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“Constitutions and Islam”

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**ABSTRACT**

“Reform in Finance: Riba vs Interest in the Modern Economy”

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On close scrutiny, the epistemological basis of Islamic finance and banking institutions appears weak at best. Such institutions have grown rapidly and gained popularity in recent years, but their establishment seems to have been largely an exercise in futility. This is because the very underlying principle, on which such institutions are based, i.e., to get rid of interest, is found, by and large, to be missing in actual practice. The interest-free principle requires these institutions to back their products (financing for various services and paying depositors) with real assets on the ground. However, in practice, such a principle is hard to realistically apply except in *mudaraba* and *musharaka* financing, which is done on a participatory, profit and loss sharing basis. Such financing, however, is found to constitute a minimal proportion of the activities usually undertaken by these institutions. Muslim scholars generally equate *riba* with interest and thus fail to make a vital distinction that needs to be drawn between *riba* declared as forbidden in the Qur’an and interest that has come to play a necessary and very beneficial role in modern finance and banking and in monetary and economic policymaking. As some modernist scholars, notably Fazlur Rahman, have shown, interest used in modern finance should be considered a legitimate economic charge. I also argue that *riba* forbidden in the Qur’an applies only for those who deserve humanitarian treatment – who need concessional or interest-free loans (*qarḥ-basana*) or outright grants (*sadaqa*).