

MONEY & RIBA

Tutorial 3

By Najmul Hussein Rassool

The Present Financial Crisis 1

- Up to early 2007 boom in US house-hold credit
- Creation of Sub-Prime loans
- Refinancing through Factoring agencies
- Securitisation for sale to general public
- Invention of a mathematical technique to pool risky loans and packaged as 'collateralized debt obligations' (CDOs).
- Securitized debts in the form of CDOs were then sliced up and exported over the world
- AAA ratings by Rating agencies

The Present Financial Crisis 2

- Creation by Wall Street of new CDOs of low-rated corporate bonds and emerging markets debts alongside the sub-prime mortgage loans
- Once CDOs exhausted the available debts, derivatives in the form of credit default swaps (CDS) came into the picture
- By 2008, the credit default swaps market had grown to \$ 60 trillion, while the entire world's gross domestic product was \$60 trillion
- During the same time, the size of the derivatives markets overall, (i.e. including Options, Futures, Swaps etc.) had increased from \$55 trillion in the mid-1990s to an incredible \$600 trillion.
- All of these derivatives were unregulated and no one could figure out who held what

The Present Financial Crisis 3

- Drop in housing prices
- Default in housing loans payments
- Debt-based assets no longer safe
- Panic-whole pyramid of debt-based instruments fell down
- Once panic set in, lending was stopped, companies suffered losses, and share prices faced steep falls
- Investors who had put millions on stake by speculative transactions in stocks and derivatives were financially ruined, and the whole economic set-up was in the grip of the crisis that is estimated to have wiped out nearly 45% of the wealth of the world

Causes of the Present Financial Crisis

- 1. Diverting 'money' from its basic function to act as a medium of exchange**
 - Making money an object of trade
 - The greed of making money out of money,
 - Turning the whole economy into a balloon of debts over debts.
- 2. Derivatives were one of the basic causes of the financial problems**
- 3. The sale of debts**
- 4. Short sales in stocks, commodities and currencies is the basic factor that makes speculation disastrous for the smooth operation of real commercial activities**

Nature of Money

- Modern economists are unanimous on the point that money is a **medium of exchange** and a **measure of value**
- Nature of money has been eroded and treated as a **commodity**
- Creation of **Paper money, Financial papers, derivatives(options, futures, Swaps)**
- **Financial engineering**
- Increased the supply of fictitious money to an unbelievable extent, that is, twelve times more than the collective GDP of the entire world!!!

Definition of Money

- Islam defines money as a medium of storing wealth and used as an exchange tool for business transactions.
- Islamic principles however do not recognize the usage of money as a tool to make profit. This is because in Islam, money is not considered as a commodity that should be used for a price. In other words, Islam does recognize money as a means of exchange, but it is not legally regarded as a commodity of exchange.
- Money, therefore, is not a commodity in its own right, but has a status only in so far as it can be put to good use.
- As per Shariah, money does not reproduce. It grows when it is invested in tangible economic activity. It is a measuring tool.

The Concept of Money

- **Imam Hasan Al-Basri**, a renowned scholar of the first century of Islamic history, has explained the nature of money as follows:
“Money is such a companion of yours that it does not benefit you, unless it leaves you”
- Money is a means of exchange, a measure of value and it has no intrinsic utility
- **Imam Al-Ghazali**, (d. 505 AH) a genius philosopher of the twelfth century said:
“The creation of dirhams and dinars (money) is one of the blessings of Allah.... They are stones having no intrinsic usufruct or utility, but all human beings need them.....”
- As per Shariah, money does not reproduce. It grows when it is invested in tangible economic activity. It is a measuring tool.

What is Riba?

- Riba (Aabic: ربا) is the term for usury, the charging of interest, which is forbidden by the Qur'an.
- Riba literally means increase, addition, expansion or growth. It 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.
- An increase or excess on exchanging or selling of a commodity to the owner without giving in return any equivalent counter value or recompense.
- The Quran strictly prohibits Muslims from any dealings that involve usury (riba). This prohibition appears in many Quranic verses. Moreover, in the hadith, the Prophet (pbuh) elaborated more on the definition and the kind of riba.

Stages for the Prohibition of Riba in the Holy Qur'an

- The prohibition of riba appears in the Quran in four different revelations.
- **First stage** – The first verse revealed on riba in Mecca, emphasized that while interest deprived one of the wealth of Allah's blessings, zakah/charity raised it many times.
- “And that which you give in gift (to others), in other that it may increase (your wealth by expecting to get a better one in return) from other people's property, has no increase with Allah; but that which you give in Zakat seeking Allah's Countenance, then those they shall have manifold increase.”
(al-Rum, 30:39)

Stages for the Prohibition of Riba in the Holy Qur'an

- **Second Stage** – The second in the early Medina period, severely disapproved of interest. It placed those who took riba in juxtaposition with those who wrongfully appropriated other people's property and threatened both with severe punishment from Allah. And
- That they took riba (usury), though they were forbidden and that they devoured men's substance wrongfully – We have prepared for those among men who reject faith a grievous punishment. (Sura An Nisa(4:161)).

Stages for the Prohibition of Riba in the Holy Qur'an

- **Third Stage-** The third revelation, around the second or third year after hijra, enjoined Muslims to keep away from riba if they desired their own welfare
- “O you who believe! Eat no riba doubled and multiplied, but fear Allah that you may be successful. And fear the Fire, which is prepared for the disbelievers. And obey Allah and the Messenger (saws) that you may obtain mercy.” (Al-Imran 3:130)

Stages for the Prohibition of Riba in the Holy Qur'an

- The **fourth stage** witnessed the total and complete eradication of riba from the society. The last stage of prohibition is signified by the verses revealed from al-Baqarah: 275-279
- 275. Those who devour usury will not stand except as stand one whom the Evil one by his touch Hath driven to madness. That is because they say: "Trade is like usury," but Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (The offence) are companions of the Fire: They will abide therein (for ever).

Al-Baqarah: 276-279

- 276. Allah will deprive usury of all blessing, but will give increase for deeds of charity: For He loveth not creatures ungrateful and wicked.
- 277. Those who believe, and do deeds of righteousness, and establish regular prayers and regular charity, will have their reward with their Lord: on them shall be no fear, nor shall they grieve
- 278. O ye who believe! Fear Allah, and give up what remains of your demand for usury, if ye are indeed believers.
- 279. If ye do it not, Take notice of war from Allah and His Messenger. But if ye turn back, ye shall have your capital sums: Deal not unjustly, and ye shall not be dealt with unjustly.

Riba in Hadith

- “The Prophet cursed
- the receiver and
- the payer of interest,
- the one who records it and
- the two witnesses to the transaction
- and said: “They are all alike (in guilt).”
- (Sources: Jabir ibn Abdullah, Muslim, Tirmidhi, Musnad Ahmed)

Riba in Hadith

- “A dirham of riba which a man receives **knowingly** is **worse than committing adultery thirty six times.**”

(Sources: Abdallah ibn Hanzalah. Mishkat al-Masabih. Bayqahi)

- The Prophet said: “Riba has seventy segments, the least serious being **equivalent to a man committing adultery with his own mother.**”

(Sources: Aby Hurayrah, Ibn Majah)

- The Holy Prophet said: “**Even when interest is much, it is bound to end up in paltriness.**”

(Sources: Ibn Mas`ud, Ibn Majah, Musnad Ahmad)

The Types of Riba

- Islamic jurists have classified riba in two types, Riba al-jahiliya or Riba an-Nasihah and Riba al-Fadl
- Riba al-Jahiliya or Riba an-Nasihah (interest in debt/deferment in a loan or debt). The term nasiah means to postpone, defer, or wait, and refers to the time that is allowed to the borrower to repay the loan in the return for the addition or the premium. Hence riba al nasiah refers to the interest on loans. The prohibition of riba al nasiah essentially implies that the fixing in advance of a positive return on a loan as a reward for waiting is not permitted by the shariah.

Riba Al-Fadl in Hadith

- Riba al-Fadl (interest in barter). It is based on sales or exchanges in which there is an excess without any counter-value).
- The Prophet said: “Sell,
- Gold in exchange of equivalent Gold,
- Silver in exchange of equivalent Silver
- Dates in exchange of equivalent Dates
- Wheat in exchange of equivalent Wheat
- Salt in exchange of equivalent Salt
- Barley in exchange of equivalent Barley
- But if a person transacts in excess it is usury (riba), However, sell gold for silver anyway you please on the condition it is hand to hand (spot) and sell barley for dates anyway you please on the condition it is hand -to-hand.”

Imam Al-Ghazali on Riba

- “Riba (interest) is prohibited because it prevents people from undertaking real economic activities. This is because when a person having money is allowed to earn more money on the basis of interest, either in spot or deferred transactions, it becomes easy for him to earn more money on the basis of interest without bothering himself to take pains in real economic activities. This leads to hampering the real interests of humanity, because the interests of humanity cannot be safeguarded without real trade skills, industry and construction.”

The Rationale behind the prohibition of Riba

- Money is not a commodity
- Injustice to society
- Based on Capitalist economy
- Unfair distribution of wealth
- Not financing real economic activities
- Greed for more money