

## 8. SIMPLE AND COMPOUND INTEREST

Riba an Nasiyah can be classified into two types:

- Simple Interest
- Compound Interest

### **Definition of Simple Interest:**

Interest calculated only on the initial investment.

### **Definition of Compound Interest:**

Reinvestment of each interest payment on money invested to earn more interest.

During the pre-Islamic era, when a borrower used to fail to pay back the principal and interest charged on him, then the lender used to extend the loan on the condition that the interest will also become part of the loan essentially Compound Interest. The following verses of the Quran were revealed in order to stop the people from such practices:

*“O believers, take not doubled and redoubled interest, and fear God so that you may prosper” (Surah Al ‘Imran, verses 130-1).*

To eradicate this abominable practice of the period of ignorance, this verse was revealed. By mentioning the practice of doubling and redoubling, it was condemned and declared unlawful in view of its adverse impact on the community and the selfishness that it bred. It does not mean that if there is no doubling and redoubling (i.e., if there is simple interest, in today's jargon), then it is lawful. No. In Surah Al Baqarah and Surah An Nisa, the prohibition of interest in its entirety and in absolute terms is clearly mentioned, whether or not there is doubling and redoubling.

Since the aforementioned verse prohibits compound interest only, some people misinterpret it even today that compound interest alone is forbidden in Islam, not simple interest. They fail to see that there is absolute prohibition of simple interest in a number of other Quranic verses. The reason that the above verse specifically uses the words “doubled and redoubled interest” is to highlight the shameful aspect of compound interest and not to limit the scope of Riba only to compound interest. This is similar to Allah's command, “Do not bargain on my orders for paltry gains in this world.” The reason for mentioning paltry gains is that even if all conceivable material goods and luxuries of this world are obtained in exchange for ignoring Allah's commands, even then this is a paltry gain. It does not obviously mean that it is prohibited to obtain paltry gains but permissible to obtain (by one's standard or judgment) a hefty price. Similarly, in the verse under consideration, the mention of doubling and redoubling is to condemn the shameful practice rather than limit its permissibility.

## Verses on the Absolute Prohibition of Simple and Compound Interest

*“O believers, fear God and give up the interest that remains outstanding (i.e. whether it is simple interest or multiplied interest) if you are believers” (Surah Al-Baqarah, verse 278).*

*“If you do not do so, then be sure of being at war with God and His Messenger. But, if you repent, you can have your principal (only - not any kind of interest or premium). Neither should you commit injustice nor should you be subjected to it” (Surah al Baqarah, verse 279).*

The above two verses demand to abandon the amount of Riba and directs that only the principal amount should be paid back, nothing in excess. The second verse explains that any excess on principal, no matter how insignificant, is cruel.

The following hadith also proves that both simple and compound interest are forbidden:

*“Listen! all Riba liable to you in the pre-Islamic days has been completely eliminated. You have to pay back the principal amount only. Neither hurt someone nor get hurt by someone. And the first Riba to be completely eliminated is Abbas bin Mutalib’s.”*

The above evidence proves that the claim that ‘only compound interest is prohibited and any Riba less than that is allowed in Islam,’ is wrong. Any amount in excess of the principal fixed in the contract of a loan is called Riba an Nasiyah. If simple interest is accepted, it can also be used to give out additional loans, which will again pay out simple interest. In effect, the interest will keep on becoming part of the principal, which is essentially compound interest.