Interest (*riba*) vs profit (*ribh*)

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Literally, *riba* means "increase." However, *riba* is commonly translated into English as "interest." *Riba* is mentioned in the Qur'an in 30:39, 4:161, 3:130, 2:275-276, and 278. Most commentators agree that *riba* is a sum of money a lender claims from a borrower on top of the principal amount of a loan, as a reward for extending the loan, or for allowing more time for repayment. It does not matter whether the additional amount is small or large; even the smallest amount is still *riba* because it constitutes an "addition."

The amount of *riba* (interest) added to a loan is commonly specified in advance. Moreover, it is specified as a proportion (percentage) of the total amount of the loan. The total amount of interest paid thus depends on the total amount lent and on the rate of interest charged. The higher the amount or the rate of interest or both, the more interest will be paid.

Riba mentioned in the Qur'an takes place in the course of lending, and is known as *riba al nasi'ah*. Despite the fact that the Qur'an draws a sharp distinction between a sale (*al 'bay*) and *riba* (Qur'an 2:275), according to prophetic traditions *riba* may also arise in the course of trading (buying and selling). This type of *riba* takes place when items of equal weight but unequal value are exchanged in barter, or when an asset is traded at a price that substantially exceeds or falls short of its market value. In trading, *riba* is known as *riba al fadl*.

The loan and its repayment with interest constitute an exchange of values. In so far as a loan at interest is invariably smaller than the repayment, the amounts of money exchanged in such a loan are always unequal. The smaller amount is paid on the spot, while the larger amount is paid later. Thus, as in a trade, the values exchanged in a loan at interest are *unequal*.

Because the counter values exchanged in both types of riba are unequal, *riba* may be defined as the amount by which one of two countervalues exchanged exceeds the other counter value, regardless of whether this takes place in lending or in trading.

Riba is prohibited (*haram*). This is clear from a definitive (*qat'i*) verse, "God has permitted trade but forbidden usury" (Qur'an 2:275). The cause (*illah*) of the prohibition of *riba* is the difference between the counter values exchanged. The rationale (*hikmah*) for the prohibition is to realise justice in dealing.

The injustice in a *ribawi* transaction, whether in a loan or in sale, arises from the fact that one party receives greater value than the counterparty. In such a transaction, the difference between the two values is transferred from one party to the counterparty. Effectively, the party receiving the higher value benefits at the expense of the party receiving the lower value. One may say that the party receiving the greater value "takes advantage" of the counterparty.

Transactions in which one party receives a greater value than the counterparty will, over the longer term, produce and perpetuate a divided society. In such a society, people will be divided into debtors and creditors. This runs counter to the ethos of Islam, which emphasises the need to *share* wealth, rather than concentrate it among a few wealthy creditors at the expense of the majority. “Balanced economic development” will remain elusive in any society where this takes place.

The Qur’an leaves no doubt as to the seriousness of the offence of *riba*. It calls on the believers to give up whatever remains of their demands for *riba*. (Qur’an, 2: 278). It advises the believers to give time to debtors in difficulty to repay the principal amounts of their debts. Indeed, it recommends forgiving even the principal sums by way of charity. (Qur’an, 2: 280). In other words, *the Qur’an calls for debt forgiveness*.

A common rationale used to justify payment of interest is that the lender needs to be compensated for the erosion of the purchasing power (currency debasement) of money that takes place due to inflation by the time the debt is repaid. With regards to this view, we note that lending rates generally exceed the inflation rate by several percentage points (3% on average), so the party that lends at interest normally receives more than what is necessary to compensate for inflation.

Another rationale used to justify the payment of interest is that lenders need to be compensated for a lost opportunity to earn profit with the money they otherwise lend to borrowers. With respect to this view, we note that as there is no way of confirming that the lender “would have earned” any profit at all just because he had the *opportunity* to do so, this claim remains unconfirmed. Having an opportunity to earn profit, and earning profit are two very different things. Many have the opportunity to earn profits, but few do.

The Qur’an draws a distinction between *riba* and sales (*al ‘bay*). The difference between *riba* and selling, however, implies a distinction between *riba* and *ribh* or profit. Thus, the meaning of *riba* can be brought into sharper focus by comparing lending with trading, as well as by contrasting *riba* with *ribh* or profit.

Ribh – commonly translated as “profit” – is an amount of money added on top of the cost price of a good or a service. This “extra” is known as a “mark-up.” The profit of the entrepreneur comes from this mark up, after all expenses are paid. The “extra” in the form of a mark-up represents compensation to the trader for his expenses and for making the effort and taking the risk to bring a product or a service to market. *Riba*, by contrast, is generally added not to a cost of a product but to a loan of money.

Riba (interest) and *ribh* (profit) are different because they are earned in different ways. Trading and by extension investment take place in the real economy. Buying and selling meets people’s needs. Lending at interest, by contrast, does not directly meet people’s needs, as money in itself is not useful. While profits have to be earned by active participation in economic activity, interest is gained passively, without the participation of lenders in the production or distribution process. In the case of collateralised loans, interest is earned even without taking risk.

It is important to maintain an awareness of the difference between profit and interest, as well as between the types of activities – trading and lending – that generate them, respectively. If these distinctions are not maintained, it may become difficult to tell the difference between *ribh* and *riba*. Without a good understanding of the difference between forbidden *riba* (interest) and permitted *ribh* (profit), it will be difficult to maintain the compliance of Islamic finance and banking with the Shariah.