

FATAWA INFLATION 2003

Is Interest a Compensation for Inflation?

From: Monzer Kahf
Sent: Monday, December 29, 2003 7:27 AM
To: Islam on Line
Subject: Inflation and Getting Interest Rates

My Answer:

Bismi Allah al Rahman al Rahim
Al Hamdu li Allah Rabb al 'Alamin
wa al Salatu wa al Salamu 'ala Sayyidina Muhammad wa 'Ala 'Alihi wa Ashabihi
Ajma'in

Dear Br. Rami

Assalamu Alaykum wa Rahmatullahi wa Barakatuh.

While it is true that inflation reduces the purchasing power of an amount of cash a person holds, interest is neither the cause nor the effect not the contractual compensation of inflation. Interest is a contracted increment in a loan and that is forbidden in Shari'ah.

Inflation reduces also the value of cash you keep in your pocket is the bank going to compensate you for it? it also reduces the value of contractual future salaries of salaried persons and of debts you may have on your brother or mother is the bank going to compensate you for that reduction?

Wa Allahu A'lam

Wa Alhamdu li Allah Rabbi al 'Alamin

Wassalam

Sincerely,

Dr. Monzer Kahf

Question:

From: Islam on Line

Sent: Sunday, December 28, 2003 2:40 AM

To: monzer@kahf.net

Subject: Inflation and Getting Interest Rates

Name of Questioner Rami

Gender Male

Age 31-45

Education

Date Submitted 12/18/2003

country of Origin Spain

User Ref. No. TFW49G

Country of Res.

Question

Dear Brothers, Inflation rates actually diminishes the value of money we deposit in banks and therefore, I don't see nay valid reason why we shouldn't get a kind of compensation in the form f interest rates. What's your opinion? Jazakum Allahu Khairan!

From: Monzer Kahf
Sent: Sunday, November 23, 2003 7:26 AM
To: David
Subject: Riba, inflation and the abstract nature of money

My Answer:

Bismi Allah al Rahman al Rahim
Al Hamdu li Allah Rabb al 'Alamin
wa al Salatu wa al Salamu 'ala Sayyidina Muhammad wa 'Ala 'Alihi wa Ashabihi
Ajma'in

Dear Br. David

Assalamu Alaikum wa Rahmatullahi wa Barakatuh.

The point you raise is important and well taken, but if leave the nuance of economic jargon, do you really think that interest is a compensation of inflation? is it not a policy tool? is it really determined by the difference valuation through time of goods and services? is the reality as simple as you abstract it in ten loaves of bread? is contracted interest a good approximation of what will happen in the future of inflation? And how about deflation, has it ever happened that the creditors pay interest to borrowers? also who is going to pay for those whose money value has been eroded while they still keep it in their vaults or in checking accounts that pay no interest?

Another thing, do you see a difference in the example you mentioned between Riba and value erosion? without denying the beauty of the abstraction of money "abstract representation of value of good" is it not something that people exchange and actually treat like any other commodity. So as simple as: if you give me 10 units of money you get back 10 units and if you give me 10 unit of bread you also get back 10 unit of bread. Is it not rational that if you allow such a contractual increment in one you should also allow it in the other? and is abstraction of money dynamic or fixed? don't people also look at some commodities as quasi cash?

Besides, let us take a moment to go to law. any law must have certain line between the do and the do not. would you draw the line, even in your example, that any contractual increment in any thing is Riba or you would exclude one thing, money? so that people would use it to get gains, not really to compensate for value erosion, and avoid using other denominators for the pretext.

Also, Indexation is been discussed in Islamic economics. It is considered by many as the right compensation of inflation. Yet many others argue that it opens a back door for Riba that must be kept closed because through it many pure Riba practices may go too.

Finally I would like you to read the paragraph; I quoted below from a forthcoming article by Prof. Siddiqi that puts some of these points in perspective.

Please write again if you feel you like to continue this and any discussion on any of these subjects.

Wa Allahu A'lam (and God knows Best)
Wa Alhamdu li Allah Rabbi al 'Alamin
Wassalam
Sincerely,
Dr. Monzer Kahf

"INTEREST AS COMPENSATION FOR INFLATION

“While some of the bad effects of interest mentioned above, e. g., interest causing instability, have come to light recently its unfairness as a social arrangement has been in focus for ages. What makes it tick, then, not only among those who stand to benefit by it but also by people in general? There seem to be two main reasons, one a product of the circumstances during the last half century and the other rather old. The older reason for general acceptance of interest is the perceived lack of an alternative. The recent reason is erosion in the value of money due to persistent inflation during much of the last half century. Bank depositors as well as creditors of all sorts stood to lose in terms of purchasing power unless compensated for the decreased value of the sums originally involved. Interest was looked upon as such compensation.

But is that true? And is the borrower/debtor the right party to be obliged to pay the compensation? Inflation is caused by wrong monetary policies in the first instance. Certain factors at the macroeconomic level, e.g., deficit financing..... may also be responsible. Neither has anything to do with the borrower/debtor. Insofar as the debt is the deferred price of goods or services purchased, the expected inflation can be taken care of by contracting for a higher than spot price. In cases of money loans it cannot be ascertained whether the benefits actually derived from the liquidity so obtained are sufficient to afford extra payment. Intermediation by a bank does not change the situation. All that can be asserted with a degree of plausibility is the entitlement of the lender to some compensation. But this applies even to the owner who keeps his/her money under the mattress, a case in which no other party is involved. In all fairness a compensation for the loss in purchasing power of money due to inflation should come either from the authority which manages the society's money or from the party which actually benefited from inflation.

Making interest take over the role of compensating for inflation has two distinct disadvantages. First, it hurts certain social classes which hardly deserved to be hurt; and second, it gives undeserved benefits to certain other classes. This became very evident in the United States and many other countries during the Reagan/Thatcher era in the nineteen-eighties when the authorities allowed double digit rates of interest causing huge sufferings to farmers and home owners whose cost of servicing their debts and mortgages skyrocketed but brought windfall gains to creditors". [Prof. Muhammad Nejatullah Siddiqi, upcoming article on economic effect of Riba, in the Encyclopedia of Islamic Economics, V 2].

Question:

From: David
Sent: Sunday, November 23, 2003 2:44 AM
To: monzer@kahf.com
Subject: Riba, inflation and the abstract nature of money

Dear Dr Kahf
Riba and Inflation

I have read widely on this in relation to Islam and your comments alongside that of other eminent Moslem scholars are that adjusting a debt for inflation is Riba and therefore wrong.

The reason I question whether it is really Riba is the fact that "money" is merely an abstract representation of the value of goods to avoid the inconvenience of a bartering system. If I borrow 10 loaves of bread from a friend, it is right that I pay back the same. If they demanded 12 it would be Riba. The point is if we converted into money and the abstract representation of the 10 loaves of bread was "100 units of currency" but I later paid back the loan when the cost of the loaves was "110 units" the extra units would not be Riba, it would be simply the same amount once converted to tangible goods. Surely there is no usury or Riba going on here? I would dearly like an explanation why adjusting for inflation is in fact Riba of this in logical terms. The only explanations I have received so far have been circular arguments such as "the Qur'an forbids it so it is wrong, it is wrong because the Qur'an forbids it". The Qur'an does understandably forbid Riba but it is a question of the context it was written in Thanking you in advance for a logical answer in relation to the abstract nature of money.

Interest in Saving Bonds and Inflation

From: Monzer Kahf
Sent: Thursday, December 11, 2003 2:00 PM
To: housam
Subject: savings bonds and Inflation

My Answer:

Bismi Allah al Rahman al Rahim
Al Hamdu li Allah Rabb al 'Alamin
wa al Salatu wa al Salamu 'ala Sayyidina Muhammad wa 'Ala 'Alihi wa Ashabihi
Ajma'in
Dear Br. Housam
Assalamu Alaikum wa Rahmatullahi wa Barakatuh,

Is this in the USA? If it is then you are wrong. There is an interest rate and this interest rate is related to inflation.

I don't know of any bond anywhere in the world that has no return on its own, add to it the indexation. Besides who tells you that it is spent on roads and similar? Why not on weapons to attack other countries like Iraq? It is a general bond to supplement the treasury of the government. There is no escape from the answer I gave you and you have to repent, quit, give all return to charity and pay Zakah on principal.

Wa Allahu A'lam
Wa Alhamdu li Allah Rabbi al 'Alamin
Wassalam
Sincerely,
Monzer Kahf

Question:

From: housam
Sent: Thursday, December 11, 2003 1:42 PM
To: monzer@kahf.com
Subject: Re: savings bonds

ALSO I want to add that the return on these I bond is purely related to the inflation index nothing more of less housam

From: Monzer Kahf
Sent: Thursday, December 11, 2003 7:12 AM
To: housam
Subject: savings bonds

My Answer:

Bismi Allah al Rahman al Rahim
Al Hamdu li Allah Rabb al 'Alamin
wa al Salatu wa al Salamu 'ala Sayyidina Muhammad wa 'Ala 'Alihi wa Ashabihi
Ajma'in

Dear Br. Housam
Assalamu Alaikum wa Rahmatullahi wa Barakatuh.
1 - To begin with buying these bonds and holding them is Haram in Shari'ah.
These are interest-based loans to the government, no more no less. What is

prohibited in interest is not its fixity but rather its being an increment in a loan contract. Riba you know is one of the worst sins in Shari'ah. The indexation of the return in these loans is a different issue that is itself controversial because of its proximity to interest but under all view indexation is not the reason for prohibition in these loans; the reason is being an increment in a loan. Financing government projects can be done in accordance with the Shari'ah on the basis of Ijarah bonds or Mudarabah bonds.

2 - Any interest obtained from others, government, companies or individuals is NOT EARNED from a Shari'ah point of view. You must make Istighfar, quit this kind of investment and give away ALL its return to Muslim charity because it is not yours. As you do not own it there is no Zakah on it!

3 - Zakah on investment in permissible stocks and shares is on the net asset value on the day when Zakah is due. There is nothing in the Shari'ah like this 10% on net income of stocks. Stocks are not agricultural products, even in agriculture the 10 percent is on the entire product not on the net. Such an analogy is far fetched and unsound. Stocks are tradable assets and whatever dividends you may get is normally added to your cash flow and, if not spent, included into your end of the year balance that is subject to Zakah at 2.5%. The net asset value of the stocks is also subject to 2.5% at the end of the year like any other tradable assets.

Wa Allahu A'lam
Wa Alhamdu li Allah Rabbi al 'Alamin
Wassalam
Sincerely,
Dr. Monzer Kahf

Question:
From: housam
Sent: Wednesday, December 10, 2003 8:12 PM
To: monzer@kahf.com
Subject: savings bonds

I would like your opinion about investing the US saving bonds type (I) from Shari'ah standpoint

1- the money from these bonds is used for supporting the government operation including ,may be building roads bridges supplying all type of public services--- you have stated in some of what I read for you that participating in such activity is Halal

2- the return on theses funds is paid from the government treasury department, mostly from taxes which the government gets in return for these services

3- the government only promises protection against inflation for the money in this type of funds

4- the rate of return is variable and determined every 6 months by indexing this return to the inflation index that is determined carefully on specific data.

5- so basically this rate might go down to 0%. When I started investing it these Bonds the rate was 7.5% and now it is 2.16% for the same bonds

6- so this investment helps stabilize the buying power for the money and at the same time helps the general public

my other question

do I pay Zakah of the profit only at 10% or on the profit and principle at 2.5%,or this is considered a loan to the government that you pay Zakah on when you cash it as some scholars allow (malki mazhab)

thank you for your help, if you need more information please let me know.

alsalamoalekom warahmatoallah wbarakato

housam
