

Riba vs al-kharaj bi al-daman.



Mohd Bahroddin Badri

It is worth noting that the misconception of equating riba with trade has been around for more than a thousand years. Some Arab traders in the era of Prophet Muhammad (peace be upon him) argued that the income earned through riba-based transactions is no different than profit earned in sales transactions on the basis that the end results of both kinds of transaction appear similar; both the lender and seller enjoy an increase to their original capital. Thus, it is no wonder that many perceive interest-based loans offered by conventional banks to be no different than the financing facilities offered by Islamic banks, a perception similar to that of the Jahili Arabs who saw no difference between riba and trade, either due to real or feigned ignorance.

Islam does not acknowledge an individual's right of property unless it is created through an exchange of assets or through real economic activities that involve labor, skills and natural resources. Profit earned in a sale transaction is permitted because it is created as a result of exchange activity that involves the real exchange of counter-values ('iwadayn). The profit created from the mark-up price enjoyed by the seller is justified as the counter-value is present. The profit is legitimate as it is attached to the price of the existing asset, which is traded by the contracting parties. Conversely, in a loan transaction, there is no asset or counter-value involved. The absence of counter-value implies that there is no rational basis to justify earning an excess. Islam does not acknowledge this kind of unjustifiable income as it results in *akl mal al-ghayr bil batil*, i.e., taking the property rights of others wrongfully. Riba is absolute exploitation as the lender asserts a claim to the property right of the borrower without valid justification.

The loan transaction implies that the lender has transferred his right to profit from the capital to the borrower as soon as the lending contract is concluded. That is because the borrower undertakes sole liability for any risk to the capital. This transfer of liability disqualifies the lender from claiming any extra return other than the principal amount. Conversely, a capital provider who advances his money for an investment or business venture is entitled to enjoy profit as he retains his right of ownership (the capital) and shares the risk of real investment activities with entrepreneur.

The intended meaning of risk here is the type of risk that is an inevitable part of a contract or transaction. The right of earning return in a transaction can be enjoyed by the parties

involved provided that they are fairly liable for risk. In other word, the absence of risk in a transaction disqualifies the contracting party who avoids it from entitlement to return. This is based on the principle of al-kharaj bi al-daman, derived from a Prophetic tradition which signifies that the entitlement to profit is dependent on liability for attendant risk of possible loss or defect. The element of mutual risk-bearing exists in the buyer-seller and investor-entrepreneur relationships, but it disappears in the lender-borrower relationship.

Riba is exploitation of the borrower by the lender as the lender is guaranteed a return without sharing any risk with the borrower, who assumes all kinds of risk in the venture. In a loan transaction, the lender and the borrower do not mutually bear the risk; rather, the lender's position is secured irrespective of whether the borrower is successful or not in his business or investment activities. It is the borrower who bears all the risk while the lender does not assume any risk beside credit risk. Allowing one party (the lender) to enjoy guaranteed interest and principal from the loan without assuming risk is an act of injustice against the other party (borrower). Credit risk in a loan transaction is not acknowledged by Islam as a basis for entitlement to income due to the fact that it appears from a mere loan contract, which has no connection with real economic activities. Lending activity is totally detached from the growth of economic activities, which involve selling and purchasing existing assets or producing and processing raw materials. The lender-borrower relationship implies that real investment and economic activities, which involve exchanges of wealth, do not materialize.

Earning income from an interest-based transaction is definitely unjust from the Islamic perspective; likewise, there is no rational justification for it. It is obvious that the first party (the lender) enjoys guaranteed benefit at the expense of the other party (the borrower), who bears the risk of loss. Islam acknowledges that the property of every individual is sacred; thus it comes with mechanisms to protect it, and one of them is the prohibition of riba. Islam condemns all sort of wealth accumulation through unjustifiable means, particularly riba, which is exploitative and manipulative and violates welfare and socio-economic justice in a society. At the same time, Islam promotes wealth enrichment through fair and ethical means through the principle of al-kharaj bi al-daman.