

## **Chapter Four: Riba and PLS System in Islam**

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### **Definition of Riba**

Riba literally means increase, addition, expansion or growth. It is, however, not every increase or growth which has been prohibited by Islam. In the Shari‘ah, riba technically refers to the "premium" that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity.

**There are two types of Riba identified to date by these scholars, namely**

‘Riba an Nasiyah’ and ‘Riba al Fadl.’

‘Riba an Nasiyah’ is defined as excess, which results from predetermined interest which a lender receives over and above the principle (Ras al Maal).

‘Riba al Fadl’ is defined as excess compensation without any consideration resulting from a sale of goods. ‘Riba al Fadl’ will be covered in greater detail later.

**Five characteristics of Riba al Nasiah are:**

- i. It is fixed.
- ii. It is guaranteed.
- iii. It increases with the increase of time.
- iv. It secures the lender but exposes the borrower to great danger.
- v. It does not increase with Allah and invites his anger and wrath.

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## RIBA IN THE QURAN

Different verses of the Quran related to Riba are given in the following:

### 1. First Revelation (Sura Ar-Rum, verse 39)

The earliest revelation of the Quran related to Riba is preceded by a verse enjoining to give his right to the relative, the needy and the wayfarer, which clearly indicates the spirit of the Islamic Economic System.

وَأُولَئِكَ هُمُ الْمُفْلِحُونَ فَأَتَى الْقُرْبَىٰ حَقَّهُ وَالْمِسْكِينَ وَابْنَ السَّبِيلِ ذَلِكَ خَيْرٌ لِلَّذِينَ يُرِيدُونَ وَجْهَ اللَّهِ  
تُرِيدُونَ وَجْهَ اللَّهِ فَأُولَئِكَ هُمُ وَمَا آتَيْتُم مِّن رَّبًّا لَّيْرُبُو فِي أَمْوَالِ النَّاسِ فَلَا يَرْبُو عِنْدَ اللَّهِ وَمَا آتَيْتُم مِّن زَكَاةٍ  
الْمُضْعِفُونَ

*So, give to the relative his Right, and to Al-Masakeen (the needy, whose business has stalled, or who has lost his job, or whose hard-earned income is insufficient to meet the basic needs), and Ibn-e-sabeel (the homeless son of the street or the needy traveler). This is best for those who seek Allah's Approval, for, it is they who are the successful.*

*And whatever you give for **Riba** in order that it may increase in people's wealth, it will not increase in the sight of Allah; and whatever you give for Zakat, seeking Allah's pleasure, it is they who are the multipliers (to get manifold reward)*

*Al-Quran 30/38-39*

The above given verse of Sura Ar-Rum is believed to be revealed in Makkah as the earliest reference to the term Riba in the Quran. This verse is not of prohibitive nature. However, it clearly shows that Riba is not favoured and rewarded by Allah.

## 2. Second Revelation (Surah an-Nisa', verse 161)

The verse 161 of Sura An-Nisa alludes that Riba was prohibited for the Jews but they did not comply with the prohibition in their practical lives.

فَيُظْلَمُ مِّنَ الَّذِينَ هَادُوا حَرَّمْنَا عَلَيْهِمْ طَيِّبَاتٍ أُحِلَّتْ لَهُمْ وَبِصَدِّهِمْ عَنِ سَبِيلِ اللَّهِ كَثِيرًا  
وَأَخَذَهُمُ الرَّبُّ وَقَدْ نُفُوا عَنْهُ وَأَكْلِهِمْ أَمْوَالَ النَّاسِ بِالْبَاطِلِ وَأَعْتَدْنَا لِلْكَافِرِينَ مِنْهُمْ عَذَابًا أَلِيمًا

*So, because of the injustice committed by those who followed the Jewish faith did We deny unto them certain of the good things of life which [aforetime] had been allowed to them; and [We did this] for their having so often turned away from the path of God,*

*and [because of] their taking **Riba** although it had been forbidden to them, and their wrongful devouring of other people's possessions. And for those from among them who [continue to] deny the truth We have readied grievous suffering.*

*Al-Quran 4/160-161*

## 3. Third Revelation (Surah Ale 'Imran, verses 130)

The following verse of Surah Ale-Imran contains a clear prohibition of *Riba* in express terms:

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا الرِّبَا أَضْعَافًا مُّضَاعَفَةً وَاتَّقُوا اللَّهَ لَعَلَّكُمْ تُفْلِحُونَ

*O you who believe! (Do) not eat Riba doubled, re-doubled. And consciously revere Allah so that you may (be) successful.*

*Al-Quran 3/130*

Just a couple of verses followed by the above verse (Ale-Imran 3/130), there is a strong exhortation for doing charity both in prosperity as well as in adversity. This

again highlights the spirit behind the prohibition of Riba, which is helping the poor and needy rather than lending them money on interest.

وَسَارِعُوا إِلَىٰ مَغْفِرَةٍ مِّن رَّبِّكُمْ وَجَنَّةٍ عَرْضُهَا السَّمَاوَاتُ وَالْأَرْضُ أُعِدَّتْ لِلْمُتَّقِينَ

الَّذِينَ يُنْفِقُونَ فِي السَّرَّاءِ وَالضَّرَّاءِ وَالْكَاطِمِينَ الْغَيْظَ وَالْعَافِينَ عَنِ النَّاسِ وَاللَّهُ يُحِبُّ الْمُحْسِنِينَ

*And vie with one another to attain your Sustainer's forgiveness and a paradise as vast as the heavens and the earth, which has been readied for Al-Muttaqeen,*

*those who spend (in charity), both in prosperity and adversity, who restrain their anger and are forgiving towards people. God loves those who do good works.*

*Al-Quran 3/133-134*

#### **4. Fourth Revelation (Surah al-Baqarah, verses 275-81)**

The fourth set of verses is contained in Surah Al-Baqarah where the severity of the prohibition of Riba has been elaborated in detail.

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا فَمَنْ جَاءَهُ مَوْعِظَةٌ مِّن رَّبِّهِ فَانْتَهَىٰ فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ وَمَنْ عَادَ فَأُولَٰئِكَ أَصْحَابُ النَّارِ هُمْ فِيهَا خَالِدُونَ

*The standing of those who eat Riba is like standing of the one who is confounded by Devil's stroke – that's because they say trade is just like Riba, whereas Allah has permitted trade and forbidden Riba. Hence those who have received the admonition from their Lord and desist, may keep their previous gains, their case being entrusted to Allah; but those who revert shall be the inhabitants of the fire and abide therein forever.*

*Al-Quran 2/275*

In Al-Quran 2/275, the term Riba has been used in contrast with the term Bai'.

Bai' (بيع) has the following meanings:

- Sale {Hans Wehr Arabic Dictionary}
- Exchanging or exchange of property; making an exchange with property; making a contract (of sale and purchase); baa'a (بَا عَ) mostly means "he sold" and sometimes means "he bought or purchased" {Lanes Lexicon}
- Commercial transaction {Steingass}
- Sale or purchase {Hava}
- Interchange by sale; selling; merchandising; barter {Penrice}
- Bargaining; selling and buying {AA Nadwi}

An example of Bai' is that you purchase an item from person A for \$10 and sell it to person B for \$11. The extra \$1 is a lawful profit. {Profit is lawful as long as it is reasonable}.

An example of Riba is that you lend a person A, \$10 and say, after a period of one year get back \$11. The extra \$1 is unlawful Riba. In both examples, you get extra/addition/growth of \$1 but in case of Bai' , this extra \$1 is lawful but in case of Riba, it is unlawful.

يَمْحَقُ اللَّهُ الرِّبَا وَيُزِيهِ الصَّدَقَاتِ وَاللَّهُ لَا يُحِبُّ كُلَّ كَفَّارٍ أَثِيمٍ

*Allah deprives Riba of all blessing, whereas He blesses Sadaqaat (i.e. charities) with manifold increase.*

*And Allah does not love anyone who is stubbornly ingrate and persists in sinful ways.*

*Al-Quran 2/276*

إِنَّ الَّذِينَ آمَنُوا وَعَمِلُوا الصَّالِحَاتِ وَأَقَامُوا الصَّلَاةَ وَآتَوُا الزَّكَاةَ لَهُمْ أَجْرُهُمْ عِنْدَ رَبِّهِمْ وَلَا خَوْفٌ عَلَيْهِمْ وَلَا هُمْ يَحْزَنُونَ

*Those who believe, perform good deeds, establish the salat and pay the zakat, their reward is with their Lord; neither should they have any fear, nor shall they grieve.”*

*Al-Quran 2/277*

يَا أَيُّهَا الَّذِينَ آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنْتُمْ مُؤْمِنِينَ

*“O, believers, consciously revere Allah, and give up what is still due to you from the Riba, if you are true believers.”*

*Al-Quran 2/278*

فَإِنْ لَّمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِنَ اللَّهِ وَرَسُولِهِ وَإِنْ تُبْتُمْ فَلَكُمْ رُءُوسُ أَمْوَالِكُمْ لَا تَظْلِمُونَ وَلَا تُظْلَمُونَ

*“If you do not do so, then take notice of war from Allah and His Messenger. But, if you repent, you can have your principal. Neither should you commit injustice nor should you be subjected to it.”*

*Al-Quran 2/279*

In the following words, the preposition la (لَا) refers to, (one’s) right or that one deserves (استحقاق), and ruūsu amwālikum (رُءُوسُ أَمْوَالِكُمْ) means ‘Your Principal’. It implies that the lender is allowed to have only the Principal back, without any increase.

فَلَكُمْ رُءُوسُ أَمْوَالِكُمْ

In the inflationary system of paper money, the currency may lose value over time. Lending may be linked to price of a commodity having intrinsic value to account for inflation in the paper money so that neither the lender nor the debtor is at loss.

لَا تَظْلِمُونَ وَلَا تُظْلَمُونَ

*Neither should you commit injustice nor should you be subjected to it.*

### **The Ten Qur`anic Statements about *Riba***

The contents of the four Qur`anic passages mentioned above can be conveniently divided into ten statements about *riba*.

- 1) *Riba* is a type of increase in a loan.
- 2) Taking *riba* is *zulm* on the borrower.
- 3) Depriving the lender of *ra`s al-mal* is *zulm*.
- 4) *Riba* often involved doubling and redoubling of the debt:
- 5) Charity is an alternative or an opposite to *riba*.
- 6) *Riba* is not like sale.
- 7) *Riba* leads to destruction and *sadaqah* to growth.
- 8) Dealing in *riba* is gaining through the wealth of other people.
- 9) *Riba* was prohibited earlier for the Jews.
- 10) Taking *riba* is a very serious sin.

### **Hadith on Riba**

حَدَّثَنَا مُحَمَّدُ بْنُ الصَّبَّاحِ، وَزُهَيْرُ بْنُ حَرْبٍ، وَعُثْمَانُ بْنُ أَبِي شَيْبَةَ، قَالُوا حَدَّثَنَا هُشَيْمٌ، أَخْبَرَنَا أَبُو الزُّبَيْرِ، عَنْ جَابِرٍ، قَالَ لَعَنَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ أَكِلَ الرِّبَا وَمُوكِلَهُ وَكَاتِبَهُ وَشَاهِدِيهِ وَقَالَ هُمْ سَوَاءٌ .

Jabir said that Allah's Messenger (ﷺ) cursed the acceptor of interest and its payer, and one who records it, and the two witnesses, and he said: They are all equal.(Sahih Muslim 1598).

حَدَّثَنَا مُحَمَّدُ بْنُ الصَّبَّاحِ، وَزُهَيْرُ بْنُ حَرْبٍ، وَعُثْمَانُ بْنُ أَبِي شَيْبَةَ، قَالُوا حَدَّثَنَا هُشَيْمٌ، أَخْبَرَنَا أَبُو الرَّبِيعِ، عَنْ جَابِرٍ، قَالَ لَعَنَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ أَكِلَ الرَّبَا وَمُوكِلَهُ وَكَاتِبَهُ وَشَاهِدِيهِ وَقَالَ هُمْ سَوَاءٌ .

Jabir said that Allah's Messenger (ﷺ) cursed the accepter of interest and its payer, and one who records it, and the two witnesses, and he said: They are all equal.

## **Why riba is prohibited?**

### **Misallocation of Capital**

Unlike riba-based lenders, investors into a business need to believe in the underlying businesses outlook to generate profits by creating economic value. Since riba-based lenders only care about the likelihood to repay the loan with interest, money flows mainly into the hands of borrowers who are likely to repay, rather than towards the best and most productive economic activities.

Riba leads to excessive leverage in business which can lead to systemic risks and business failures. In finance, leverage means using debt to buy assets. After the 2008 financial crisis, many businesses failed because they had high levels of debt (leverage) and they could no longer sustain the payments of riba. Economists call this process “de-leveraging”.

### **Exploitation Not Partnership**

Riba conflicts with the spirit of brotherhood and sympathy, and is based on greed, selfishness and hard heartedness. Rather than sharing in the risks of a business or investment, riba sets up a lender/borrower relationship. The lender has a financial



incentive to squeeze the borrower as much as possible to get the loan back with interest, regardless of the borrower's situation.

An example of this can be seen when mortgage-holders default on their home loan. Banks often repossess a family's home and put them out on the street, even if the family has already paid the full price of the house.

## **PLS**

*Profit and Loss Sharing* (PLS) is the method utilized in Islamic banking to comply with the prohibition of interest. The Islamic solution, commonly referred to as Profit & Loss Sharing (PLS), suggests an equitable sharing of risks and profits between the parties involved in a financial transaction. In the banking business, there are three parties - the entrepreneur or the actual user of capital, the bank which serves as a partial user of capital funds and as a financial intermediary, and the depositors in the bank who are the suppliers of savings or capital funds. There are two different partnerships of the type mentioned in Islam: the partnership between the depositors and the bank, and the partnership between the entrepreneur (or the borrower) and the bank. Under this proposal, financial institutions will not receive a fixed rate of interest on their outstanding loans, rather, they share in profits or in losses of the business owner to whom they have provided the funds. Similarly, those individuals who deposit their funds in a bank will share in the profit/loss of the financial institution.

## **Modes of PLS in Islam**

## **1. Mudaraba (Investment made by the entrepreneur)**

### **Definition of Mudaraba**

The term Mudaraba refers to a contract between two parties in which one party supplies capital to the other party for the purpose of engaging in a business activity with the understanding that any profits will be shared in a mutually agreed upon. Losses, on the other hand, are the sole responsibility of the provider of the capital. Mudaraba is also known as Qirad and Muqaradah.

### **Rules of Mudaraba**

- There are some legal rules that govern the business relationship Mudaraba which are as follows.
- It is a condition in Mudaraba that the capital be specific in nature. In other words, the amount of capital must be known at the inception of the contract.
- It is a condition that capital must be in the form of currency in circulation.
- It is a condition that the capital of the Mudaraba is delivered to the Mudarib.
- It is permissible to impose restrictions on the Mudarib as long as the restriction is beneficial and does not hinder the agent's ability to make a profit.

## **2. Musharaka**

Musharaka is an investment model focused on profit-loss-sharing (PLS), where one, two, or more entrepreneurs approach Islamic Financial Institutes (IFIs) to

request the funding needed for a project. The IFI provides the requisite funding for the project along with other partners. Both participants have the right to participate in the project, including IFI. This right can also be waived by them. The income must be allocated by the negotiated ratio, which must not be the same as the capital ratio. However, costs are shared in precisely the same proportion as the funding for the project was given by the various partners

### **Features of Musharaka**

- The capital in Musharaka comes from all the partners.
- In Musharaka, all partners can participate in the management of the business and can work for it.
- Profit is distributed as per pre-agreed ratio.
- Loss shared as per capital ratio.

### **Concept of Islami Banking**

The concept of Islamic Banking represents a radical departure from traditional banking. Almighty, Omnipotent, Omniscient and Ubiquitous Allah have strictly forbidden investing or earning on the basis of interest (riba). Because, according to Islamic Shari'ah, interest (riba) is prohibited in Islam. So every sort of transaction must be free from riba.

An Islamic Bank is a financial institution that operates with the objective to implement and materialize the economic and financial principles of Islam in the banking arena. The Islamic banks organize their operation on the basis of profit/loss sharing and other modes which are permitted in Islam.

According to Organization of Islamic Conference (OIC), “Islamic bank is a financial institution whose statutes, rules and procedures expressly state its commitment to the principles of Islamic Shari’ah and to the banning of the receipt and payment of interest on any of its operations.”

According to Dr. Ziauddin Ahmed “Islamic Bank is essentially a normative concept and could be defined as conduct of banking in consonance with the ethos of the value system of Islam.”