest?

Despite the efforts spent in sustaining the law, the history of many Muslim countries furnishes contrary examples. In fact, there is not a single period during which interest taking was actually prevented. Apart from a handful of deeply religious men, whose names sound like legendary heroes, by far the greatest majority has always been engaged in interest taking.

Here we have the evidence of an open conflict between practice and law. To bridge the gap, Muslim authorities as well as Christian scholars of the Middle East had a hard time searching ways and means of re-interpreting and legalizing at least the mild forms of interest without getting into explicit conflict with the established beliefs. The attitude of various Islamic schools with regard to this question did of course greatly differ. Time and space forbid a detailed and thorough explanation of the conflicting ideas and doctrines. However, leaving aside the subtle differences, one might say that in cases where interest taking was inevitable, the efforts of the lawyers were concentrated on reinterpreting actual contracts so as to convert an illegal act into a legal one, as for example the conversion of the *ribā'* contract into an association (*sharikah* whereby the interest is changed to or rather renamed as a premium risk (*mukhatarah*) which is legally quite permissible. A more common way was to affiliate the loan act with a trading contract that would supersede the former. In this manner the loan act had a chance of becoming a legal procedure. The common practice was as follows: the borrower sells to the lender a specific good which will thereafter be resold to him at a lower price, the difference taking the place of interest. By doing so, the loan act seems to have been completed without interest. This is a procedure which was in common use in some Muslim countries, for example, in Turkey before the Revolution (with banks called *Eytam Sandigi*).

### **The reconciliation of the West to the institution of interest**

To complete the above picture, I may also add that some of the measures taken or suggested were adopted, probably due to the impact of Muslim philosophy, by the Christian Middle Ages of Europe, with the ultimate result that, despite the resistance of the Church, the reconciliation in the West was a more systematic and fundamental one. From among the obvious factors responsible for this change, I would like to point out a specific fact that, although quite often overlooked, gives a clue to a better understanding of the divergence between the two great cultural areas since the end of the 15th century: this is the century of growing maritime trade in the West which because of heavy risks involved facilitated or even imposed the transition from loan contracts to various forms of associations whereby the interest could be integrated, as an invisible factor, with the premium of risk. On the other hand, due to the decadence of maritime trade, especially in the Mediterranean, a similar transition had no chance in Muslim countries of imposing itself to the same extent, and so interest kept being an open target for attacks and criticisms.

The rest of the factors responsible for the divergent courses of development in the two areas, such as growing capitalism and developing monetary institutions in the West, are too well known to need any explanation. All the observations suggest that a conflict between law and practice continued to exist as an unsolved problem in the Muslim world up to the present time.

The above survey brings us to the problems of our day. The existing tension between Islamic Law and practice may cause a good deal of perplexity and doubt as to the nature of the way to be followed in the minds of people with strong religious feelings. On the other hand, we must guard ourselves against hasty generalizations in the opposite direction, i.e., in adopting the present-day practices of advanced economies. In fact, following the modern view, one would be inclined to argue that the Islamic notion of interest is but a rudimentary and medieval idea and has, therefore, no connection with what actually takes place in the modern world. This is not always true. To begin with, we have in the usury doctrine a system of coherent ideas, indeed, one of the most elaborate intellectual achievements of the past. As for its practical significance, we should bear in mind that usury continues to exist as a problem to be dealt with in most of the backward areas, and more specifically, in under-developed countries with a great will and high potentialities of growth. As repeatedly observed in history, the growth of money economies tends for a while to stimulate money demand to a greater extent than money supply, owing to the psychological stimulus for a disproportionate expansion of wants far beyond the limits of technical capacities. That is what in countries having insufficient monetary instruments and banking practices makes money, and hence the premium paid for its use, i.e. interest, always dear and usury very profitable (not to mention other obvious factors such as the greater risks involved).

### **Is "interestless economy" possible?**

What is then to be done? Is an "interestless economy" the right answer to this question? And here again, even if the essential features of such an economy could be theoretically outlined in a pure model, to what extent could this kind of an experiment be successfully carried out? If not, shall we cease to be a good and sincere Muslim?

If I am right in my judgment, experimentations of this kind have been doomed to failure. The reason for this lies in the fact that interest is not always an easy target to shoot for. The crux of the problem is that, after allowance is being made for such elements as the premium of risk, the objections against interest reduces itself in the final analysis to what economic theory calls pure interest, i.e., to an intangible factor. Each time when attacked this factor could freely move in any direction, trying to disguise itself as a premium of risk or as a normal profit, with the loan act being changed to a trading act. That is why most of the experiments up to the present time focused attention on limiting rather than eliminating interest. To construct a model of an economy where interest does not exist while the premium of risk and normal profit are tolerated, and then to call it an "interestless economy", would be too naïve an experiment to rely upon seriously.

Yet, with this point in mind, one should note that at least in highly-developed countries the objection against interest has decreased to a considerable extent. Apart from a few exceptions, of which the German experience or rather doctrines of the 1930s, with the slogan "Breaking the slavery of interest" (*Brechung der Zinsknechtschaft*) was the chief example, recent history does not reveal any serious effort to combat against interest. There seem to be other questions that attract more attention than the problem of interest considered as a mere surplus. In other words, the focus of attention has been shifted considerably to different aspects of the same phenomenon. And here are the facts:

(a) Interest in the sense of a surplus, that under the circumstances explained above comes close to usury, is not a problem to be dealt with in the first instance. As a matter of fact, growing capitalism and more specifically developing banking facilities created a *milieu* where usury has been minimized. Thus, being reduced to a fair level, interest does not even seem to maintain the predominant position it used to have as the most effective factor in determining the individual's decision as to saving or non-saving. And yet:

(b) With the growth of modern capitalistic practices, interest, in the sense of a discount factor used to evaluate and compare the efficiency of different investment and production projects, seems to attract more attention. That is why most of the modern economists who express doubt as to the significance of interest from the individual's point of view attach a great deal of importance to interest as a factor indispensable in computing the overall efficiency of the economy.

**The crux of the problem for under-developed countries is to differentiate between interest as a surplus and interest as a factor in computing the overall efficiency of their economies**

Here is the crux of the problem for under-developed countries: While they still have to deal very rigorously with interest as a surplus, they lack the practice of using it in the second sense. In fact it is fair to say that the situation here is contrary to that in the highly-developed countries: the significance of interest as a basic element of calculation lags far beyond its usual aspect as a premium or surplus. It is essential that, while the struggle against interest in the latter sense should rigorously be carried on whenever necessary, interest in the former sense ought to be adopted, if Muslim countries are to reach the scale of efficiency of the Western economies. In fact, one of the chief obstacles retarding economic development is the fact that business firms as well as governments have a habit of making decisions in a rather loose and spontaneous manner, ignoring the criteria supplied by a sound cost accounting analysis.

It would have been too naïve a view to argue that Islam with its *ribā'* doctrine did ultimately prevent the Muslim countries from adopting modern capitalistic practices. It is not so much the religious beliefs as such as the lack of entrepreneurial abilities and techniques that brought about the present situation. Introducing Islam into the chain of obstacles would but make the difficulties encountered at least twice as heavy as they really are. Muslims should not hesitate to adopt the Islamic concept of interest as an effective method to fight against usury wherever they see it in action. The Qur'an maintains its freshness in this case as if it were

revealed only yesterday. But such an approach, however justified in those cases, ought not make us forget the utmost importance of interest as an element of cost accounting in modern economies.

It seems to be that most of the difficulties stem from a too narrow interpretation of the Qur'an with regards to usury. As explained before, the objections were chiefly directed against the underlying circumstances rather than against interest as such — to repeat the words of the Qur'an already mentioned: "O ye who believe! devour not usury doubly doubled" (3:30). Finding examples that would exactly fit into the specifications of this phrase is in highly-developed countries, and even in the larger cities of under-developed areas, not always easy. To do justice to the Qur'an, we must be aware of the fact that the Islamic concept of usury cannot be sought in or reduced to a single word, *ribā'*, but must be understood in its entirety, i.e. in the phrase as it was literally revealed with the necessary qualifications such as "those who devour" and "doubly double". As soon as we drop out these qualifications, we would face a phenomenon of an entirely different nature. It would, therefore, be a great mistake to insist on classifying events that may have undergone a substantial change and even become an entirely new phenomenon still under the old name. However, as far as terminology is concerned, we are better off with a pair of words — *ribā'* (usury) and *fa'yd* (interest). It may be well to reduce the former, following the traditional approach, to those cases where a surplus, subject to the above qualifications, arises, whereas the latter may be used to denote the premium paid for the use of money. And here another difference immediately suggests itself: *ribā'* (usury) may come into existence in a barter economy as well, whereas interest is to be conceived of as a purely monetary phenomenon.

All these facts, taken together, clearly indicate that we are dealing in the modern economy with a problem which by its nature differs from what has been envisaged by the Qur'an. As referred to above, the exchange economy which was chiefly responsible in its early stages for a disproportionate rise of money demand and therefore, to a great extent, for usury, did furnish in the later stages of its development the necessary remedy, thanks to growing monetary instruments and banking practices. Instead of launching on a hopeless experiment of fighting usury as such, it seems far more desirable to plant the seeds of monetary institutions into the body of under-developed economies so as to make the adaptation a short and painless one, just as in medicine preventive measures against certain diseases are taken by injecting viruses of these same diseases into the organism.

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