

## Debate over Interest: Islamic Perspective

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**Abstract.** The purpose of the present paper is to present a succinct review of early and modern theories of interest in order to get a fair idea about the nature and significance of interest in a modern economy and also to provide a detailed discussion of the Islamic theory of interest to find its current relevance.

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**Key Words:** Interest; Islam.

### 1. Introduction

Interest lies at the heart of the modern economy because it plays a central role in the allocation of scarce resources among competing uses. Interest has been a highly complex and controversial issue in economic literature. Economists have proposed different theories on the definition, rationale, and role of interest.

### 2. Western Theories of Interest

Interest was despised and prohibited in tribal and primitive societies. The Greeks, Romans, Jews and the Christian church all condemned usury. In classical times, the writings and teachings of philosophers and moralists were instrumental to the strong opposition to usury. The views of Aristotle, Seneca, and Aquina provided the foundation for the medieval prohibition of usury. According to Aristotle, money was an “inorganic object” and could not be used as a source of augmenting wealth. Money is sterile and barren (Taylor and Evans, 1987:15-17).

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Aristotle made the important distinction between value in use and value in exchange. **The true and proper use of goods is the satisfaction of natural wants.** A secondary use occurs when goods are exchanged for the sake of monetary gains. The exchange of money for a promise to pay back the principal with interest is considered the most unnatural one. The medieval doctrine of interest, which equated it with usury, was derived from the teachings of the Fathers who in turn had found the confirmation of their views in several passages of the *Old Testament* as well as in the words of Jesus, cited in Luke 6: 35: “Lend freely, hoping nothing thereby.”

The early medieval society was a primitive and overwhelmingly agrarian one for which the prohibition of interest have been as much suited as it was for the earlier *Hebrew* society to which the rules of the *Old Testament* had first been applied. Saint Thomas in the *Summa* made a distinction between *Consumptible* and *Non-Consumptible* goods and between a loan and a lease. In the case of *Consumptible* goods, the use exists exclusively in their being consumed that is destroyed or alienated. Moreover, a loan of grain or wine as distinguished from the lease of house involves a transfer not only of possession but also ownership. Money was considered a *Consumptible* good and the lender of money is debarred from asking for a return in excess of the amount lent just as is the lender of wine or grain.

Because of strong opposition of lending money on interest, partnership became a preferred form of investment and one that was not stained by usury. By outlawing lending at interest, the medieval doctrine of usury may have driven the capitalists to seek risk-sharing investment in a partnership, the lawful way to share also in the gain from the venture. This form of business served as a stimulus to economic expansion in the Middle Ages. Thus concentration on partnership had the effect of turning the capitalist into a risk-taking entrepreneur rather than a rentier occupied with clipping coupons. But for those who wanted to earn a return on their money, annuities were also an important financial institution of the Middle Ages.

After the close of Middle Ages, accepting an increasing variety of returns on loans was justified. It became recognised that parting with one's funds constitutes a loss, and that present money has a higher value to the holder than future money. The reaction to the medieval usury doctrine changed with the times. Adam Smith condemned an outright legal prohibition of interest. He favoured a low rate of interest because this would increase the chance for savings to go into new investments rather than into debts. Keynes was also convinced of low rate of interest. During the

seventeenth century outlawing interest altogether was now out of question. What was discussed often with great vigour was the ceiling that should be placed on interest rates. The seventeenth century authors did not discuss the matter of interest from the point of view of the moral **Theologian**, as had been the case.

Calvin argued that Interest is payable as an opportunity cost because the lender, had he used his funds for the purchase of land, would earn a return, an opportunity he forgoes by lending out the money. Turgot reinforced it with another consideration, based on the right of the property so dear to the Physiocrats: the lender is the owner of his funds; he can do with them as he pleases and no one has the right to claim their use for nothing. Turgot attached to interest a strategic function in the economy. It is “the thermometer by which one may judge the abundance or scarcity of capital.” Capital can only be employed in investments that yield as much as the interest rate. The latter can be considered a kind of “level beneath which all labour, all agriculture, all industry, all commerce come to an end.” Turgot likens the interest rate to an ocean spread over a vast area (for detail see Spiegel, 1971).

Interest was forbidden in the early days of the Roman Empire but emerged with the rise of the merchant class. It was strictly prohibited up to 13<sup>th</sup> century while the Church was dominant. The reformation movement of the 16<sup>th</sup> century caused Canon law to be reviewed. The concept of interest gained support with the steady decline of the authority of the Church and the rise of secular power. The word “usury” was replaced by “interest” on the plea of human weakness” (Qureshi, 1970: 6-8).

Mercantilists equated money with capital and considered interest on capital as payment for the renting of money. They supported low rates of interest to stimulate trade but failed to regulate the rate of interest. N.W. Senior was the first economist who introduced the importance of time element in the use of capital. He put forward “The Abstinence Theory of Interest”. By abstinence he meant refraining from unproductive use of a resource or sacrificing present over future and argued that interest was the price for the abstinence. Marshall replaced the word “waiting” for abstinence (Qureshi, 1970: 16–18). This theory has been criticized on the grounds that it gives equal weight to sacrifices made by people of different income levels, which imply that different people make different sacrifices. This is true, but each makes a sacrifice whether small or large, and therefore, must be

compensated according to the degree of sacrifice. Hence abstinence serves as a rationale for charging interest.

Proponents of the “Productivity theory of interest” regarded productivity as an inherent property of capital and argued that the productivity of capital is the cause of interest. Its widely accepted version, the marginal theory of interest does not offer a genuine explanation of the rate of interest, because (i) it assumes a pre-existing rate of interest, “the very thing it has to determine” (ii) it does not explain why interest is charged on consumption goods; (iii) it does not give a proper role to money and expectations; (iv) no consideration has been given to changes in the quantity of money; and (v) it is based on static conditions (Qureshi, 1970: 18 – 20).

These objections carry some weight but the limitations and weaknesses of the theory do not imply that capital has no productivity. Capital produces goods that could not be produced without it. This suggests that capital has a positive return, which should be compared with the cost of borrowing — the rate of interest. Moreover, capital also produces consumption goods, so charging of interest on capital indirectly explains the charging of interest on consumption goods. The concepts of real and nominal rates of interest implicitly take into account the changes in the quantity of money.

“The Austrian Theory of Interest” set forth by Bohm-Bawerk is a very powerful theory of interest. He contributed two concepts to the theory of interest: (a) the capitalistic mode of production as a time consuming process and (b) capital is nothing but a combination of intermediate goods. He explained the rationale of interest in terms of time preference. Human beings prefer present consumption or comfort to future consumption or comfort. If a person is required to sacrifice present over future, he deserves some reward or compensation known as interest. Close examination of the Austrian theory and the abstinence theory reveals that the two theories do not differ substantially. The rate of interest is determined by the marginal productivity of capital, which diminishes as the production period increases (Qureshi, 1970: 20-24).

The rationale of interest furnished by Austrian theory is not sound and valid because the theory is primarily concerned with “an explanation of the origin of accumulation of capital goods”. The rationale provided by this theory cannot be accepted in modern times because today cash capital or “capital funds” are used (Uzair, 1980: 40). The suppliers of cash capital or

capital funds part with their funds, thereby sacrificing present use over future use. They are entitled to remuneration and compensation in the form of interest.

According to Adam Smith and David Ricardo, interest is the compensation, which a borrower pays to the lender for the profit he makes by use of the lender's money. Classical economists argued that saving and investment are both functions of the rate of interest. Saving is an increasing function of the interest rate while investment is inversely related with the rate of interest. The equality between saving and investment is brought about by rate of interest (Ghatak, 1981:10). Qureshi (1970:15) asserts that saving and investment are not influenced by the rate of interest. Though the evidence is not conclusive, a number of studies (Gupta, 1970; Brown, 1973; McKinnon, 1973; Khan, Hasan and Malik, 1992; Afzal 2004) have concluded that savings are positively correlated with the rate of interest. Similarly, a low rate of interest induces investment though it is not the sole determinant of investment.<sup>1</sup>

Fisher's theory of interest was largely a clarifying restatement of ideas developed originally but less cogently by Bohm-Bawerk. Fisher considered the interest rate "as determined by impatience to spend income and opportunity to invest." He made the distinction between a "nominal" rate of interest and a "real" rate of interest, which corrected the former for price changes. This distinction figured prominently in Fisher's work, as did the concept of Wicksell's natural rate of interest and Keynes's marginal efficiency of capital. The rate of return over cost, later designated by Boulding as "Internal rate of return" was the hypothetical rate of discount at which the investor would exactly get back through the present worth of the return from an investment, the present worth of its costs. The rational investor would make use of an investment opportunity if it yielded a rate of return over cost greater than the market rate of interest (Spiegel, 1971: 624). The best illustration of the classical quantity theory of money is given by the Fisher (1911) equation of exchange:

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<sup>1</sup> The importance of interest rate for investment is evident from the more recent decision of the government of Pakistan about lowering interest rate on national savings schemes. When the newsmen asked president Musharraf about the decision, he said that the decision was made in response to persistent demand by the investors to reduce interest rate in order to promote a favourable investment environment [see Urdu daily, "Jang" July 15, 2002].

$$MV = PY, \quad (1)$$

Where  $M$  = total quantity of money,  $V$  = velocity of money,  $P$  = price level,  $Y$  = aggregate output, and  $PY$  = nominal income. Fisher argued that  $V$  is constant since it depends on the institutions in the economy that do not change rapidly over time.

This view lead to the Quantity theory of money, which states that nominal income ( $PY$ ), is determined exclusively by the changes in the quantity of money,  $M$ . This theory is in fact a theory of demand for money because it shows how much money is held for a given level of aggregate income. Equation (1) can be written as:

$$M_d = kPY \quad (2)$$

Where  $M_d$  is the quantity of money demanded and  $k = 1/V$ . Since  $V$  is constant, so is  $k$ . This equation tells us that nominal income determines the quantity of money demanded by the people. Thus, Fisher's quantity theory holds that demand for money only depends on income and is insensitive to interest rates. Cambridge economists developed a money demand equation identical to Fisher's equation (2). Their approach differed in that they recognized the effects of the interest rate on the demand for money. Keynes did not accept the classical view that velocity of money is constant. Keynes argued that demand for money or "liquidity preference" is positively related to income and inversely related to interest rate. His theory implies that  $V$  is not constant but instead is positively related to interest rate. Hence, his theory raises doubts about the validity of the classical quantity theory that nominal income is determined by changes in the supply of money alone (see Mishkin (1989) for detail).

Baumol (1952) and Tobin (1956) independently developed models that revealed that even money balances held for transaction and precautionary purposes are influenced by the interest rates. These models implied that there is an opportunity cost associated with the holding of money – foregone interest. Recent studies have supported Keynesian theory. However, an effort to improve the rationale of Keynes for the speculative demand for money has been only partially successful.

Using the theory of asset demand, Friedman (1956) developed the theory of demand for money, which states that demand for money depends on permanent income and the expected returns on alternative assets relative

to expected return on money. Friedman is of the view that demand for money is stable and second; demand for money is not affected by interest rates. These two differences imply that velocity is predictable which leads to the classical quantity theory conclusion that nominal income is determined solely by money supply.

The above analysis shows that there is disagreement among western economists regarding the rationale and role of interest and this makes interest a complex issue in economics. While discussing the flaws in the various theories of interest, Uzair concludes, “perhaps the theory of interest is the least clear part of the entire economic theory. This is so because an effort has been made to explain something which is difficult to justify” (Uzair, 1980:41).

The disagreement among western economists does not suggest that there is complete consensus on the undesirability of an interest rate. Economics literature is replete with examples that demonstrate marked differences of opinion among economists as discussed above. It is sometimes said that when there are two economists, there will be three opinions. The main thrust of the arguments of Muslim scholars is that interest does not play any role in the modern economy and thus attempt to provide a theoretical foundation for an interest-free economy. There is disagreement among Muslim economists on the various aspects of Islamic banking (see for example, Arif, 1992). Does this difference of opinion among Muslim economists imply that Islamic banking is “something which is difficult to justify”? A difference of opinion does not negate the existence of something and in no way suggests that the particular thing is unjustifiable and therefore, should be done away with.

### **3. Islamic Theory of Interest**

Socio-economic justice is an important characteristic of a true Muslim society. Islam has attempted to eliminate all sources of exploitation and undue advantage in business transactions. The Quran strongly urges Muslims not to acquire each other's property wrongfully. Obtaining a monetary advantage in a business transaction without giving a fair counter value is an important source of unjustified earnings. Riba represents a conspicuous source of unjustified benefit in the value system of Islam (Chapra, 1985:55).

In the early period of Islam, the economy was mainly a barter economy and there were no banks and other financial institutions, which play a central role in modern economies. The concepts of fair price and just wages were “common themes” in early economic literature. The objective was to prevent any exploitation of poor people in socio-economic transactions. In actual practice, the ruthless feudal lords and tribal chiefs exploited the poor and weak slaves and serfs (Haque, 1989).

#### 4. Prohibition of Riba in Islam

In recent years the meaning of Riba has attracted the attention of Muslim scholars. Haque (1989) raises the question what is Riba? Is it usury, unearned income, interest, or a pre-feudal phenomenon irrelevant to modern times? This is a question of increasing importance because an adequate answer will have a significant bearing on the functioning of the modern economy, especially financial institutions. The prohibition of Riba appears in four different revelations in the Holy Quran:

1. *First Revelation (Surah al-Rum, Verse 39)*

That which you give as interest to increase peoples' wealth increases not with *Allah*

2. *Second Revelation (Surah al-Nisa, verse 161)*

And for their taking interest even though it was forbidden for them, and their wrong appropriation of other peoples' property, we have prepared for those among them who reject faith a grievous punishment.

3. *Third Revelation (Surah al-Imran, verses 130–2)*

O' believers take not double and redouble interest so that you may prosper. Fear the fire, which has been prepared for those who reject faith, and obey *Allah* and the prophet so that you may receive mercy.

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

Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the Devil; this is because they say “trade is like interest” while *Allah* has permitted trade and forbidden interest.

The first revelation, which was revealed in Mecca emphasized charity and discouraged interest. The second in the early Madina period equated Riba-takers with those who wrongfully appropriated other peoples' wealth and strongly condemned interest in the way it was forbidden in previous scriptures. The third one, revealed around the second or third year of Hijra (migration from Mecca to Madina) instructed Muslims to refrain

from interest for their own welfare. The fourth revelation, near the completion of the prophet's mission, denounced Riba-takers and differentiated between Riba and trade which were regarded by the pagan Arabs as synonymous (Chapra, 1985:56).

The order of the revelations shows that Riba was prohibited gradually and in the most rational way. The prophet (peace be upon him) also condemned interest in strong words in several authentic hadiths (a collection of the acts or sayings of the prophet Muhammad). These sayings severely admonish not only those who dare to violate the injunctions but also those who help in a Riba transaction, if only as a scribe or witness.

## 5. Meaning of Riba

Riba literally means increase, addition, or growth which “in the pre-feudal and pre-Islamic times was generally an excess or increase in an economic transaction, loan, or sale”. *Riba al – nasiah* and *Riba al – fadl*<sup>2</sup> are two kinds of Riba.

*Riba al – Nasiah*: means to postpone, defer or wait and it is in this sense that the word Riba has been used in the Holy Quran and refers to interest on loans. There were different forms of loans and business transactions. When a person borrowed food, money, cattle, etc., he would pay back the principal with an increase after an agreed period. This increase was termed by Muslim jurists as *Riba al – Nasiah*. According to jurists it was not a fair exchange because the lender exploited the borrower (Haque, 1989: 8).

*Riba al-fadl*: Islam wanted to abolish not only the exploitation inherent in the institution of interest but also to close all doors of unfair and unjust transactions. *Riba al – fadl* deals with all spot transactions involving cash payment and the exchange of other commodities. This kind of Riba originated from a saying of the Prophet (“If gold, silver, barley, dates and salt are exchanged, they should be exchanged spot equal and alike). There is difference of opinion regarding the nature and extent of *Riba al- fadl*. One opinion argues that all saleable commodities would be subject to *Riba al-fadl*. Second opinion holds that all edible commodities would fall in the

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<sup>2</sup> Chapra [(1985,pp. 236-245] and Qureshi [(1970), pp. 42–45 and pp.61–71] have cited a number of *hadiths* as well as the views of famous Muslim jurists having bearing on Riba, *Riba al- nasiah* and *Riba al- fadl*.

category of *Riba al-fadl*. A third opinion is that all items that sustain life and are storable are subject to *Riba al-fadl*.

However, these opinions ignore the crucial questions: why is exactly the reciprocal payment required? The answer is to ensure justice and fair play in sport transactions and to close all doors to Riba because in Islam any means that leads to unlawful gain is also unlawful. Thus *Riba al-fadl* and *Riba al-nasiah* follow from the verse “Allah has allowed trade and prohibited Riba”. The former concerns trade and is implied in the first part, while the latter relates to loans and is prohibited in the second part (Chapra, 1985:58–61). According to Haque (1989) there was no confusion about *Riba al-nasiah* while *Riba al-fadl* was ambiguous and controversial, so it was not defined clearly by the jurists. He asserts that Islam is a revolutionary religion that wanted to eradicate all forms of injustice. Therefore, Riba was annulled in all forms, “whether deferred in time or in direct sales”.

## 6. Different Interpretations of Riba

Muslim scholars (Khan, 1986; Ahmed, 1985; Qureshi, 1985) have argued that there is consensus among all schools of thought that interest is forbidden in all its forms. This is not true absolutely because there is marked difference of opinion concerning the implications of Riba in the modern world. One opinion is that Riba encompasses any return of financial transactions and should be removed. A second opinion holds that only compound interest falls in the category of Riba; simple interest does not and therefore only compound interest should be abolished. A third opinion is that Riba is related to consumption loans because there were no production loans during the Prophet’s period. The fourth opinion is that bank interest is not un-Islamic because there were no banks when the Riba verses were revealed (Ahmed, 1985; Haque, 1989).

Muslim scholars have attempted to prove that the above views are not valid. Ahmed (1985:4–5) cites verses 276, 278 and 279 (*Sura al-Baqrah*) arguing that the said verses show that simple interest as well as compound interest is forbidden, because Islam allows the taking back of principal only. He also refers to the “unanimity” of prominent jurists on the prohibition of Riba in all its forms. Qureshi (1970:101) makes reference to the Oxford dictionary which defines usury as the “practice of lending money at exorbitant interest especially at higher interest than is allowed by law” and argues that a rate of interest which is considered exorbitant today, may be

considered moderate tomorrow. Qureshi also states (1970:115), “Islam has fixed zero rate of interest and any rate above the zero rate is a usurious rate of interest”.

Another argument is that interest was prohibited during the Prophet’s days because there were only consumption loans and production loans were non-existent. There is documentary evidence available in research of various scholars that in the time of prophet, loans were also given for production purposes (Udovitch, 1970:86; Ahmed, 1985:6). Hamidullah<sup>3</sup> has offered a realistic interpretation of interest. To construct or sell a house you borrow from a bank or an individual. You either lives in that house or rent it. In both cases you benefit. A person who has helped you in this venture has a share in your house and he must be given some reward or return. This is not interest but business, so argues Hamidullah. Regarding punishment for taking interest in Islam, Hamidullah maintains that in some cases like murder and theft Islam has prescribed clear punishments like death sentence for murder and amputation of hand in case of theft. Telling lies is a major sin but no punishment has been prescribed. This implies that Allah can forgive a Muslim who lies or give him punishment in the next world. Muslims would borrow from the non-Muslims during the life of the Holy prophet and to discourage Muslims, mention has been made of punishment in the life hereafter.

The following arguments have been advanced in favour of the prohibition of Riba (Chapra, 1985: 63; Qureshi, 1970:45–58 and 96 –100).

1. Through Riba the lender wrongfully acquires the wealth of the borrower
2. Riba represents an income that is earned without labour, which induces the lender to shirk from labour
3. Debt destroys “one’s honour and respect” in society. If interest is abolished people will refrain form “borrowing and squandering”
4. Riba makes the lender rich, the borrower poor. If Riba is made legal, rich people will take away poor people’s resources
5. If interest is charged on basic consumption requirements, it amounts to taking advantage of a man’s inferior economic position and is therefore morally abominable and prohibited

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<sup>3</sup> See Dr. Mohammad Hamidullah interview in “Urdu Digest” Lahore, February 2003, pp.19–44.

6. The charging of interest on loans for productive purposes is prohibited because when money is invested in a productive undertaking, the magnitude of profit is uncertain and there is also the possibility of loss, while the interest is fixed and certain. Islam, however, does not prohibit taking a return on capital if the provider of the capital funds is prepared to share the risk of the productive enterprise with the entrepreneur. It is for this reason that profit and loss sharing is considered an acceptable alternative to interest in an Islamic economy. This is the reason that Islam has allowed trade and forbidden interest
7. The Quran and the *Sunnah* have categorically prohibited interest.

The person who lends money or any other commodity sacrifices his own needs or comfort. Common sense and justice require that the lender be given adequate *quid pro quo*. The lender does not force the borrower to borrow at interest. If the first argument implies that the lender should give money free of interest to the borrower, then will it not be an exploitation of the lender? Does Islam protect the interest of the borrower only or both the lender and borrower are protected? If Islam protects the interest of both the lender and the borrower then the lender should also be compensated and interest is the partial compensation.

The major indictment against interest is that it is fixed and predetermined so it is wrong and unjustified. Sharing of risk is true if the borrower uses the capital for productive purposes, but if the borrower borrows for consumption purposes then how the risk will be shared? How will the utility that the borrower will derive from consumption be measured? Moreover, fixed and predetermined return is not confined to money only, there is a same fixed and predetermined return when a landlord rents out his land, house, or shop. What losses does the landlord incur by renting his property against a fixed and predetermined "rent"? If the property sustains wear and tear or, in the extreme situation, is destroyed by a natural disaster, the same damage could be done if the landlord himself makes use of his property. Then, why is the rent fixed and predetermined?

Why should the lender alone bear and share the risk and loss? Does this step motherly treatment of financial capital not constitute exploitation and injustice? Economic theory tells us that in inflation the value of real estate appreciates while that of money depreciates. The owner of real estate

gets increasing, fixed and predestined return while the owner of financial capital receives decreasing return.<sup>4</sup>

The second argument, that the Riba-taker becomes indolent and evades labour is not tenable. Why is the same argument not applied to the real estate owner? Qureshi (1970:97) contradicts the labour criterion. He states “Islam has not illegalised all those transactions which produce income without labour”. The discussion reveals that in the eyes of Islam as interpreted and explained by Qureshi (1970) and other Muslim scholars, financial capital is the major culprit which must be punished with the risk of loss while the physical capital is given a *carte blanche*.

The third argument that debt destroys one’s honour and respect is curious and irrational. Qureshi has not explained how debt does so. Even governments borrow from their own people as well as from abroad. Third World debt crisis is a well-known phenomenon. The argument that people tend to borrow and squander more if the cost of borrowing is nominal or zero appears to be more plausible and sound.

The fifth argument is sound on humanitarian grounds. However, indigent and poverty –stricken people can be helped through *Zakat* (Islamic wealth tax) and government welfare funds and cannot be used as the principal reason for interest free consumption loans.

With regard to the sixth argument, it is pointed out that if sharing of risk is the sole criterion that makes trade and business legal and interest abominable, then why is it that gambling is strictly prohibited in Islam, which also involves risk? By virtue of the risk-sharing principle, gambling should also be allowed. The main reason governing the principal “trade is allowed, interest is prohibited” in Islam might be due to the fact that trade involves labour and misfortune while interest does not. But it has been

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<sup>4</sup> A schoolteacher in Pakistan in 1980 borrowed Rs.600 [Pakistan’s currency rupee] from his GPF Accumulations and purchased one *Kanal* land for residential purpose for Rs.300 and loaned another Rs.300 to a clerk in the same school. Later the clerk refused to pay the borrowed amount. He sold the same plot of land for Rs.50,000.00 in 2003 and the clerk paid him only the same amount [Rs.300.00] when he was going to *Haj* in 2003 after a lapse of 23 years. Who suffered? If the market interest rate is known, the computation of present and future values will decide how much loss the lender sustained. Many such examples could be found in daily life.

shown above that Islam allows income to be earned without labour. Hence even the principle of labour is not universal.

The discussion boils down to the point that Riba is a highly complex issue and therefore, it is interpreted with adequate caution. Riba is prohibited in Islam because Islam aims at establishing a socio-economic order in which there is no exploitation of man by man. Haque (1989:10) argues that the problem of Riba is not the problem of declaring interest legitimate or illegitimate, it is the problem of human freedom, equality and a just and an egalitarian order where human beings could live without exploitation, violence, war, slavery, hunger, disease and ignorance. This observation is less likely to be supported by the early as well as contemporary history and the level of socio-economic development achieved by the Muslim countries. Throughout history Muslim society has not been an egalitarian society completely; there have always been glaring inequalities and injustices. Riba has to be interpreted in the context of the modern needs and realities. Mere rhetoric will not work.

The last argument that Islam has given a final verdict on the prohibition of Riba and thus it is compulsory for every Muslim to desist from Riba is debatable. This raises the question of whether Islam and its teachings are “eternal” or restricted only to the early period of Islam? Obviously the teachings of Islam are eternal, because the Prophet Muhammad (Peace be upon him) is the last of all the Prophets whom *Allah* appointed for the guidance of humanity.

We are living in the 15-century according to the Hijra (Muslim) calendar. During these fifteen centuries the conditions of life have undergone tremendous and radical changes. We are living in socio-economic conditions, which are radically different from the early pristine Islam. The eternal teachings of Islam as well as the changed conditions of present life demand reinterpretation of Riba. The discussion of the early theories of Interest point out to the fact that the prohibition of Riba is not peculiar to Islam. Greeks, Christian church, the Jews and primitive societies forbade it. But when the conditions of life changed, Riba was legalized and practiced. Taylor and Evans (1987:35) concluded that Islam and other systems have identical verdicts on Riba in the early times.

It is very difficult for a Muslim country to live in isolation. It has to trade and have other relations with non-Muslim countries. Because of uneven distribution of resources, countries are dependent on each other in

order to cater to the growing needs of their economies. Oil producing Muslim countries derive a major share of their national income from the sale of petroleum products. Besides export dependence, Muslim countries are also heavily dependent on the import of diverse capital and consumer goods to feed their industries and satisfy their peoples' consumption needs.

There is no debate on the teachings of Islam. However, ground realities are also taken into account. Islamic teachings could be adapted according to changing conditions of time. The observation of Islamic injunctions depends on the peculiar conditions and circumstances and if a change occurs in those conditions, the injunctions will change. During the month of *Ramadan* a *sick-man* is exempted from fasting so long as he is sick. The moment he recovers from his illness, the exemption is over. Eating of pork is strictly prohibited in Islam. However, if a Muslim is dying of hunger, he is allowed to eat little pork and if he finds some food, he cannot eat pork.

Unless the international economic system is interest free, serious efforts by the Muslim countries to have interest free economy seem less likely to have enviable success. A particular sector of the economy may be run interest free but to run the entire economy interest free is very difficult. Many Muslim countries borrow from IMF and other sources and pay interest.<sup>5</sup>

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<sup>5</sup> Interest payments on debt have emerged as the single largest item of expenditure in Pakistan's economy. Its share in total expenditure increased from 24.3 percent in 1994-95 to 34.7 percent in 1999-2000. Similarly its share in current expenditure increased from 30.1% to 40.6 percent during the same period [Government of Pakistan, Economic Survey [(1999-2000), p. 64]. Public debt payable in rupee increased from Rs.1.71 trillion in 2002 to Rs.1.74 trillion in 2003. Debt payable in foreign exchange stood at Rs.96 billion in 1980, increased to Rs.428 billion in 1990 and shoot up to almost Rs.1.70 trillion by mid-2000 [Government of Pakistan, Economic Survey (2002-03), p.76]. Since the fall in Concessional aid flows, Pakistan has to borrow from IMF and World Bank and Asian Development Bank at near commercial terms. In case of extreme difficulties the Government did not hesitate to borrow heavily short-term money from commercial banks at very high rates of interest [Burki (1996)]. Pakistan embarked on Islamisation program to make the Economy interest free in early 1980s [see Afzal (1992)].

If Muslims aim at interest free world economy, they must direct efforts through serious research to convince the non-Muslims countries notably the Western countries about the colossal harmful effects of interest-based international economic system. Attempts by Muslim countries to purge interest from their economies are not expected to prove more fruitful; it is apprehended that such efforts would make the confusion worse confounded.

## **7. Conclusions**

In early times as well as in the middle ages, the charging of interest was strictly forbidden. However, with the decline in the power of the church and changing needs of the economy, interest started taking root gradually. Economists have offered various theories of interest over time. These theories did not provide a satisfactory explanation of the cause and determination of the rate of interest. Yet every theory made a valuable contribution to the theory of interest. The controversy over the role of interest does not imply that interest rate cannot play a part in the functioning of the economy and thus should be abolished as the proponents of the Islamic economic system prescribe. The Islamic theory of interest is diametrically opposed to Western concepts and theories of interest. While Western theories have attempted to explain the rationality and desirability of interest, Islam has given a harsh verdict against interest. The principal reason for the prohibition of interest, as explained by Muslim scholars, is that Islam purports to establish a socio-economic order that is based on justice, equity, and fair play and closes all doors to all means and forms of exploitation and injustice.

However, the 7<sup>th</sup> century religious dictates should be adapted according to the present economic realities. We are living in a highly integrated and complex international economy whose needs and preference are radically different from the non-agricultural, non-industrial and non-commercial economy of the 7<sup>th</sup> century. It is appropriate that Muslim scholars reinterpret Riba in such a way as to enable Muslim countries to run their economies efficiently and smoothly, meeting the demands of the domestic as well as international economy.

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