

# A BROADER DEFINITION OF RIBA<sup>1</sup>

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The paper analyzes different interpretations of riba and discovers that the main source of confusion about the concept has been misunderstanding of riba in hadith in general and riba in barter exchange with a time lag, hereafter called riba in barter loans, in particular. A majority of jurists has, so far, either overlooked riba in barter loans or has included it in the category of trivial riba. That is why riba is confined to a contractual increase on the principal in a loaning deal. On the contrary, the main finding of this research is that riba in barter loans, which is clearly evident from many ahadith, also falls in the category of real riba. It emerges when any of the six commodities; gold, silver, wheat, barley, dates and salt, are barter exchanged with a time lag in equal or unequal measures. The reason for this prohibition is that the possibility of change in the price of underlying commodity creates undue uncertainty for both parties of the exchange. It is therefore recommended that barter exchange with a time lag of all those commodities whose relative prices normally change in short periods should be subject to riba in barter loans. In context of modern financial system, it is opined on the reasoning of analogy that trading of stocks, which serve as the subject-matter of joint stock businesses, should also be treated as riba in barter loans. However, if some method of exchanging stocks on their par value is worked out, then their exchange should be exempted from riba in barter loans.

The paper is divided into five sections. First section is for introduction of the paper. It points out lack of consensus about the definition of riba and, thus, emphasizes the need for further probing into the subject of riba. Second section puts together selected commandments from Quran and hadith on the topic. Third section critically evaluates current interpretations of riba. In section four a broader definition of riba is proposed. Last section presents a summary of the whole paper.

## INTRODUCTION

Prohibition of riba is, no doubt, the most eminent feature of Islamic economics. Yet, surprisingly enough, its meanings are not crystal clear. The sayings of Caliph Umar and different interpretations of riba testify the existence of this proverbial dilemma.<sup>2</sup> Literally speaking, there are too many and too detailed interpretations of riba to be covered in a single paper. However, for pedagogical reasons, they can be lumped under three main headings; liberal, mainstream and conservative views. Briefly, the liberal view entails the

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<sup>1</sup> Riba is an Arabic word that is often translated as interest though some Muslim jurists do not agree with this translation as explained below.

<sup>2</sup> Caliph Umar said that there were three issues, he wished, that the Prophet could have explained them in more detail. Two of them were about Inheritance Law of Islam and the third one was about riba. (reported in Al-Tafseer Ibne Kaseer, Ibne Majha and Ibne Mardoodia) At another occasion, he said that since some kinds of riba were not quite clear to them (Muslims at that time), therefore they had left almost 90 percent of otherwise permissible transactions in fear of involving in riba even unknowingly. (reported in Al-Kanz)

narrowest definition of riba; it equates riba with usury, which is defined as an exorbitant rate of interest compounded at short intervals. Interest rate paid and charged by financial intermediaries, henceforth called bank interest, is considered to be outside the ambit of riba. The mainstream view is that any contractual increase, whether small or large, is riba. Hence, riba encompasses bank interest as well. The conservative view is that in addition to usury or bank interest or both, riba also includes all forms of economic exploitation of the poor by the rich like profiteering and paying of subsistence wages to laborers.

The problem with liberal and conservative views is that their definitions of riba do not conform all verses and ahadith on the subject and they interpret riba in relative terms. The drawback of mainstream view is that its definition entails some contradictions in theory and practice. The main reason for prohibition of interest is stated to be making both financiers and users of funds for a project share its actual outcome. However, in recent experimentation of interest-free banking, mark-up has predominantly replaced bank interest, through which a positive return like bank interest is fixed for financiers. Furthermore, for the success of interest-free system, deepening of financial markets and securitization of financial assets is being encouraged, while the fact is that high turnover of financial assets in secondary capital markets impedes fair sharing of ex post outcome of an underlying project.

The objective of this research is first to analyze critically different interpretations of riba and then to probe afresh into the original commandments on the topic to deduce an absolute and cohesive definition of riba, if possible. A critical analysis of alternative definitions of riba brings out that the main source of confusion has been riba in hadith, particularly 'riba in barter loans.' This research, therefore, focuses on 'riba in barter loans.' It clarifies its logic and interprets its relevance in the modern financial system.

## **RIBA IN QURAN AND HADITH**

**Riba in Quran:** The word 'riba' means to increase, to grow, to multiply and to climb. However, in economic context, it is generally considered as a contractual increase on loaned money or commodity. This word as such or its variants have been used in numerous verses of Quran. There is, however, a complete consensus among Muslim jurists that only in the following eight verses of Quran, this word has been used in its economic sense: -

And from the riba-based giving (investment), you think as if your wealth is increasing at the cost of others (borrowers), but in the sight of Allah (from overall perspective), it is not increasing. On the other hand, when you give something in charity to please Allah, then your wealth is increasing (in the sight of Allah). (al-Room 30:39)

And for their (Jews') devouring of riba even though it was forbidden for them, and for their (Jews') wrongful appropriation of other peoples' property, We (God) have prepared for those among them who reject faith a grievous punishment. (al-Nisaa 4:160-1)

O Believers! Do not charge riba on top of riba and fear God so that you may prosper. (Aale-Imran 3:130)

People who indulge in riba shall be raised like those who have been driven to madness by the touch of Devil. That is because they say that a riba-based transaction is just like trading, while God has permitted trade and prohibited riba. Hence those who have received the admonition from their Lord and have desisted accordingly, may have what has already passed, their case being entrusted to God; but those who revert to riba-based dealings, shall be the inhabitants of the hell-fire and abide therein for ever. (You must know that) God deprives riba from all blessings and blesses charity; He loves not any ungrateful sinners. (al-Baqarah 2:275-6)

O you (who claim to be) believers! Fear God and give up riba that remains outstanding if you are true believers. Watch out! If you do not obey this commandment, then God declares war against you from Himself and from His Prophet. But, if you give up your outstanding riba, then you can claim your principals. Neither should you inflict harm (due to riba) to others, nor others should do harm to you. (al-Baqarah 2:278-79)

**Riba in Hadith:** On the topic of riba, there is a big number of ahadith.<sup>3</sup> Here a selection of commonly quoted ahadith is reproduced that is divided, for pedagogical purposes, under the following four titles: -

### **1. Ahadith that reinforce the concept of Quranic riba**

- 1.1 The Prophet said: "There is no riba except in loaning." (Nasae 4504)
- 1.2 The Prophet said: "Verily riba is in loaning." (Muslim 2991)
- 1.3 The Prophet said: "There is no riba in hand to hand (spot) transactions." (Muslim)
- 1.4 At the last Pilgrimage, the Prophet said: "All of the riba of Jahilliya is annulled.<sup>4</sup> In this respect, the first riba I annul is the riba that the

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<sup>3</sup> See Shafi (1996).

borrowers owe to my uncle Abbas; it is cancelled completely. (Muslim)

- 1.5 After the prohibition of riba, all Muslims were clear not to indulge in it anymore. However, a dispute arose between two Muslim tribes about the settlement of outstanding interest on previously loaned capital. The dispute was put up to the Prophet who forbade demand and payment of that interest too. (See Shafi 1996 p.28-9)

## **2. Ahadith that refer to riba in barter trade**

- 2.1 Abu Saeed Khudri said that once companion Bilal brought to the Prophet some good quality dates. The Prophet inquired as to where he got those dates. Bilal replied that he had some low quality dates. which he had exchanged in 2:1 ratio for high quality ones in order to present the latter to the Prophet. Upon hearing this, the Prophet said: "Oh no! Oh no! That is riba. That is exactly riba. Do not do it again. If you want to do such an exchange, first sell your dates (for money or another commodity) and then buy other ones." (Bakhari 2145)
- 2.2 The Prophet said: "While exchanging gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, exchange like for like (in equal measure) and exchange at spot. Whosoever paid more than what he received or demanded more than what he gave, verily he dealt in riba. Both the payee and the receiver are equal in violating the Law of God." (Muslim 2971)
- 2.3 The Prophet said: "While exchanging gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt, exchange like for like (in equal measure). Whosoever gave more or took more, verily he made a riba deal. However, you are permitted to exchange gold for silver, wheat for dates, or barley for dates as you wish (in equal or unequal measures) provided that, such an exchange is at spot." (Tirmizee 1161)
- 2.4 The Prophet said: "Do not exchange gold for gold except it is like for like (in equal measure) and do not increase one over the other; do not exchange silver for silver except when it is like for like (in equal measure) and do not increase one over the other. Furthermore, do not exchange a commodity in hand with the one not in hand."<sup>5</sup> (Muslim and Bakhari)
- 2.5 Two traders asked the Prophet about their mutual barter trade. He said: "If it is at spot, it is all right. But, if it involves loaning then it is not permissible." (See Shafi 1996 p.90)

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<sup>4</sup> Riba that was prevalent before the inception of Islam.

<sup>5</sup> Keeping in view the text of ahadith 2.2 to 2.4, Caliph Umar was of the view that, in a barter exchange, either party should not delay payment of underlying commodity even to such a short period that is required to go and come back from one's home. (Mawatta, also reported by Mansoori 1997 p.32)

- 2.6 The Prophet said to companion Jabir b. Abdullah: "In a credit transaction, it is not permissible to take two animals for one. However, if it is a hand to hand (spot) transaction, such an exchange is acceptable." (Tirmizee)
- 2.7 The Prophet prohibited trading of animals for animals on credit. (Tirmizee 1158)
- 2.8 Ibne Umar used to sell camels for dinars (gold coins) but used to receive payments in dirhams (silver coins). He asked the Prophet about the legitimacy of his act. The Prophet said that it was all-right to take dirhams (instead of dinars) provided that, the count of dirhams had been according to the then prevailing exchange rate and you had settled the accounts before leaving the market. (Nasaee 4506)
- 2.9 Abdullah Ibne Amr states that the Prophet directed him to arrange a good number of camels for an expeditionary force. Abdullah did but could not get the desired number (with the cash at hand). Then the Prophet directed him to acquire more camels in exchange of those young she-camels they were expecting to receive later in alms (zakat proceeds). So, Abdullah acquired additional camels at the rate of one camel at hand for two camels to be paid later.<sup>6</sup> (Abu Daud 2913)

### **3. Ahadith that refer to implicit riba**

- 3.1 The Prophet said: "When one of you grants a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers him a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favors mutually." (Ibne Majah 2423)
- 3.2 The Prophet said: "If one of you extends loan to another fellow, the former should not accept any gift from the latter." (Mishkat)
- 3.3 The Prophet said: "A loan from which some benefits accrue to the creditor is one of the many different forms of riba." (al-Bayhaqi)

### **4. Ahadith that talk about the general concept of riba.**

- 4.1 The Prophet cursed all those who take riba, who give riba, who write a riba contract and the two witnesses to a riba contract. He further said: "They are all alike (in guilt)." (Muslim 2995)
- 4.2 The Prophet said: "On the night of my ascendance to the Heavens, I came upon people whose tummies were as big as houses that were filled with snakes visible from outside. He asked Angle Gabriel as to

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<sup>6</sup> Once Caliph Ali sold one camel in hand for 20 camels to be received later. (See Shafi 1996 p.126)

who they were. Gabriel replied that they were the people who received riba (in their lives)." (Ibne Majah)

- 4.3 The Prophet said: "Riba has 70 segments, the least serious being equivalent to the sin of a man who commits adultery with his own mother." (Ibne Majah 2265)
- 4.4 The Prophet said: "As soon as a society deeply indulges in riba and adultery, wrath of God becomes due for it." (See Shafi 1996 p.79)
- 4.5 The Prophet said: "In any society, when riba becomes common, it causes hunger and poverty in it. And in any society, when bribery becomes common, it makes it depressed (as compared to other nations)." (See Shafi 1996 p.79)
- 4.6 The prophet counted the most heinous seven sins and riba was one of them. (See Shafi 1996 p.71)
- 4.7 The Prophet said: "Even when interest is much, it is bound to end up into paltriness." (Ibne Majah)
- 4.8 The Prophet said: "Deceiving of an uninformed entrant into a city-market is riba." (Kanz al-Ummal)
- 4.9 The Prophet said: "The person who serves as an agent to bid up prices in open auctions is a cursed taker of riba." (Kanz al-Ummal)

The first three headings clearly indicate the types of ahadith they contain. The fourth heading includes those ahadith which portrait riba as one of the major sins and also those ahadith, which do not fit to any other category, but are important to general understanding of the concept.

### **ANALYSES OF EXISTING INTERPRETATIONS OF RIBA**

Before analyzing different viewpoints one by one, it will be interesting to go through a general description of riba as reported in most of the writings on the subject. Traditionally, riba is divided into two parts, riba in loans (riba al-nasia) and riba in excess (riba al-fadl). The word 'nasia' means to postpone, defer or wait and the word 'fadl' means to increase, add or exceed. Riba in loans is defined as a contractual increase, be it normal or excessive, on loaned capital that could be either in money form or in kind. All Quranic verses unanimously imply only this kind of interest. Other terms that are commonly used for riba in loans are riba of old times (riba al-jahiliyya), riba of credit, explicit riba and a price for time. On the contrary, riba in excess that is proven by ahadith only has following two forms: -

- a) Riba in Barter Exchange: It arises when the same variety or two different varieties of the same commodity are exchanged in unequal measures at spot or with a time lag.
- b) Implicit Riba: It arises when a person lends money without any explicit contractual increase over the principal but over time he draws some casual or regular favors from his borrower. Such favors may be of negligible money value like a ride on an animal of the borrower, a meal or a gift from the borrower.

Other terms used for riba of excess are riba in hadith, riba in trade and implicit riba. Almost all jurists agree on this categorization of riba.

A majority of jurists including those who support liberal view go for another categorization; they call riba in loans as real riba and riba in excess as trivial riba. However, different authors have offered different reasons to justify the categorization of real and trivial riba: -

- a) Riba in loans is prohibited in Quran, whereas riba in trade is prohibited in hadith only.<sup>7</sup> Therefore, the former should be treated as real and the latter as trivial.
- b) In ahadith 1.1 to 1.3, 2.5 and 2.6 the Prophet said that riba is only in loans and not in spot transactions, but in ahadith 2.1 to 2.4 he himself defined riba in barter trade. The apparent contradiction is resolved by terming riba in loans as the real one and riba in hadith as the trivial one.
- c) For practical purposes, gradual obsolescence of barter system has reduced the importance of riba in hadith a great deal, even if it is considered to be of equal status on theoretical grounds.<sup>8</sup>
- d) Riba in loans may have more treacherous affect on the pocket of a borrower when lending is for a long time. The accrued interest may

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<sup>7</sup> Rehman (1963 p.40) writes, "The basic moral idea underlying the Quranic prohibition of riba has been given a wider extension and application in the hadith literature, but contradictions and inconsistencies in the riba-hadith and the evolutionary trend in this literature leading to an ever-increasing rigidity vitiate its authenticity and authority." Ahmad (1978 p.171) writes, "It may be noted that the unlawfulness of the Riba al-Jahilliyya is Qat'i (absolute), i.e., established by an explicit text of the Quran, hence there is no scope for any difference of opinion on its illegality. But due to the lack of Qat'i evidence, the unlawfulness of Riba al-Sanna is not deemed so severe." Tahir (1994 p.4) writes, "The Ahkam in Ahadith are to be viewed as "complementing" rather than "supplementing" the Quranic Ahkam on riba."

<sup>8</sup> Ahmed (1995 p.8) says, "[T]he transactions to which riba al-fadl applied were mainly related to the barter system which is no longer in vogue, therefore, it is unnecessary to discuss and explain that category of riba." Also see Ahmad (1978) and Federal Shariat Court (1991 and 1999).

become several-folds of the principal with the passage of time, whereas riba in trade being a one-time charge generally does not exceed the principal even if it is too high. Hence, both should not be treated alike.<sup>9</sup>

According to conservative view, riba in loans encompasses only unearned income of moneylenders, whereas riba in trade refers to unearned income of merchants and landlords. Riba in trade, in their view, has been at least as exploitative as riba in loans throughout the history. Therefore, if real riba is confined to riba in loans only, then a major part of any economy will remain open to exploitation and oppression.<sup>10</sup>

**Liberal View:**<sup>11</sup> Liberal view often starts with pointing out open contradiction in faith and practice of Muslim masses. According to this view, presently a majority of Muslims considers bank interest as riba, yet it deals with bank interest one way or the other. It is so because bank interest is inevitable for the functioning of modern financial system. Therefore, to relieve Muslim masses from the guilt of conscience, proponents of liberal view recommend a lenient treatment for bank interest.<sup>12</sup>

[A]ll the Muslims of the world condemn it (riba) and yet almost the entire Muslim world indulges in the practice which they consider to be riba... One of the reasons appears to be that the condemnation of riba hits thousands of monetary, financial, fiscal and economic activities yet the alternative methods that are suggested or prescribed for carrying on these activities do not adequately meet the requirements of the existing conditions... The Muslims of the world are thus placed in a sadly embarrassing situation. (Ahmed 1995, p.7)

Liberal view that equates riba with usury only is based on two different pieces of juridical reasoning; how it is decided whether a word in Quran refers to its lexical or terminological meanings, and how it is decided whether a new act or issue, about which Quran and Hadith are silent, is licit or illicit.

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<sup>9</sup> See Ahmad (1978) and Mawdudi (1977).

<sup>10</sup> See Haque (1993 p.937).

<sup>11</sup> See Jafri (1988 and 1995), Ahmed (1995), Pal (1994), Rehman (1963), Shah (1959), Kuran (1986), Katouzian (1981) and Ulgener (1967).

<sup>12</sup> For example, Kuran (1986 p.159) writes, "[T]he spirit of the ban on interest was routinely violated throughout Islamic history." He further says, "As for the prohibition of interest, it is effectively unforeseeable in a large heterogeneous society." Pal (1994 p.75) writes, "Interest rate would, therefore, persist in the market in one form or another, even if it were officially eliminated from the economy." Shah (1959 p.35) opines that (interest-based) productive credit does more good than harm to economic growth of a society. Therefore, it should be accepted in Islamic law as a need of time. Rodinson (1974 p. 45) concludes that Muslim society provided itself with ideological percepts that conflicted with its practice, and had to find a solution to the problem.



Regarding the first point there is a common rule in Arabic as well as in English language that when 'al' equivalent to 'the' comes as a pre-fix of a common noun, it becomes a proper noun. Such a proper noun always refers to its terminological meanings that may be different from its lexical meanings. With regard to permissibility and non-permissibility of a new act, the principle is that if such an act adds to the overall welfare of society and does not contradict any other settled act or issue in Quran and hadith, then it should be deemed permissible. Otherwise if either or both conditions are not met, it should be declared non-permissible.

In fact, the pre-fix 'al' comes before the word 'riba' in all relevant verses of Quran except in the first one quoted above, al-Room 30: 39. Therefore, liberal view refers to its terminological meanings only. Then, according to their research, at the time of revelation of Quran, money was borrowed mainly for bare consumption needs and on such loans a high rate of interest used to be charged keeping in view the degree of severity of borrower-needs. In case of non-payment on a due date, interest used to be doubled and tripled to penalize defaulters. In Islamic literature such an interest is known as riba of old times, whereas in current terminology, it is called usury. Liberal view gets further support from one of the verses of Quran (Aale-Imran 3: 30) in which riba on top of riba or compound riba has been prohibited categorically. They, therefore, conclude that riba refers to usury only.

According to liberal view, bank interest is different from riba of old times because it is charged mostly on productive loans and its rate is determined entirely by supply and demand forces at the market place. Its rate remains almost same for all borrowers irrespective of the purpose for which they borrow and irrespective of the degree of severity of their immediate needs. They further argue that interest-based financial intermediation has been instrumental for economic growth since its inception. Therefore, Muslim scholars should legitimize bank interest even if it comes under the purview of real riba in strict legal sense.

There are three main objections on this viewpoint. One, the verse of Quran in which the word 'riba' is not preceded by 'al' (al-Room 30: 39) does not support this meaning. Furthermore, the text of two other verses (al-Baqarah 2: 278-9) clearly refers to riba in the sense of its lexical meanings that is every

contractual increase on loaned capital.<sup>13</sup> Two, according to some other researches, lending and borrowing for business purposes was quite known at that time.<sup>14</sup> Therefore, bank interest should not be permitted under the pretext of being a new phenomenon. Furthermore, some serious side effects like short termism, income inequality, and possibility of debt deflation and financial fragility have been pointed out. Even Western economists have discussed the last two at length. The debt-deflation theory by Fisher (1933), the financial instability hypothesis by Minsky (1980, 1986 and 1992), and a business cycle model of financial crises by Wolfson (1994) illustrate the destabilizing nature of interest-based financing. Therefore, if an alternative riba-free scheme of financial intermediation can be figured out, which is quite possible, then interest-based intermediation need not be decreed permissible in Islamic law under the proviso of inevitability. Three, riba as usury becomes a relative concept that is hard to distinguish from interest unanimously.<sup>15</sup>

**Mainstream View:**<sup>16</sup> Mainstream view is that riba refers to both usury and bank interest. Riba in barter trade of six commodities, gold, silver, wheat, barley, dates and salt is also considered prohibited. Furthermore, a majority of jurists supports extension of riba in barter trade to other commodities, though they differ among themselves as to what those commodities should be.

On the basis of the characteristic of gold and silver as commodity, it has been generally concluded that all commodities used as money enter the sweep of riba al-fadl. With respect to the other four items, there is a difference of opinion. According to one opinion it has been argued that since all four commodities are sold by weight or measure, therefore, all items, which are saleable (by weight or measure), would be subject to riba al-fadl. A second opinion is that since all four items are edible, riba al-fadl should be involved in all commodities, which have the characteristic of edibility. A third opinion is that since these items are necessary for subsistence and are storable, therefore all items that sustain life and are storable are subject to riba al-fadl... A fourth but perhaps the most plausible explanation seems to be that all the six commodities were used as money in and around Madina (city of

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<sup>13</sup> See Khan (1991 p.3) and Mansoori (1997 p.21)

<sup>14</sup> Udovitch (1970 p. 77) says, "The earliest Muslim legal sources now justify the assertion that by the late eighth century, and possibly earlier, credit arrangements of various types constituted an important feature of both trade and industry." Also see Shafi (1996 pp.26-39 and 104-15), Khan (1991 p. 3), Chapra (1984) and Mawdudi (1977).

<sup>15</sup> See Katouzian (1981 p.99)

<sup>16</sup> See Ahmad (1978), Chapra (1984), The Report of the Council of Islamic Ideology Pakistan (1983), Ayub (1993 and 1996) Shafi (1996), Mawdudi (1977) and Federal Shariat Court Judgement on Riba 1991 and 1999.

the Prophet), particularly among the Bedouins, and therefore, *riba al-fadl* would be involved in the exchange of any goods against cash or any commodity which is used as money." (Chapra 1984 p.7)

However, mainstream jurists attach a secondary status to *riba* in barter trade without distinguishing much between barter trade at spot and barter trade with a time lag. That is why in recent experimentation of *riba*-free system the main emphasis has been on abolition of bank interest. So far, twelve alternative modes of bank financing have been proposed. These are lending against a service charge, *qarz-e-hasna* (lending without any interest or other charge), mark-up arrangement, leasing, hire purchase agreement, purchasing of trade bills, buy-back arrangement, partnership (*musharaka*), trusteeship (*mudharaba*), equity participation and rent sharing.<sup>17</sup> Khan (1991) explains each of them in detail. Out of them, however, interest-free banks have mostly relied upon mark-up and buy-back arrangements for advancement of their funds.<sup>18</sup>

Under mark-up arrangement, a borrower identifies the equipment or commodity he wants to buy, and then the bank buys that commodity for the borrower from a seller on cash price and charges the borrower a higher credit price that includes a time-related mark-up on top of cash price. Under buy-back arrangement, a borrower first sells any of his commodities or equipment to bank on cash price and at the same time buys it back from the bank on credit price that includes a time-related mark-up on top of cash price. Another feature of current interest-free system is that development of capital markets is over emphasized under the plea that trading in these markets resembles with trading in commodity markets.

There are three main criticisms on this definition. First, the two interest-free alternatives mark-up and buy-back, so far predominantly used by interest-free banking, are objectionable from juridical point of view. No doubt, early

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<sup>17</sup> The trusteeship contract is not known in conventional economics. In this contract, a financier or investor entrusts an entrepreneur or agent with a certain amount of money capital so that the latter can trade or do any other business with entrusted funds in hope of realizing net profits. If the venture actually ends up in success, both parties share profits according to a pre-agreed ratio. However, in case of losses, the financier bears all financial losses while the entrepreneur gets no reward for his efforts and time.

<sup>18</sup> See Ahmed (1992, pp.82 and 88), Khan (1991, pp.25-7) and Zaidi (1988, p.28). Khan (1991 p. 67) says, " Murabaha, Bai-moajjal or mark-up connote one and the same thing i.e., deferred payment arrangement with the price mark-up."

jurists unanimously believe in permissibility of credit sale and have no objection on discrepancy between cash and credit price as well but none of them has approved linking of credit price with time like interest. Sarakasi, a well-known eleventh century jurist, proves the permissibility of credit sale directly from Quran by counter argument and clearly acknowledges that a credit price is usually higher than cash price.

Proof that selling for credit is an absolute feature of trade is found in His statement, may He be exalted, 'unless it be local trade that ye are conducting amongst you.' This shows that trade can also be long distant, and this latter type of trade cannot come about except selling on credit. (Udovitch 1970 p. 79; al-Baqarah 2:282) Yet, Siddiqi, a pioneer of current interest-free banking, opposes credit sale and buy-back arrangement.

I would prefer that Bai-Moajjal (a variant of mark-up and buy-back arrangement) be removed from the list of permissible methods altogether. Even if we concede its permissibility in legal form we have the over-riding legal maxim that anything leading to something prohibited stands prohibited. It will be advisable to apply this maxim in order to save interest free banking from being sabotaged from within. (Khan 1991 p. 65)

Similarly, Usmani (1999) and Kuran (1986) find little difference between the prevailing mark-up and buy-back arrangements, and interest-based lending.

Second criticism is that over-emphasis on liquidity of financial assets in context of an interest-free financial system is ill founded. There is not a single verse of Quran or a single hadith that specifically permits trading of financial assets. Rather it should be banned because it negates the very logic of prohibition of interest; to make users and providers of funds for a project to share actual outcomes of the project.<sup>19</sup> Third criticism is that it leaves out an important component of real riba, riba in barter loans, as explained later in this paper.

**Conservative View:**<sup>20</sup> Conservative view propels mainly from the third kind of ahadith that talk about implicit riba. The argument is that since God has forbidden a lender (mostly a rich person before the dawn of modern banking) from taking a ride or accepting a meal or a gift, of whatever meager value it may be, from a borrower (mostly a poor person at that time), therefore rich

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<sup>19</sup> See Ahmad (1995) and Kuran (1986)

industrialists and landlords should also be debarred from appropriating big margins of profit and residual income (surplus value) in an Islamic framework. Haque (1993, p. 937) says that riba in loans is the domain of money lenders and hoarders of commodities who charge against time whereas, riba of excess is the domain of landlords, merchants, speculators and middlemen who give less in exchange of what they get. Ibn al-Arabi, a well-known scholar of the Middle ages, defines riba as "all excess over what is justified by the counter value."<sup>21</sup> Chapra (1984, p.1) rephrases it as "[r]iba represents, in the Islamic value system, a prominent source of unjustified advantage" and Ali (1946) as "profiteering of all kinds, but excluding economic credit, the creature of modern banking and finance."<sup>22</sup> According to proponents of conservative view, only their definition of riba can promise a just and equitable social and economic system, which is the ultimate goal of Islamic economics.

There are three main objections on this viewpoint. One, ahadith 1.1 to 1.3 go against this view. Two, Prophet's refusal to fix prices or to ban hoarding of non-food items, while responding to a complaint of people of Medina lodged against profiteering of city-traders, also foils this view. Three, riba as an unjustified advantage becomes a somewhat subjective phenomenon that cannot be settled once for ever.

### **A BROADER DEFINITION OF RIBA**

The distinctive feature of broader definition, subject-matter of this research, is that it discovers a so far neglected form of riba in hadith, riba in barter loans. Furthermore, looking at its nature, riba in barter loans is lumped with riba in loans. Then the earlier classification by majority of jurists that riba in loans is the real riba and riba in trade is the trivial one is maintained not due to all four reasons listed above but due to the second one only. Hence, this definition implies that hadith is as important as Quran in defining real riba. A practical implication of this definition is that riba in barter loans is even more intriguing than riba in loans because it forbids trading of the subject-matter of any time-related deal, be it a barter exchange with a time lag, a loaning deal, a

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<sup>20</sup> See Abu-Sulayman (1968), Ali (1946, his commentary on the verse 2:275 on p. 111), Haque (1985, 1992 and 1993), and Naqvi (1982 and 2000).

<sup>21</sup> Quoted in Chapra 1984 p.7.

<sup>22</sup> Ali is a contemporary translator and commentator of Quran in English language, see his commentary on above quoted verses of Quran. Also quoted in Noorzay (1982, p. 5)

partnership or a trusteeship contract, or a joint stock business that is now-a-days the business in secondary capital markets.

As mentioned above, all the verses of Quran on the subject of riba imply only one form of riba, riba in loans that involves a contractual increase on principal. However, in addition to Quranic riba, the Prophet identified two, thus far, unknown forms of riba, implicit riba and riba in barter trade. As far as implicit riba is concerned, its meaning is clear. The only confusion, why the Prophet used the same word 'riba' to describe it, also goes away by terming it trivial by majority of jurists. It means that though he used the same word for both, yet they are not treated alike.

However, in case of riba in barter trade, there are still doubts what it exactly means, why it is prohibited and what are the commodities other than the six mentioned in ahadith to which it applies. More importantly, it is yet to be decided whether riba in barter trade is in the category of real riba or trivial riba. To dig down into riba in barter trade, it is therefore advisable to keep in view all possible forms of barter exchange. These are twelve in number, out of which first six refer to spot transactions and last six to loaning deals: -

1. Same variety of the same commodity is exchanged at spot in equal measure.
2. Same variety of the same commodity is exchanged at spot in unequal measures.
3. Two different varieties of the same commodity are exchanged at spot in equal measure.
4. Two different varieties of the same commodity are exchanged at spot in unequal measures.
5. Two different commodities are exchanged at spot in equal measure.
6. Two different commodities are exchanged at spot in unequal measures.
7. Same variety of the same commodity is exchanged with a time lag in equal measure.
8. Same variety of the same commodity is exchanged with a time lag in unequal measures.
9. Two different varieties of the same commodity are exchanged with a time lag in equal measure.
10. Two different varieties of the same commodity are exchanged with a time lag in unequal measures.
11. Two different commodities are exchanged with a time lag in equal measure.
12. Two different commodities are exchanged with a time lag in unequal measures.

Out of six spot transactions, only type 2 and 4 involve riba according to ahadith 2.1 to 2.4. Prohibition of type 2 is quite understandable but prohibition

of type 4 is not. Type 4 resembles so closely with type 6 that a common reader cannot understand why one is prohibited and the other is permitted. A tentative explanation may be worthwhile for inquiring minds.

Since ever, people of immediate neighborhoods have been specializing in the production of one major commodity to take benefit of economies of scale and scope. In such neighborhoods, naturally the produce of each household may not be of same quality. Also each producer may not be equally aware of market price of his quality of produce relative to other qualities. In such a situation, it is quite possible that a well-informed person starts searching for a less informed person to strike an actually unfair barter exchange. If the former succeeds in his mission, then the possibility remains that the affected party would know the right price sometimes later and then would react strongly against the benefited party. Such an eventuality may strain their relations, which is detrimental to realize gains of economies of scale and scope. On the other hand, different commodities are usually produced in different neighborhoods. Therefore it becomes a hard task for a well-informed person of one locality to find a less-informed person from another locality. That is why the barter exchange of two different varieties of the same commodity is prohibited in unequal measures, while the barter exchange of two different commodities has been permitted. The same logic applies to understand prohibition of buying any stuff by businessmen at entrances of a city from incoming villagers as mentioned in hadith 4.8 and prohibition of fake bidding in an auction as mentioned in hadith 4.9.<sup>23</sup>

With regard to barter transactions with a time lag, all six types involve riba for following reasons: -

- a) Both restrictions of hand-to-hand and like for like (in equal measure) have not been lifted in hadith 2.2 above, which means that these commodities can be exchanged in equal measure and at spot only. However, hadith 2.3 further clarifies that for spot transactions, the equal-measure restriction is only for exchange of the same commodity and not for exchange of different commodities. The hand-to-hand restriction has not been relaxed in either of them. Ahadith 2.5 to 2.7 also endorse prohibition of all types of barter exchange with a time lag.

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<sup>23</sup> See Mansoori (1997) for other prohibited forms of transactions.

- b) Prohibition of all types of barter exchange with a time lag, types 6 to 12 above, makes economic sense. In such transactions, possibility of change in the price of underlying commodity creates undue uncertainty for both parties of the deal, which can easily be avoided if both parties agree to denominate their deal in prevailing currency.
- c) In Islamic jurisprudence, the subject-matter of mudharaba (trusteeship) and musharika (partnership) has to be the prevailing currency, not a measure or count of any tradable commodity because any change in the price of underlying commodity inhibits fair sharing of ex post outcome of the underlying project.

However, it is very surprising that early jurists have explicitly admitted prohibition of type 8 only. One reason could be that once the Prophet himself allowed unequal barter exchange of camels with a time lag (hadith 2.9 above) but this hadith has never been quoted for this purpose. Most of the jurists take it as an exception.<sup>24</sup> The main reason for this omission seems to be that, due to obsolescence of barter system, jurists have attached little importance to this kind of riba, even to riba that emerges from barter exchange of type 8.<sup>25</sup>

To sum up, majority of jurists rightly acknowledge prohibition of types 2, 4 and 8 but they ignore type 7 and types 9 to 12.<sup>26</sup> Some of them even believe in permissibility of type 7.<sup>27</sup> Furthermore, severity of prohibition of types 2 and 4 is equated with that of type 8 probably due to literal meaning of the word 'trade or exchange' used in ahadith to describe both spot and credit barter

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<sup>24</sup> See for example Tahir 1994.

<sup>25</sup> In Federal Shariat Court Judgement 1999, riba has been divided into four main kinds: -

- i) Any amount, big or small, over the principal, in a contract of loan or debt is riba prohibited by Quran.
- ii) A transaction of money for money of the same denomination where the quantity on both sides is not equal, either in a spot transaction or in a transaction based on deferred payment.
- iii) A barter transaction between two weighable or measurable commodities of the same kind, where the quantity on both sides is not equal, or where the delivery from any one side is deferred.
- iv) A barter transaction between two different weighable or measurable commodities where delivery from one side is deferred.

This categorization of riba is followed by the remarks that out of these four types of riba, the last two appear only in barter system that has become a rare phenomenon in modern trade.

<sup>26</sup> Mansoori (1997) has offered a funny explanation of this type of transactions. In his view, if the intention of two parties in such barter transactions is to exchange/trade, then they are free from riba. But if the intention is to loan, then they involve riba. This explanation makes riba a subjective phenomenon that is judged by intention and not by action. Hence, it limits the scope of interest-free system.

<sup>27</sup> See Tahir 1994.



exchanges. Therefore, prohibition of all three types is given a general name of riba in barter trade. Then majority of jurists include riba in barter trade in the general category of trivial riba and, thus, downplay the importance of riba in barter exchange with a time lag.

On the contrary, in this paper all types of barter exchange with a time lag, types 7 to 12, are considered as prohibited. However, to signify the prohibition of mostly misunderstood types of barter exchange, 7 and 9, they are said to be involving 'riba in barter loans' only, whereas types 8 and 10 are said to be involving both 'riba in loans' and 'riba in barter loans'. Similarly, types 11 and 12 will involve 'riba in barter loans' if contractual increase against time is not stated explicitly; otherwise they will involve both types of riba.

An interesting implication of taking types 7 and 9 as prohibited is that qarz-i-hasna should be denominated in prevailing currency otherwise it will also involve 'riba in barter loans.' This might be puzzling to many Muslims who rank qarz-i-hasna higher than charity and many secular minds who believe in time value of money. Furthermore, on the same reasoning that rationalizes prohibition of qarz-i-hasna in kind, someone may argue that in a country where the general price level fluctuates a lot, qarz-i-hasna denominated in prevailing currency should also be deemed prohibited because price instability will cause undue uncertainty for both parties. The answer is that though volatility of the general price level is not appreciated at all in an Islamic framework, yet the fact remains that changes in the general price level are caused by a monetary authority that is generally beyond any control of either party of a money loaning deal. To further clarify this point, it may be stated that either party of a single or many loaning deals can hardly cause inflation or deflation by making use of market tactics like corning or flooding of some markets, whereas in case of barter exchange with a time lag, it can do so at least theoretically.

In the new term 'riba in barter loans' the word 'loan' instead of 'exchange' has been preferred for three reasons. One, from economic point of view the word 'loan' is more befitting for types 7 and 9 than the word 'exchange' because an economically viable exchange or trade must show some profit or increase over the principal that is absent here. Also, for types 11 and 12,

loaning and barter exchanging with a time lag mean one and the same thing.<sup>28</sup> The other, the word 'nasia' used in ahadith 1.1 to 1.3 to qualify riba further encompasses both loaning and barter exchanging with a time lag. The last, since a majority of jurists already confines real riba to 'riba in loans'; therefore the new term containing the word 'loan' may be easier to digest.

It is pertinent to point out here that riba in barter loans arises only in case of commercial exchanges. Barter loaning of day-to-day consumption items among neighbors does not come under the purview of riba in barter loans because Quran itself encourages such loaning to make neighborhood a lively form of mutual cooperation.<sup>29</sup> In everyday life, it is probably not difficult to distinguish between neighborhood (non-commercial) and commercial exchanges. Anyhow, if any confusion arises about a particular commodity or a quantity, then its barter loaning for the sake of neighborhood relations should be suspended to keep away from 'riba in barter loans' a component of real riba.<sup>30</sup>

The next question is whether riba in barter exchange should be confined to barter exchange of six commodities that have been mentioned in ahadith or should it be generalized to barter exchange of other commodities as well. The answer is mixed. On one side are ahadith 2.6 and 2.7 that forbid barter exchange in general and the majority view that supports generalization of riba in barter exchange to other commodities as explained above. On the other side are hadith 2.9 and the minority view that supports confining prohibition of barter exchange to the six commodities.<sup>31</sup> The minority argument is that whatever things God and the Prophet wanted to prohibit, they prohibited them categorically without forgetting any of them. Therefore, believers should take a barter exchange of these six commodities as prohibited and treat that of all other commodities as permissible.

A majority of jurists does not accept minority view because in many cases Quran and hadith mention only symbolic incidences or set only principles and

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<sup>28</sup> Different units of a consumable commodity are generally considered to be homogenous, though they might be distinguishable from one another physically. Therefore, a borrower does not have to return exactly the same units he borrows.

<sup>29</sup> See Quran, (al-Maoun 107: 7)

<sup>30</sup> This view is in line with the established principle in Islamic jurisprudence that to achieve the pleasure of God, one should leave non-permissible things first and adopt permissible ones later if both acts are not achievable, for any reason, at the same time.

<sup>31</sup> See Chapra (1984).

leave out details to jurists. For example, Quran prohibited drinking of wine in unambiguous words but did not mention a particular kind(s) of wine. Therefore, one may argue that it is only that kind(s) of wine, which was commonly used at that time. But this logic leads to a contradiction in theory and practice because that kind(s) of wine might have been disappeared from the market since long. In that case, this commandment becomes redundant for practical purposes, though it remains a part of faith. Therefore, there is a consensus among jurists that anything that intoxicates, remains prohibited irrespective of the fact whether it existed at that time or not.

Similarly, mentioning of just six out of an innumerable bunch of commodities seems to be more symbolic than absolute. That is why a majority of jurists supports generalization of riba in barter exchange to other commodities. In this research, the majority view that riba in barter exchange should be extended to other commodities is accepted but none of the reasons quoted above as to what those commodities should be is accepted. Rather, hadith 2.9 is taken as a guide. In this hadith, the Prophet permitted a barter exchange in unequal measure with a time lag, whereas he prohibited it for 6 commodities in particular and other commodities in general. An appealing reason seems to be that the Prophet forbade barter loaning of the six commodities due to volatility of their own and relative prices over time, whereas he permitted it for one male with two she-camels whose relative price had been constant at least in the short run.

If this hypothesis is accepted, then not only the apparent contradiction between hadith 2.9 that permits barter loaning of camels and other ahadith that prohibit barter trade of 6 commodities (2.2 to 2.4) and of animals (2.6 and 2.7) is resolved but also the prohibition of barter exchange can be generalized in an objective way to other than the mentioned commodities. Barter loaning of all other commodities whose absolute and relative prices are subject to change in the short run should be treated as riba.<sup>32</sup> On the other hand, all those commodities whose absolute or relative prices do not change very often, their barter loaning may be exempted from riba with an additional condition that the

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<sup>32</sup> If it is a barter exchange of type 7, then a change in absolute price of underlying commodity matters. On the other hand, if it is any other type of exchange then both absolute and relative prices of underlying commodities matter.

party who has to deliver the commodity in future, should own it well before the time of delivery.<sup>33</sup>

## **SUMMARY**

Prohibition of interest is the most distinctive feature and probably the most intensively discussed issue of Islamic economics, yet it remains a major topic for further probing and research. There are many different definitions of riba which are arranged, for simplicity, under three main headings; liberal, mainstream and conservative views. Liberal view confines riba to usury only and, thus, does not recommend any change in the modern financial system in which bank interest plays the pivotal role. According to mainstream view, riba also includes bank interest. Therefore, it implies a major restructuring of conventional financial system, though practically interest has been replaced mainly with mark-up, which is quite similar to interest on economic grounds. Mainstream jurists also emphasize deepening of capital markets for the success of emerging interest-free system. Conservative view further extends the definition of riba to major forms of social injustice like contracting of subsistence wages and profiteering. This view suggests a radical change in whole economic system on the lines of Marxian philosophy.

Liberal and conservative views are, on one hand, subject to juridical criticism; they do not conform to all verses of Quran and Ahadith on the subject. On the other hand, they define riba in relative terms, which cannot be unanimously settled once for ever. Mainstream definition of riba is though free from these weaknesses, yet it generates some contradictions in theory and practice. According to this view, the unanimous reason for prohibition of riba is to make both financiers and users of funds share the actual outcome of an underlying project. However, practically current interest-free banking has been predominantly using mark-up in place of interest that equally inhibits sharing of ex post profits of an underlying project. Furthermore, many gurus of emerging interest-free banking are emphasizing development of financial markets and securitization of various fixed-return interest-free modes which definitely hamper fair sharing of actual outcome of a given project between its financiers and users of funds.

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<sup>33</sup> That is, the party should not have to buy it at the time of delivery. Otherwise if the price of commodity shoots up, the probability of its delivery falls. That is why forward trading is looked

The first contradiction is not serious because a majority of academia in mainstream camp still believes that profit-loss-sharing is the real alternative to interest. It is only practitioners who have adopted mark-up with the pretext that currently moral fiber of the society is not up to mark for an abrupt switch-over to profit-loss-sharing. The second contradiction is, however, worrisome. According to this research, it is due to overlooking riba in barter loans.

Riba in barter loans arises in exchange of goods with goods with a time lag. In such transactions, any change in the price of underlying commodity benefits one party while it hurts the other. It is, therefore, prohibited to let both parties realize the outcome of actual deal. Many authentic ahadith prove riba in barter loans unambiguously. It gets further support from prohibition of any measure or count of a commodity as a subject-matter of a trusteeship or partnership business in Islamic jurisprudence. Furthermore, if it is accepted that prohibition of barter exchange with a time lag in case of six commodities is to avoid uncertainty created due to possibility of change in the price of underlying commodity, then hadith 2.9 in which the Prophet permitted barter exchange of camels in unequal numbers needs not be treated as an exception. It can be rationalized by hypothesizing that the relative price of concerned camels had been fairly constant at least in the short run. Also prohibition of barter exchange specifically mentioned for six commodities can be generalized to other commodities in an objective way. All those commodities whose absolute and relative prices change often, there barter exchange with a time lag should be subject to riba in loans. In modern finance, since stocks are treated as the subject-matter of joint-stock companies and their price changes too often, their trading should also be considered as riba in barter loans. However, if some method of exchanging stocks on their par value is worked out, then their exchange needs not involve riba in barter loans.

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