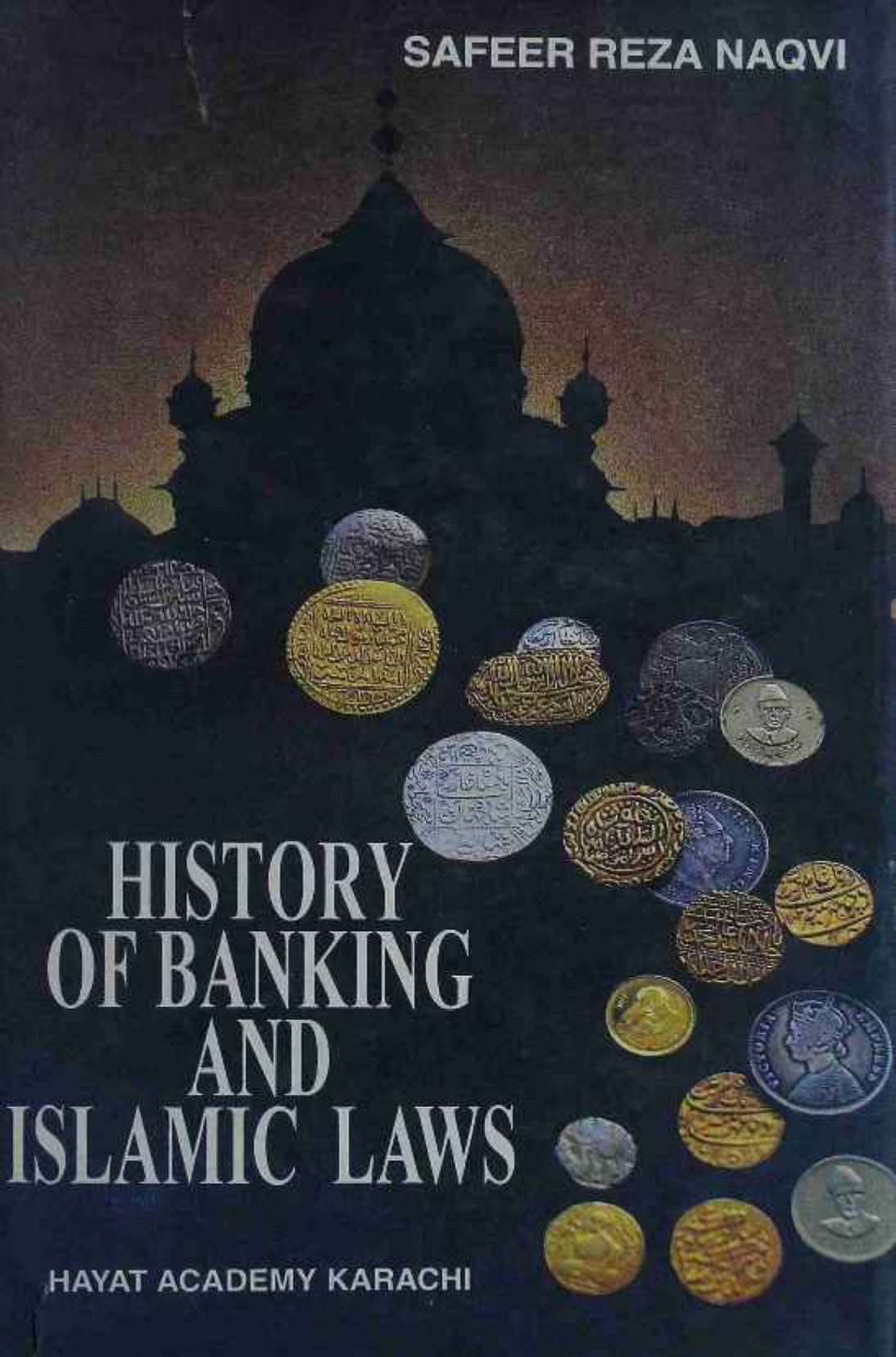
SAFEER REZA NAQVI



HISTORY OF BANKING AND ISLAMIC LAWS

HAYAT ACADEMY KARACHI

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DEDICATED TO

My Wife

HASHIMA NAQVI

For her magnificent devotion to her family

My Children

SHAH RAZA NAQVI
DR. SHAHZEB RAZA NAQVI

For making everything worthwhile

My Grand Son

SHAHZAIN RAZA NAQVI

Whose frolics always cheered me up

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MAN BEHIND THE BOOK

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Safeer Reza Naqvi, was born in early thirties of this fast fading-out century and rightly claims the honour of being the son of the most fertile soil of Amroha (U.P.), India, the land of great saints and poets. Amroha is widely recognised for producing intellectuals and artists of great renown. The works of great authors, poets and artists have earned real glory and greatness to this small town located about 90 kilometers to the east of Delhi. Many famous authors from Amroha have produced for their people what Ruskin calls **"Kings Treasuries"** - not the transient treasuries of gold and silver but the in-exhaustible **"treasure house"** of wisdom, knowledge and insight. With the present book on a purely professional subject, Safeer Reza Naqvi, has joined the elite band of writers from Amroha.

We would like to know, may be little, about the author himself who was a member of a privileged society before migrating to Pakistan after partition of the sub-continent. His grand father, apart from being a landlord was a practising lawyer in Rampur State (India) whereas his uncle Hayat Amrohvi, a contemporary of Asghar Gondvi, Faani Budayuni, Jigar Moradabadi etc. who died in his early thirties in 1946, was a popular Urdu poet of India, whose poetic contribution has recently been published by Hayat Academy established by Safeer Reza Naqvi. His father Mohammad Yousuf was a journalist, a poet and a committed social worker of a fairly good reputation in former East Pakistan.

As Longfellow says:

"The heights of great man reached and kept
Were not attained by sudden flight
But they, while their companions slept
Were toiling upward in the night."

You go through the biographies of those who have achieved something in life, you will find that the most distinguished thinkers and intellectuals owe their success, in a great measure, to their indefatigable industry and application. Disraeli believed that the secret of success consisted in being master of your subject, such mastery being attainable through persistent diligence and continuous study.

Success of Safeer Reza Naqvi in his academic pursuits and banking profession, lies in his untiring hard work. As an emigrant leaving behind all

the family had in the ancestral town, he had to make his way and fight the battle of his life confidently and resolutely and won it meritoriously. He had his early education in Imamul Madaris Inter College Amroha. He obtained his Master's degree in Commerce from University of Karachi in 1958. Started his banking career with Habib Bank Limited, the cradle of almost all the known professional bankers who filled in the vacuum created by the exodus of the non-muslim bankers after the birth of our new country - Pakistan.

Subsequently, in early 1962 he joined United Bank Limited in the initial days of its establishment. By dint of hard labour, he earned promotions and attained the present position of Senior Executive Vice President which is the most coveted one in the banking industry in Pakistan. During his eventful career, his excellent performance has been duly recognized. He handled the management and marketing functions and has successfully implemented the policies of his bank. He has remained associated with almost all the functions of modern banking, particularly the credit and investment, which have been the field of his special interest. Besides getting recognition as professional banker, he proved his capabilities as a good administrator also and has shown remarkable performance in this area. During his period of deployment as Head of Personnel Division, relationship between management and workers has been improved and strengthened. He took various measures to motivate staff and achieved excellent results. His leadership qualities were on its height when he held the assignment of managing the banks Investment and Cash Management Division. This was the time when Government of Pakistan introduced the **'Open Market Operation'** in the country and he managed this operation in the bank from its infancy and organized it not only to his own satisfaction but won the vast admiration from the top management as well.

Presently, as Senior Executive Vice President posted at Head Office, he is looking after Credit Management and Industrial Credit Divisions. Mr. Naqvi is considered, beyond any doubt, a good and an honest executive, a confident banker and a thorough professional. As a friend from childhood, I can say that Safeer Reza Naqvi enjoys the confidence of his friends and relatives and is trusted by all around him.

Undoubtedly, there is no final comfort in life except in work. It is said of Alexander the great, that he wept bitterly when he knew that he had no more worlds to conquer. It is true, to a man engaged in his work, there is no pain, no melancholy, no disappointment. Pain and disappointment come

only when there is no work to do. Fortunately, Safeer Reza Naqvi has discovered his hidden talent of writing. He is a career banker having deep knowledge and extensive experience. He has a wide-open field to enrich the banking related subjects where his contribution would be definitely welcome and appreciated. The book, **"HISTORY OF BANKING AND ISLAMIC LAWS"** in your hands is a testimony of his calibre. His handling of the subject is superb and tells loudly of his rich academic background extending to the privileged society he comes from where such subjects were normally discussed at length. He deserves all appreciation for adding a book on a rare theme.

Many areas in this profession still demand a meaningful contribution from professionals like Mr. Naqvi and "Hayat Academy" would be glad to publish such professional pursuits.

SYED QAMAR RAZI

Preface

The quest to eliminate interest from the banking system in the Islamic Republic of Pakistan is deep-rooted since its inception. While inaugurating the State Bank of Pakistan on 1st July, 1948, the father of the nation Quaid-e-Azam Mohammad Ali Jinnah in very clear language provided the guidelines for the basis of the future of banking to be practised in the country. On this occasion he expressed his desire to see the revival of the economic system introduced by the faith in which every Pakistani believed and said:-

> "I shall watch with keenness the work of your research organization in evolving banking practices compatible with Islamic ideals of social and economic life... The adoption of western economic theory and practice will not help in achieving our goal of creating a happy and contented people".

In this book an attempt has been made to investigate the theoretical and applied basis for banking operations in a manner which is compatible with contemporary requirements and needs. Behind this effort lies a hope that the reader may have a bird's eye-view of the banking history in the ancient days, the change occurred from time to time, the influence of the religious prophecies and the subsequent rapid expansions in the usury-based banking system. At the same time the landmark set for organisations which took into consideration the (practical) facts characterised by their practicability notwithstanding the banks already in existence.

What, at this stage, is required is to clear the ground for the establishment and the expansion of the banking system based on non-usury by providing

the necessary prohibiting laws, allowing or restricting certain things to the positive legislation that has the power to meet such laws as would be appropriate for the purpose.

A non-usury organisation is in reality a national development which governs the course from the convergence of capital and labour such as will maintain the social equilibrium and help the State to solve labour problem in a manner capable of satisfying the aspirations of the masses and making them happy and proud. In this way they may look to such an organisation which confirms the personal independence of the nation by having resources to the principles of dealing on the basis which is consistent with the Islamic *Shari'a*.

It would not be enough for us to boast before the world that the concept of non-usury banking business is based on co-ordination with the great guidance of God, which is the Light of the Lordly wisdom wished to be the best of the heaven's message at the hands of His chosen Prophet Muhammad (PBUH); it is rather the concept which will cause the whole world to realise once more that it is in need of the guidance which God bestowed unto this nation, calling it to the course of justice and guidance. It is the nation which God has described thus:

> "We had made of you a nation justly balanced, that you might be witnesses over the nations and the apostle shall be a witness over you".
>
> *(Surah Al-Baqara, Verse 143)*

Guided by the belief and admission that good is only done by response to the guidance of heaven, we look with sorrow to the deceit of the mirage. The best way, in our view, is the deviation which violates the commandment of God. This can be done by unveiling the usurious nature of the banking system different from the system which is in conformity with God's *Shari'a*. The usury-based banking system was able to cheat the world — east and west, so that some of the jurists of Islam were unaware that good can never lie in what is contrary to the commandments of God.

The matter is not based on an imaginary or theoretical supposition, but is felt in our practical life, while we look at the picture framework in the course of continuous work in this field for over decades. That is why we

have concentrated our attention on the investigation of changing the banking system, so as to render it consistent with the rules of *Shari'a* after cleaning it of usury. In order to achieve this objective we have carried out studies of the history of the banking business and tried to find out the shortcoming of the system under usury, which is unacceptable to the standard of the Islamic thought until we reach the conclusion where the root of the sickness is discovered and the landmarks of the cure are determined.

In the initial stages, the difficulties are bound to hinder our way, but with the devotion and consistent efforts we may not catch up the path, but can set the derailed bogies on straight line leading towards an equal and just social system which will not only create peace of mind for the humanity at large, but will also lead the whole mankind to a better end.

SAFEER REZA NAQVI

ACKNOWLEDGEMENTS

In the year 1985 non-interest banking was introduced in Pakistan on experimental basis and became burning topic not only in Pakistan but in other countries as well. People were talking for and against the changes initiated by the Government of Pakistan. Same year in the month of November I visited London for my medical check up. During my visit the subject was often under discussion with Mr. Azizullah Memon, the then General Manager, U.K. Operations of United Bank Limited. Noticing my interest in the subject he provided me some literature on the contribution of Muslims in the field of finance and banking. The study of the literature induced me to take up this project which is now before you.

While preparing the manuscript of this book I was fortunate to benefit from the encouragement of my colleagues, help and suggestions. Especially Syed Iqbal Habib, Mr. Manzar Abbas Kazmi, Mr. Muhammad Yasin Khan and Mr. Muhammad Mustaqeem without which it would have been a difficult task for me.

My profound thanks and gratitude to Dr. Ali Raza Naqvi of Islamic Research Institute, Islamabad, who, not only reviewed the manuscript but provided the authentic centuries old references.

As usual my dearest friend, Qamar Razi, continued injection of inspiration for the accomplishment of this project. The assistance provided to me by my elderly friend, Mr. Haider Raza Naqvi, had been my asset in the work.

The ever-ready co-operation of Shaikh Mujahid of Skyline Printing Press was available to me all the time.

Last but not the least, I owe a lot to my family which, though consisted upon, my two sons, Shah Raza and Dr. Shahzeb Raza and my most understanding wife, Hashima Naqvi who relieved me of many of the demanding family burdens, and without whom it would have been impossible for me to pursue my academic work.

Introduction

The word "BANK" is of a European origin and is derived from the Italian word "BANCO", which means a table or a counter. In the opinion of the eminent scholars of banking, the reason why this word was given to the banking business was the then prevailing traditions of Lombardian money changers. It was at the end of the middle ages when the trade and the business of exchange of money was flourishing in the Northern cities of Italy and the money changers used the wooden benches to carry out their business in the markets of buying and selling of various currencies.

To find an Arabic equivalent, there is the word "MASSRIF" originated from the word "EXCHANGE" i.e. sale and purchase of currency. It is the place where the exchange is affected. Therefore, the word "MASSRIF" is derived from Arabic. The idea lying behind the adoption of this nomenclature was purely to find an equivalent to Islamic word "BANK", although "MASSRIF" is not an entirely satisfactory substitute for the European word "BANK" in both the vernacular and the legal and literary use.

It will be no use to involve us in the debate of the origin of the word "BANK" at this stage. It, however, found its way through the passage of various conditions prevailing at various stages. Banking, however, did not become a co-ordinated and systematised business. It has evolved and developed according to the conditions and requirements ever since. A thorough study of subject will reveal that modern banking is not very much different with its past, and, therefore it would, no doubt, be useful to have a general comprehension of the methods which were practised in this field in the ancient days. What we would like to derive from the discussion and the historical review of the subject is to try to unveil certain aspects which may be useful while comparing the current banking business with the era

of the prosperity of Islamic civilization which benefited the Islamic countries for quite a long time. The historical services of the banking business will also help us in proving that is nothing more than an ancillary business that has been created and flourished in the stable condition which expanded the markets and the exchange business. As a matter of fact banking is always adaptable and capable of conforming itself to the conditions and circumstances inspite of its mobile ideas and philosophy.

To make more understandable, we may bifurcate our subsequent discussion in two sections: One being the salient features and theoretical or various forms of banking which were known in the ancient days before the establishment of the modern banking. It will also facilitate in drawing a distinction between the banking as it existed in the various cultures till the fall of the Roman Empire in the 5th Century A.D. and the form of banking system prevailing under Islamic culture at the beginning of its long periods of prosperity dating from about the middle of the 7th Century A.D. Secondly, the modern development in the present days banking system taking the factors and the circumstances which helped its development followed by the legislative measure adopted for giving the practical effect to the term of "BANKING". We will also discuss the most proximate classifications best sorted to the object and the selection of this treatise.

Chapter 1

A GENERAL VIEW OF BANKING OPERATIONS

....A banker or bank is a person or company carrying on the business of receiving money and collecting drafts for customers subject to the obligation of honouring cheques drawn upon them from time to time by customer ....

Dr. Hart, *"Law of Banking - 1931"*

BANKING BEFORE EMERGENCE OF MODERN BANKING SYSTEM

It is a difficult task to establish the first starting point of the banking business, but one thing is clear that the money as means of exchange at the beginning of organised agriculture, industry and trade gave birth to the banking transaction first and then converted the scattered money transaction into an organised shape. The conditions needed for the growth of the system are the development of civilization, its stability and the environment in which the confidence grows and trade flourishes. The first were the cultures of Sumerians and Babylonians under which the various activities of banking were practised. Later on the Greeks and Romans, though they were quite different in the form and appearances, were introduced in the banking system.[1]

The research in the banking has proved that the Sumerians, who were inhabited in an area to the South of Rafidain and were at the top of civilization for about 34 Centuries B.C.[2] carried on various kinds of banking activities. These activities actually began in their sacred temples. The most famous of them was 'Le Temples Rouge D'Orouk'. The scripts dating back to the 20th Century B.C. were discovered in the Babylon area, where a new civilization emerged from the rubble of the Sumerians. The scripts proved to be very useful in identifying some aspects of banking of those days. It could be gathered from the tasks of the historical documents that the Babylonians attained a high degree of progress in the field of credit. The situation prevailing at that time necessitated the emergence of a financing system which also covered the agriculture sector. The English translation of a text of one of scripts shows that Ward Llish, a farmer, had borrowed from the priestess of the temple a quantity of silver to meet his financial needs for the purchase of sesame and promised to pay for the equivalent of the silver in the sesame at the price prevailing, at the time of the harvest, to the holder of the document given by him in the form of a deed made to the bearer. This means that the deed was negotiable and transferable. However, certain scholars believed that the first legislative investment of the banking business dates back to the Law of Hamurabi (18th Century B.C.) which contained a modification of the rules of obligations prevailing at the time and includes some of the banking operations, such as interest-bearing loans and deposits.[3]

The Babylonians regarded their sacred temples as the most and appropriate place to keep their money not only because the risk of theft was not there,

but also due to the fact that these temples used to provide them the accurate and complete account of their deposits. The services provided by the temples were due to their being the most sacred place and as they had the vast properties and their large size permanent resources. Thus the sacred temples performed the role of the first deposit banks within the framework of their ever-expanding field of banking.[4]

The Greeks, in the early stages, had almost the similar banking activities to that of Babylonians. At that time too the sacred temples were the most popular place of banking operations but did not monopolise it totally as was the case with the Babylonians. The financial activities like accepting deposits giving loans, checking and exchanging money and making remittances between different cities, to minimise the risk of carrying money, were being carried out during 4th Century B.C.[5]

The Romans, when appeared on the horizon of a new civilization, served their apprenticeship in the art of banking under the Greeks and altogether changed the banking procedure in most of the ancient world alongwith the expansion of their influence. During the first and second centuries A.D., Egypt attained the highest degree of improvement in the art of banking, and brought a lot of development in the field of financial activities. However, the instability, the disturbance of peace and the interruptions in the means of communication created hindrance in flourishing the banking business.

The cultural and economic collapse of the Roman Empire and its subsequent political disaster before the end of the 5th Century A.D. severed the link with the established traditions.

After the fall of Roman Empire till the dawn of Islam the world passed through the darkest period and faced the most corrupt and unsettled conditions known in the history of Banking. With the dawn of Islam, the darkness was removed from the face of life and the environment of security and stability re-established in the areas which came under the influence of Islam. A question now arises, as to what was the form of banking in this culture? Or did it come into conflict with the guidelines and teaching precepts regulating the lending business, exchange sales and foreign currency exchange, thus being unable, as some commentators contend, to flourish in the cultures of the powers lasted for several centuries before they lost their influence and became the thing of the past.

The following chapters may reply the above questions to a great extent.

BANKING UNDER THE INFLUENCE OF ISLAMIC CULTURE

A thorough study and analysis of the forms of banking, the traditional exchange system of currencies and the customs of the people provided in the Islamic societies confirm one important matter, the ability of banking to adopt the changed colour according to circumstances and conditions. Before the appearance of Islam "MEKKA" was a safe haven in the disturbed world. Traders caravans used to make two trips—north and south—to and from MEKKA during the summer and winter. Amid this relative security and the local prosperity in trade and business, it is obvious that primitive system of deposits and the utilization of money shall appear in pre-Islamic MEKKA society.

As regards keeping the money as deposit, people took pride in their good reputation, which was adequate security for them to keep their money and valuables under the care and custody of those who were known for their trustworthiness and the satisfactory discharge of their obligations. The Prophet (PBUH), before the declaration of his prophecy carried the reputation as "Trustworthy" (AMIN). Deposits of money and valuables remained in his custody until he emigrated from MEKKA to MEDINA. At the time of HIJRAT (Emigration) he assigned the job of keeping the money and valuable of the people till the return of these deposits to their owners to ALI BIN ABU TALIB (A.S.), his cousin and son-in-law.[6]

The people of MEKKA knew two methods of utilization of their money: (1) giving money for sharing the profit and (2) lending upon usury, which was very common during the pre-Islamic days, in the Arabian Peninsula, between the Arabs and the Jews who were at that time resident in the area.

Islam came as a religion for the guidance of the misled humanity and to rectify the deviation of belief, to establish justice and to guide life to righteousness and goodness. For a better understanding of the above principles the ban on usury (RIBA) was necessary for the way of life Islam introduced in the society which was aimed to honour and provide protection from being either the oppressor or the oppressed. What the Muslims believed there was nothing in the ban on usury which obstructed the progress of life. God would not ban anything which cannot be substituted with a better alternative.

There is no doubt that in the pre-Islamic days and after the dawn of Islam the kind of safe-keeping of deposits, where a deposit was supposed to be returned to the depositors in the same form as it was deposited with a person and disposal of the deposit was not allowed, was very well-known. However, there is an instance in the early days of Islamic civilization which carries importance, because it is associated with Az-Zubair Ben Al-Awwam, a person who was a great companion of the Prophet (PBUH). Az-Zubair was one of the most trusted persons in safe-keeping of money. He was a man of sagacity and intelligence who refused to take money on deposit and preferred it to take as loan. In his mind, perhaps, he had firstly to reserve the right to dispose of the money, considering it a loan and not a deposit. Secondly, the idea provided a guarantee to the owner, as the money remaining in the form of deposit without using it might be a loss to the owner. But when the deposit is converted into loan it is secure as it becomes the liability of the borrower.

Ibne Sa'ad (in his book "The Largest Classes, Part-III, Page No. 109 published in 1957 by Beirut House of Printing and Publishing) has said:

"Abdullah Ben Az-Zubair quotes his father as saying that when a man brought money to be deposited with him, Zubair would say: No, it is a loan, because I am afraid it may be lost. Thus the total money due from him as computed by his son Abdulla amounted to 2,200,000 Dirhams, a large sum according to the standard of that time."[7]

From the behaviour of a respectable companion of Prophet (PBUH) in early Islam many things can be inferred, some most important of which are as follows:

i) The concept of deposit is changed from that of trust to that of loan which is the "exceptional or inchoate" deposits which was developed by the modern banking until eventually it became defined in many modern laws.

ii) The deposits kept with Az-Zubair, in the form of loan, were neither owned by one nor restricted number of persons, but it seems they belonged to several persons. That also might be the reason for the extensive fame earned by Az-Zubair.

The method adopted by Az-Zubair confirms the plurality of the depositors and that they were not confined to a small number of the persons.[8] Abdulla,

son of Az-Zubair, after the death of his father refused to divide the wealth left by his father, among his brother even after he had paid the debts which he considered were due to Az-Zubair. Instead he made repeated announcements during the Hajj season for four consecutive years. The announcement read: He who has money with Az-Zubair let him come to us to take his money. After the announcement period of four years he divided the remainder of his father's inheritance which was estimated to about 35,000 Dirhams.[9]

After God's Prophet (PBUH) coming to Medina the need of exchange or barter of monies was felt. It is said that one Ibne Omer came to God's Prophet (PBUH) and sought guidance from him as regards the exchange of Dirhams with that of Dinar, the Prophet (PBUH) said: "there would be no objection if you take the price of the day unless you depart and leave something between you".[10]

The exchange did not conform to monies but went further even to something nearer to the transfer transaction of the present day. It is said that: Ibn Al-Abbas used to take Dirhams in Mekka and write acknowledgement thereof to Kufa in the same manner as Abdulla Ben Zubair used to take Dirhams from the people in Mekka and then write acknowledgement thereof to his brother Mis'ab Bin Az-Zubair in Iraq where they used to cash it.[11] It seems that this kind of money transaction developed, and later became money changer's profession.

In copied tales we find the use of Cheque for commercial purposes was common in the city of Basra in the 11th Century A.D. This method had established rules and procedure of the seal and witness. The existence of money changer was indispensable in Basra, as it used to be a centre of trade with various countries by Muslims through sea. Alexandria and Baghdad used to determine the prices of goods for all the world at that time.[12]

Naser Khusro in his "Safarnama" has written that during his travel between the years 437-444 A.H. (1046-1051 A.D.) he saw how the money business was carried in the city of Basra. In his words:

"A market is set up in three locations in Basra every day. In the morning exchange is carried out in Khaza market, at noon in Othman market and at sunset in Qaddahin market; the work in a market is as follows : every person who has money gives it to the money exchanger and takes in return

a "cheque" and then buys all his needs and pays for them by the money changer's "cheque": a purchaser used no other than the "cheque" of the money exchangers so long as he is resident in the city".[13]

Our intention to quote the above extract was to derive the conclusion that a selective, expressive and developed banking system was in existence within Islamic societies which was adequately satisfying the need of that time. As regards the financial investments, we find that premature ways of investments were not as rich and efficient as of modern days. The reason for this finding is due to the fact that banking operations in the old cultures were of service feature and did not carry the features of investments. It would not be appropriate to think that the Islamic societies of that time did not anticipate to proceed ahead of time and create the art of investment and the need did not arise nor did the banking system acquaint with this method of financial nature.

We do not agree with the non-muslim scholars who are of the opinion that the banning of usury had an adverse effect in the development of banking and trust operations during the Islamic period. Our argument in support of our view is that the banking operation samples quoted earlier by us were not in any way less important and less progressive than those which were known to the societies which were not strict on the matter of usury. It would also not be fair to compare what was known to the Islamic societies with that of modern banking and financial systems, because a justified comparison would require the equal conditions and situations in both the cases.

Islam has banned usury but did not put a ban on the investment through mudaraba. Islam has not prohibited the transaction where a person who owns money but has not business aptitude or does not know how to manage it, may give the money to another person who would manage it in consideration of a certain share of profit.

The dealing was confined to personal contacts to the extent of relations and needs and did not necessitate the expansion of the means of aggregating monies to be used in big enterprises as is in the case of modern, contemporary societies. The plurality of the owner of the money and the active partners began to move from the limits of purely personal relationship and pave the way to the birth of financial intermediaries who took the money in silent partnership, not to manage it by themselves, but to lend it to whoever will manage it according to an agreement in that respect.

The progress of banking and financial system remained confined to the foregoing limits until the end of the period of Islamic cultural prosperity which was beginning to wane. The people of East went into a deep slumber and, thus deprived their future generations of harvesting the cultivation of the rich crops sown by their ancestors.

Whereas the fall of Roman Empire and the dark medieval ages in the European continents severed completely the links which connected the various fields of banking business of old civilizations, the self-imposed backwardness hit the Islamic countries and led to the severance of all links and forms of banking system which was being practised in ancient times. The East surrendered itself to the West like a prisoner of war. At the same time the West, which was awakening to its new dawn, started to enjoy the benefits arising out of it.

After the fall of Islamic era and the dawn of the modern European culture we should examine the development of modern banking art and the progress achieved under the domination of this world by both East and West.

EMERGENCE OF MODERN BANKING

The banking which was known in various forms and guises in the ancient civilization in various parts of the world did not coincide with the emergence of the modern Banks. The banking which had its roots in the flourished culture and had lost its required effectiveness regained the strength with the development of the modern banking.

In the earlier discussion an attempt has been made to illustrate the selected forms and conditions of banking which were known to former civilizations. We have also tried to distinguish between what was banking prior to Islam and the dealings in the field under the patronage of Islamic culture. It was also necessary to draw distinction in order to take into account certain considerations, the most important of which were the following:-

(1) Islamic culture has a distinctive imprint that the people sought the guidance from the relative commandments and indictments of their religion which have positive or negative effects on many aspects of banking activity and dealing.

(2) Of course Islamic culture took advantage of the knowledge of its predecessors. It rightly deserves special place in financial field and has provided guidelines for the dealings in the systems which differ from what was known to earlier and contemporary generations. The prosperity brought under the Islamic culture came at a time when the world was still under the darkness of ignorance.

We will now consider how modern banking harmonised itself with the various conditions and circumstances of earlier culture to serve both the needs of the people, simplified itself to suit the needs of their lives and conformed to the constant change of the circumstances and situations. The authorities on the subject are of the opinion that the development of the modern banking operations began when the trade in the cities of North Italy flourished due to the advantage of their locations, as they were situated near the passes of Alps and were being used as trade routes. Thus the birth of the modern banking took place in the same area which had witnessed the burial of the ancient relations of cultures of this field. Probably this might be the reason the name of first bank was given as "BANCO" which means the wooden desks. The money changers of Lombardia used to sit behind their wooden desks and, therefore, the place

became known as Banco. At a later stage, this word became closely connected with every banking title in the current age.

Lombardia, Geneva and Milano became famous but Florence and Venice excelled. The various conditions and factors which were responsible for the slow beginning in the development of banking in the early period had a significant effect on giving banking operations a form which was pragmatic. It was because of the various laws which remained inconsistent, reflecting the difference and disparity of the points of view of the various legislations on this subject. We should deal the following points emerging from the above solution:

(1) The conditions and factors which provided assistance in the development of the modern banking.

(2) Banking operations meaning as taken in the various legislations.

(3) The practice adopted in the banking operations.

(4) Classification of banking operations.

THE FACTORS LEADING TO MODERN BANKING DEVELOPMENT

The increase in the quantum of the commercial dealing led to the re-emergence of banking operations at the end of Medieval ages. The banking business, therefore, started flourishing in the cities of the Northern Italy, where a section of people emerged who indulged in the exchange, verification and the ascertainment of various kinds of metal currencies having different weights, types and purities. The widespread commercial transaction, due to the increase in the trade, gave birth to the traders in money who were given the name of money exchangers. The banking operations thus became dependent on these professionals. The money changers gradually linked the banking operations with commercial operations which paved the ground for the prosperity of the banking subsequently. With the passage of time the relationship of banking operations with the commercial operations developed to the extent that the survival of these two operations became interdependent on each other for subsequent centuries.

This dependency of the banking activities gave commercial prosperity to the European countries one after another. Moving from Italy it entered into Spain and Holland, until it settled in England. The stability and the isolation of this country became the nursery of the newly-born banking system and provided the opportunity to play the role of being the pioneer of the modern banking in the new era.

The commercial activity in England motivated a group of Lombardian traders from Italy, around the 14th Century A.D. to settle there. The new comers settled in that part of London which is known today as the famous Lombard Street.[14] The commercial activity in the field of maritime transport led to the improved communication between London and the other parts of cities which further paved the way in rapid expansion of the newly-born banking system. With the arrival of the Lombardian immigrants in London, the most important part of banking operations, the documentary credit also commenced, besides the lending operations of usury. Due to their links and acquaintance outside England, they were enabled to introduce a new kind of money-transfer operations based upon usury of paying the prices of the imported goods with the definite instructions to their agents for paying the value of relevant documents. The external money-transfer operations for personal purposes were also carried out in the same way where the amounts were transferred against receipt, and the specified value was paid in the pre-determined place abroad.

The English men took advantage of this favourable development in the banking sector and accepted promptly the principle of dealing upon interest. They assumed the form of it a reduced usury than that practised by the Jews and later the Lombardians. Subsequently King Henry III issued an order banning the Jews from charging interest in excess of 43% per annum.[15] The successive laws passed were to reduce the allied interest. The laws were enacted for the punishment of the level of the usury and were confined only to the interest which was in excess of the rate of interest allowed to be charged under the law.[16]

The English jewellers found the opportunity and took the advantage of the circumstances to perform an important function in developing the banking deposit services. They started the money business as trustees by keeping the funds against receipts. As the confidence in the accredited jewellers increased, the business became more widespread. The receipt issued by them stated to be used as means of payment instead of using the deposited money in species.[17] The wealthy English traders exchanged with each other large sums of money by negotiating the receipts issued by the accredited jewellers.[18] At the same time, the English people were ignorant of what was happening around them. The negotiation of the deposits receipts developed gradually, thus enabling a depositor to order the jeweller (Trustee) by written letter to pay or transfer the money deposited with him to the account of another person. This written order gave birth to the modern banking cheque. It is said that the first cheque in this form was drawn on a jeweller in London in 1675 A.D. Although the use of these written orders became widespread, yet it was without the standardization of the form of cheque and the proper statutory protection. The situation remained unchanged until a private Banking Company under the name "CHILD & CO." in London made available the printed form of cheques ready to be filled in with sum to be drawn in the name of the beneficiary in the year 1722 A.D.[19]

When this method of service operations became known to the people, the English jewellers started using the fund deposited with them for short-term loans. This was due to the persistent experience gained by these jewellers, when they felt that there was no need to keep all the funds deposited with them idle but to utilize a part of them in loans and the remaining amount be kept ready for drawing and payment of orders made on them.[20] This bold step brought a change in the concept of the development of modern

banking, as prior to this the lending from the monies deposited was not allowed.

The articles of association of "De Rialto Bank" banned the granting of loans or payment of interest on deposits, but it failed to observe this ban and gave loans to certain parties which included even the local Governments. This was obviously the violation of the articles of its association. Almost the same situation applies to Amsterdam Bank of Holland which was established in 1609 A.D. It was incumbent on the bank to keep in its care gold and silver equal to 100% of its deposits. After 180 years of the commissioning of the bank operations it was revealed in 1790 that out of the silver and gold kept in its care which the bank was supposed to keep in reserve, it had loaned a large part to parties including "The East India Company" of Holland. This policy resulted in the loss of confidence in the bank and its management.[21]

The 19th Century brought the industrial renaissance as well as the funds it needed. This opened a wide door for the modern banking business. In the 20th Century the money dealing shifted finally to proper currencies and the remaining quality of the traces of the previous deposits within the meaning of "Trust" vanished from the world of practice. Legislation was enacted considering the banks to be the owner of the funds deposited with it, but with an obligation of refunding in accordance with the agreement reached with the customers.

The general bases became the standard in the field of banking operations as per experience in the various states, but the legislation adopted in this regard differed from one state to another. The legislative meaning of banking operation remained more contradictory than their practical content among the various states.

MEANINGS OF BANKING OPERATIONS AS TAKEN IN THE VARIOUS LEGISLATIONS

Despite the long period of stability in modern banking dealing, the banking operations seem in practical application flexible and simple. The same flexibility made the banking operation more complex to understand and control. The old legal provisions of the French Commercial code enforced in 1807 had their justifications, because of the proximity of that epoch to the charisma of banking operations, but the situation is the same upto this day due to the non-existence of a meaningful legal definition covering these operations. This situation is not confined to certain specific statutory provisions, but covers the whole scope of legal regulations. The Hungarian civil law enacted in 1959 concerning certain banking operations such as deposits and loans failed to define the banking operations and their scope.[22] Similarity is found in Czechoslovakian law of External Trade of 1963.[23]

While studying legal system in practice in various European countries, England seems better in practising the legal system relating to banking operations as compared with the other systems. The reasons for this better situation seem to be stability and the security enjoyed by the British Isles which is the most important requirement for the development of law. But the actual state of affairs is quite different to the above observations. There too, we do not find a satisfactory definition of banking operations in any Parliamentary statute.[24] The Courts of Law have also failed to give an adequate definition of such operations.[25] The apparent difficulty in specifying the banking operations is set because of the legislator's incapability, but it is basically due to the nature of the banking operations as they are no more than a collection of activities which change according to the needs and circumstances. However,the absence of a comprehensive definition to cover the various activities of banking operations does not necessarily mean that the laws are completely devoid of any reference in one way or the other to these operations. Ignoring the laws which dealt casually with banking operations, we do find the code of laws concerned basically with regulating the banking profession which are known as "Laws of banks and credits".

Though the latest laws covering the banking operations are nearer to the specific meaning, but they do not completely define what is meant by "Banking Operations".

While going through the various laws which gave a definition for Banking Operations, we find that the terms "Laws of Banks" means all banking services alongwith the other resources of the bank wholly or partly used in investment by lending or by any other method admissible by the laws. Summing up the various meaning and the explanations of the definition of banking operations in the laws of bank, we conclude that the expression "Banking Operations" means as follows:

"The operations of accepting currencies as current or time deposits, extending the credits, issuance of guarantees, payment and collection of cheques, orders and other valuable papers, discount of Bills of Exchange, Promissory notes and other negotiable instruments, foreign exchange operations as well as other related operations of banks.[26]

It is, of course, a reality that the legal meaning of "Banking Operations" is still not standard, and does not have an agreed and established concept. Our concept is also supported by various Professors of the subject that the time is not ripe yet to write down a complete law for operations of banks, and this view will remain valid in foreseen future and applicable to the status quo.

CLASSIFICATION OF BANKING OPERATIONS

Having failed in finding out a specific meaning of banking operations, the legislators tried to classify them. In doing so, they said that they have opted for lesser evil and that one classification was aimed to reach nearer to the scopes of the banking operations. It was, of course, an uphill task to classify these operations in a comprehensive and absolute formulation to cover the various scattered parts of all the different aspects. However, a broad classification was formulated in the following forms:

(i) Trading in monies.

(ii) Creating and allocating the resources in short-term lending.

(iii) Utilizing the resources on long-term operations.[27]

The classification obviously omitted several important aspects of banking operations, like accepting of deposits, transactions relating to transfer of funds, various types of collections and many other aspects of modern banking activities.

Noting the above-mentioned short-comings the subsequent scholars attempted to classify the banking operations into three groups:

(1) Commercial operations took the first place which were further divided into several divisions.

(2) Financial operations which were relevant to long or short-term investment such as participations in industrial projects, issue of shares, debentures and other instruments of Companies.

(3) Service and commission operations which cover a variety of operations among which are:

   (a) Safekeeping operations i.e. safe deposits lockers.

   (b) Management of service operations of the customers.

(c) Providing the financial informations to the clients.

(d) Creating a link between the Stock Exchange and the customers for Exchange operations.[28]

The title given to the first group of this classification i.e. commercial operations, is objected to because the terminology does not contain the distinctive feature. It is well-known that all banking operations are commercial operations. Therefore, the nomenclature does not cover fully the description of the operations. On the other hand, the above classification neither provides umbrella nor controls all kinds of banking operations. For example, we do not know whether we should consider the taking of deposits as commercial operation or commission operations. Should we include these operations within the scope of management of customers dealing? Assuming the bank to be an intermediary, would a documentary letter of credit opened by a bank in favour of a beneficiary be considered a service operation or would it be a commercial activity, because eventually a letter of credit may accompany the commercial operations.

Ivan Meznerics, a Hungarian Professor, has discussed and objected to these classifications and called these as negative, positive and neutral operations. He has advanced an idea of classifying banking operations into two categories i.e. Domestic and External. His proposed classification expressly affirms that it has originated from the actual socialist banking operation which differentiates between domestic operations and those related to external trade.[29]

The classification of Professor Ivan Meznerics also does not meet our requirement as it only differentiates between the similar nature of the transactions. There is no justification of giving the names of some similar operations only because of the restrictions which divide the nature of the operations. The role of the bank is the same when transferring a sum of money from one place to another within the country or from the country to abroad inspite of the fact that the matter involves an exchange operation.

It is well-known that the age of the theory of commercial loans which is characterized by short-term banking loans has ended. Even the English banks who are the inventors and makers of the theory have ignored them as they had to satisfy the needs of the national economy for long-term loans.

They had to follow the footsteps of the European continent and Japan as they had no better alternative of the system practised in these areas.

Having examined the various classifications given to the banking operation by the authors of a number of books on the subject in Eastern and Western banking circles, we may draw the following classifications:-

(1) Development of Resources which includes accepting the deposits in various types of account whether they are demand or time deposits.

(2) Credits and investments operations. In this group we include the loans given to the clients of the bank on short and long-terms. The investment operations means where the bank invests part of its own assets or of deposits of its clients in buying securities which are often in the form of Bonds, Certificates or Bills issued mostly by the State. Though not in the strict sense, this also includes the guarantees of various types which sometimes end in financial transactions.

(3) Ancillary operations which consist of collecting of cheques, handling of negotiable instruments, transfer of money from one place to another whether within or outside the country, opening of letters of credit, local or international, and leasing out the safe deposit lockers.

We end this Chapter here in which we reviewed the banking operations from their beginning upto the present time. The foregoing discussion has also prepared us for assessing them in the light of Islamic *Shari'a* in our successive Chapters.

Chapter 2

OBJECTIVES & MEANS ADOPTED BY THE MODERN BANKING OPERATIONS ACCORDING TO ISLAMIC SHARI'A

....The service rendered by a bank to its customers for or without consideration does not conflict with the Islamic Shari'a....

Dr. Ali Jamaluddin Awadh,
"Bank Operations from the Legal Point of View - 1969"

MODERN BANKING AND BANKING UNDER ISLAMIC PRINCIPLES

While discussing the banking operations in a system based on Islamic culture, it was noted that these operations as practised prior to the introduction of the banking operations according to Islamic principles, were able to adapt themselves to the concept which existed in the Islamic society. The ban imposed on dealings based on usury (Riba) did not constitute an impediment to the development of appropriate forms of banking services which were adequately capable to fulfil the needs of the time. The stipulations under Islamic *Shari'a* do not interrupt in any way the course of life, but they regulate the flow of its course.

Modern developments of the banking operations being practised at present are quite different from what they were in the past. Modern banking is no longer confined to the services rendered but has become an advanced form of investment. The banking operations which were copied by the countries of Muslim world from the western countries are, in their nature interlocked with legal relations so that it seems impossible for the rules of the positive law to comprehend the contractual relations within the international banking system.

While considering the modern banking operations in the light of the criteria laid down by the Islamic *Shari'a* it will be advisable if we take into consideration the attitude of Islamic principles in accepting the new contracts and dealings. Having done so, we shall proceed to consider the extent and the capacity of these principles to comprehend the changing relations of banking operations. We should also not ignore the fact that the regulations of banking operations carry the purposeful objectives as well as the means for their accomplishments.

That is why it is advisable to consider, in general, the objects and practice of banking operations with regard to their conformity to the Islamic banking. The reason for their examination will, therefore, be to find out the explanations of the points where these operations conform to or are at variance with the Islamic laws which will, of course, help a great deal in identifying the extent to which banking operations may be developed and made conforming to the rules of Islamic *Shari'a*.

PRINCIPLES OF CONTRACT AS REGARDS BANKING DEALING

During the period Islam appeared on the horizon of civilization, we find that the people continued to buy and sell and enter into contract in regard to all things which were not banned by the Islamic legislators as most of the contracts and dealings were classified and acknowledged by them. The Muslim jurists faced the problems arising out of the new dealings. At that time the interpretation was swarming with the well-known jurists. This situation is actually nothing but to find out a justification for individual dealings in accordance with the rules and procedure from the detailed study and evidence of the principles as laid down by the *Shari'a*. The same thing applied to the contracts which were introduced into the society. After scanning, the dealings which were conformant were adopted and that which violated the *Shari'a* were rejected. The rejection of the dealings which were not in conformity with *Shari'a* was done not because it was a new contract without the known name but were rejected due to their in conformity with the *Shari'a*.

For a better understanding of the matter we find the examples of scanning new contracts, such as a contract to manufacture or a sale of redemption. According to Zakaria Ali Yusif of Cairo: "A contract of manufacture is an agreement to buy a thing to be manufactured at the request of purchaser, i.e. where a person agrees with a blacksmith or a carpenter to make a door of specified description. At first there was a difference of opinion about the possibility of the contract on the assumption that it is impermissible, because it is a sale of something which a person does not have, but it was allowed as of preference on the ground of need."[30] Mustafa Ahmed Az-Zarqa in his paper "Insurance Policy and attitude of Islamic *Shari'a*" which was delivered in the conference of the week of Islamic Jurisprudence in April, 1961 at Damascus, says: "redemption sale is a written contract in the form of a sale where both the parties reserve the right to return the considerations. This kind of contract was well-known in Bukhara and Balkh in the 5th Century A.H. It was the subject of controversy until at last it was deemed to be a new contract and introduced into the Ottoman Civil Law."

Although clarity exists of this matter in Islamic jurisprudence, some jurists maintain that the basis in regard to contract is one of the interdictions except where the Islamic *Shari'a* law provides for it. Those who were of this

opinion did not validate any contract or condition other than what was proved valid pursuant to stipulation or unanimity.[31] The other concept in this regard is that "the basis in contracts and conditions is legality and validity". According to this concept nothing thereof is interdictable except where it is interdicted and invalidated pursuant to a stipulation in the Islamic *Shari'a* or by analogy.[32] Ibn Taymiya is of the view that "There is no meaning for rectification but the effect it produces and that which accomplishes the intent thereof i.e. the intent of a contract in performance thereof."[33] The opinion of Ibn Taymiya conforms to the procedure and the pronounced essence of the *Shari'a* that what must be considered is the intention and not the form. This opinion carried more importance in the present era where lot of contracts and dealings of various kinds have emerged and where the specialists of jurists did not hesitate to say that people may create such new contracts as they please so long as they do not violate the established procedures of *Shari'a*. Professor Mustafa[34] Zarqa in his book "Islamic Jurisprudence in its new clothes" Part. II General Jurist introductory, (6th Edn. published by Damascus University Press-1959) says that the Islamic *Shari'a* does not confine contracting to specified subject and puts a ban on other subjects. There is nothing in the stipulations of the *Shari'a* which makes it incumbent to limit the kinds or restrict the subjects of contracts except that they may not be contradictory to the rules and general principles which have been determined by the *Shari'a* for contracting. Mohammad Jawad Mughnia in his book "Jurisprudence of Imam Jaffar Sadeq A.S." Part-III, Ist Edn. Page-18 published by Darel Ilm Lilmalayeen in 1965 from Beirut, is also of the same opinion.[35]

From the opinion of the above-mentioned scholars we may draw the conclusion that it is evident that banking operations do not contain anything which restrict or bar their acceptance within the framework of the Islamic jurisprudence. All that must be ensured in this regard is to ascertain that this new business does not violate or conflict with the intentions and objective of the *Shari'a* or that it manifests said intention and objectives. It must be clearly kept in mind that the Islamic *Shari'a* will not contain anything which imposes restrictions on the life of the people, and it would rather be improper to say that there is conflict between the valid interest and the guidelines provided in the *Shari'a* which involve the best of religions of the world.

It may also be noted that Islamic jurisprudence had from the very beginning known the idea of the change of the contractual description of the similar

type and these changes of description did not create insurmountable problems for the jurists. The jurists considered the intentions rather than the wording of the contract. This practice has given birth to the well-known Juristic rule that the intention and meaning and not the wording and construction of a contract must be considered.

It can, therefore, be concluded from all the foregoing discussion that the new contracts relating to the modern banking operations do not constitute vis-a-vis the Islamic jurisprudence an obstacle on the one hand and will not constitute a problem to this great vast and flexible jurisprudence due to change of colour and description.

While concluding the introduction regarding the possibility of the acceptance of banking operations in the light of the Islamic *Shari'a*, we will proceed to the next step to find out how they conflict with the Islamic *Shari'a* law as per the objectives intended and the means adopted for the achievement of these objectives.

POSSIBILITY OF ACHIEVING OBJECTIVE THROUGH THE MEANS OF MODERN BANKING OPERATIONS WITH THE INTEGRATED HARMONIZED LAWFUL INTENTION

The banking operations have certain specified objectives which may be achieved through certain means. For instance, accepting money for safe-keeping is aimed to provide an assurance to the owner of the money that money deposited will be safe against theft or loss. The means to achieve the safekeeping could be through the delivery of the money to an honest man or by opening an account with a Bank. Though the means are different in the above case, but the objective is the same. When we talk about banking operations according to the Islamic *Shari'a* law, the objectives to be achieved are in accordance with the *Shari'a*. What is different is the means to be used to achieve such objectives. The achievement of such objective does not constitute an insurmountable problem, because the means vary in most of the cases although the objective is the same.

Banking operations comprise two main objectives. Firstly, rendering various services, and, secondly, utilizing the assets in such a manner as is appropriate to the nature of the capital which is raised from the different sources carrying distinctive features, or we may say that raising the funds through various sources and revenues where it has a considerably stable level and a fixed volume. Banking services are, however, varying and different according to the variety and difference of the needs which are to be satisfied in one form or the other. Some of the services rendered by the bank are independent of the lendings and borrowings, as in the case of hiring of lockers and the transfer of money from one place to another or from one account to another. The other type of services is mixed with the operations falling within the scope of lending or borrowing. Such type of services include the opening of deposit accounts and documentary credit operations.

The services rendered without consideration or as a business of the bank do not conflict with the Islamic *Shari'a*. People, in the modern age, are bound to exchange services and need the services of one another where a person may take advantage ot another experience and resources. Islamic *Shari a* does not ban the services rendered by one person to another for advanta-

geous use like trade, industry and education. The arguments advanced by the jurists of Islamic *Shari'a* for the advantage, considered valid for contracting and entailing payment of the considerations are based on good intentions. Some jurists consider leasing of money for ornament during a certain specified period to be permissible.[36] They base their arguments on the fact that where the object of use is clear, the fear of the transformation of the leased amount into a loan ceases to exist. Therefore, where a lease is made absolute, in such case, it will not be valid, as money will be a loan.[37] There is no rental for the loan because the surplus is usury.

The object of the above-mentioned discussion was that any operation offered by the bank should, if it falls within the scope of a legitimate advantage which is not forbidden, be deemed to be a permissible service operation for which the bank may charge a fee, except where a fee is a cover for the banned illegitimate usury.

The investment operations are of two characters, viz:

1. Accepting the deposits, whether they carry interest or not.

2. Monies received for investment added to the banks own assets, subsequently giving loans-bearing interest, or by purchasing of stocks and securities which produce interest or other similar operations.

The intention behind the above two aspects is to invest money for the advantage of both the owner and the person investing it. The investment, development and utilization of money are something called for or rather to be done. Those who have clear understanding into the matter will find that Islam has a specific view in regard to money. Islam on the one hand forbids the accumulation of wealth, and, on the other hand, forbids spending it lavishly. If these two limits are kept in mind, we will find that the banking method which raises the funds and maintains account thereof in the name of the owners and, then invests these funds in the society in different ways, as much as regards the objectives, totally conforms to the general intention of the *Shari'a*. We will not be exaggerating if we declare that the banking method of raising and investing money is a practical application of the concept of *Shari'a* as regards the role money should play in the betterment of the society. It is the method which reconciles the right of the individuals to own money with the right of the community to use it to its advantage,

so that such money will not remain idle by being paid up. However, the banking system of using money, whether in the form of raising funds or lending it in an interest-based system is nothing but usury. Any system based on usury is violating the intention of *Shari'a*. The use of it, in any form, is banned and is sinful. We shall in our subsequent approach to the problem try to lay down the rules for practical application which conforms to the requirements of our time and the need of the community which at the same time is confined within the framework and the guidelines of the *Shari'a*.

It is now clear that the conflict of banking operations with the Islamic *Shari'a* is quite irrelevant in regard to the objectives but it is relevant to the means used to achieve the said objectives. This has naturally created a question whether or not there are ways for developing these operations by changing the shape of the means used to achieve the required objective which does not violate the very foundation of the matter? In the following section we shall try to answer this question.

The conflict between the banking operations and the Islamic *Shari'a*, whether they are in nature of service or investment lies in the means and not the objectives. The rules, as regards the development or the operations, do not seem unattainable, as the means are generally known to be varied. This varying nature of rules provides the required assistance in adopting the means which are appropriate for achieving the objectives which conform according to Islamic *Shari'a*. If we take the case of investment and development of money, it is a lawful matter, but this objective should not be achieved through usury. This makes our point of view more clear that the achievement of the objective is allowed but adopting the means of usury is not permissible, as we should adopt the means which are permissible according to the Islamic *Shari'a*. Therefore, the legislator should not forbid the lawful means such as sale,purchase and partnership.It should be necessary for the legislator not to ban means which are indispensable. He must also have a better alternative which is at the same time purer, more virtuous and straightforward.

Transferring the banking operations from the existing form with inherent aspects clashing with the Islamic *Shari'a* depends on the finding and the alternative means which will make the achievement of the intended objective possible in such a manner as is appropriate with the *Shari a*. If such an achievement is possible then no one can contest that the means adopted

are defective, because certain specified methods have not been followed. The various civilizations have achieved the same objective by following the different means. In our present day, skyscrapers are being built for the same objective, i.e. living and sheltering with different methods and in different forms.

Our further studies will therefore be focused on the alternative means which lead to the same objective in the banking operations sector. At this stage a question may arise whether the present day banking operations can accept the subordination of the Islamic *Shari'a*. Our answer to this question is that the banking operations, in the ancient and modern history, were subordinate and not the principle operations. They were framed and co-ordinated according to the notions and primitive needs of the ancient civilization like Sumerians and Babylonians and also responded to the various stages of European Renaissance Era. They were English with the English, German with the Germans, French with the French and American with the Americans.

We are now in a position to determine the broad outline of the business which constitutes the proposed evolution of banking operations according to Islamic *Shari'a*, at the same time leaving intact the objective and aims which may be achieved through these operations.

The foregoing study of the various aspects with the objectives as laid down in the Islamic *Shari'a* may be summarized as follows:

1. Cleaning the banking operation of all forms of express or implied dealing based on usury by attempting to understand and explain the problems under usury system.

2. Highlighting the banking services as distinct from usury on the basis that it represents a lawful advantage against a consideration i.e. fee, and as being an act which entitles the lawful profit.

3. To regulate the investment through banking method and lay down the general lawful guidelines which regulate the relation of capital and labour, keeping in view the changes in the forms of existing contractual relations to conform to the contemporary needs of the modern societies.

By having this exercise, it will not be difficult to bring the objects and the means of the banking operations within an integrated system which may at the same time comply with the lawful intentions.

Chapter 3

USURY AND PROFIT - HOW IT DIFFERS

....Usury means the increase which is received with the principal amount after an extended period....

Syed Mohammad Baqer Sadr,
"Bank La Ribbavi"

....Profit means exchanges of the commodity for a more precious commodity or a higher price than that paid for it....

Mohammad Bin Jarir At Tabari,
"Jami'a Al-Bayan an Taweed Ay El Qur'an, Part-6, P-7 (undated)"

MEANINGS OF USURY AND ITS JURISTIC DIVISION

There is no doubt that the Quran has prohibited usury. The prohibition on the usury is established beyond any doubt by the text of Holy Book—Quran. There also exists the unanimity among the Muslim scholars from the early period of Islam till todate on the subject. In the words of Professor Sheikh Muhammad Jawad Mughniya :

"The proof is a guide to the theories of interpretation and matters of guesswork; the natural clear things are known by both the informed (knowledgeable) and the ignorant as well as the interpreter and initiator."[38]

The discussion in the following paragraphs, therefore, does not aim at unveiling the ban as the intention is taken basically for granted. It is, therefore, to demonstrate the ban of usury to clarify the various matters in this regard, and to analyse the difference and suspicions arising out of it. This clarification will help us to determine the definition which will rest on sound basis and will ultimately clear the differences between unlawful usury and the profit, particularly the profit is generally inter-linked with usury.

We will, therefore, now focus our study on the following points :

1. The meaning of usury and its juristic division.
2. The different thoughts over usury — past and present.
3. Differences between usury on the one hand and profit on the other.

Literarily "USURY" (Riba) means increase or growth. Ibn Manzar in "LISSANUL ARAB" describes: "The root of it is the increase of the usury of money where it has increased."[39] According to Al-Imam Al-Wahibi, in"Tahzeb al Asama Wallughat" : Linguistically usury is increase.[40] Mohammad Bin Jarir At-Tabari has mentioned that Rabia (hill) was thus called because it is greater in height then and overlooks the level of the ground around it.[41]

According to the description of the above-mentioned scholars, the pure linguistic meaning could be an increase to the thing itself and it could also

be an increase resulting from comparison or differential between two things. Both the said cases were mentioned in the Holy Book — Quran.

In the first case — an increase to the thing itself, we find the example which came in His saying "You see the land lifeless but when we make water fall on it, it shakes and grows" (Verse No. 5 of Surat Al Hajj). In this Verse the meaning of the word (Rabat) is "elevated" and the land elevates and increases, where rain falls on it, of its own accord.[42] In the second case — the saying of God "One nation is more numerous than another (Verse No. 99 Surat An Nahl) where the word "Arba" means more numerous which is increase, quoted where two nations are being compared.

In the pre-Islamic era the Arabic speaking people knew another meaning for the word "Riba" (Usury) which was used to deal in on the basis of increase of money in consideration of the term maturity, either from the date of maturity or from the actual date of the debt. The following quotations will make it more clear :

> "In pre-Islamic days where a man was indebted to another, he used to say 'I give you so much if you extend the period for payment whereupon the creditors extends the date of payment."[43]

It was the quotation "Mujahed" has taken from Tabari's interpretation about the usury which was banned by God.

Al-Fakhr Ar-Razi has interpreted the dealing on usury prevailing in pre-Islamic days in the words that the Arabs used to pay the money on loan and receive each month a certain sum leaving the principal sum intact. When the debt matured they claimed the principal sum from the borrower. If it was not possible on the part of the debtor to pay then they used to increase the principal sum and extend the time. This was the usury which provided in dealing of pre-Islamic days.[44]

In the biography of the Prophet (PBUH) Ibn Hisham has quoted, that in the course of his talk about the re-construction of KABA in pre-Islamic days, he said: "O ye people of Quresh do not include the re-construction of Kaba except your good gain: it may not include an illegitimate pony, a sale upon usury nor the oppression of any person."[45]

From the example quoted above, it is clear that in pre-Islamic days the use

of the word had a customary connotation other than its linguistic meaning and that the money dealings among the people upon usury were in use in pre-Islamic period. The people also considered usury (Riba) as a source of gain. But they considered it to be malignant gain.

Quran has used the word "Riba" (Usury) alongwith its derivatives in the pure linguistic meaning. This provides us the ground to believe that God has used the same word as comprehended in usage where He said:

> "Oh ye who have believed do not eat "Riba" which multiplies and fear God that you may thrive" Verse 130 (Surat Al-Imran).

Abu Ja'far Muhammad bin Jarir At-Tabari in his interpretation says: He (God) means :

> "Oh ye who have believed in God and His Messenger do not eat "Ar-Riba" (Usury) in your Islam, after he had guided you to it, as you used to eat it during the pre-Islamic period."[46]

In the Hadith of our Prophet (PBUH) the word "Riba" has also been considered as a banned activity of two types. The first type is confined entirely to the meaning of "Riba" (Usury) by the Arabic speaking people where the Prophet (PBUH) defined it according to its use in pre-Islamic days. In his last pilgrimage sermon he said "However, every usury of pre-Islamic period is abolished; you are entitled to take your capitals so that you do not oppress nor be oppressed.[47] The second type dealt within *Sunnah* is relevant to the Prophet's banning of the exchange of sale of certain kind of goods seems new to the understanding of "Riba" (Usury). According to Abu Huraira there are certain exception of the commodities with some conditions. These commodities are gold, silver, wheat, barley, dates and salt. He who increases or ask for an increase commits usury. There are, however, differences of opinion in using these as a criterion and also as to the cause suitable to be a criterion.

So far we have considered the general uses of "Riba" (Usury) in the pure linguistic meaning, its use by the Arabic speaking people of pre-Islam and the use of the word according to its relevant meaning in the *Shari'a*. In our further task we will consider the attitude of jurists as regard to the meaning intended for "Riba" (Usury) according to the *Shari'a* as understood by them.

DIFFERENT THOUGHTS OVER USURY — PAST AND PRESENT

In "Al-Mugadimat" Muhammad ben Rushd (the grand-father), a well-known jurist, says that the word Usury mentioned in "Quran" was the subject of difference between the following two concepts :

(1) The purpose of using the general words is to understand it clearly due to its generality until something comes to specify it.

(2) The use of the words have an inchoate meaning where the intended meaning is not understood by utterance only but is supported or explained by other words to clarify the meaning.[48]

What we need to understand is the effect of the concept of the word "inchoate or general" in regard to usury so that the meaning of those as intended in *Shari'a* are explained. We shall also not go in detail to consider the opinions of various jurists rather content ourselves to the few selected opinions.

Zakaria al-Birri in his book "Origins of Islamic Jurisprudence" has explained the meanings of general words and inchoate words as follows:[49]

The general word is what which is given to denote one meaning for the purpose of generality and to cover all its units without being restricted to a specified number thereof. Inchoate is a word the meaning of which is not clear in itself where the ambiguity is clarified by a statement of the speaker, for example the word prayer or Zakat, where the linguistic meaning of prayer is the call for good and Zakat is growth. However, these words, according to the intention of the *Shari'a*, had specific meanings which could not be apprehended except by a clarification from the legislator. Thus came the practical and spoken *Sunnah* to explain what is intended by these inchoate words which occurred in Quran.

Al-Jassas, a Hanafi jurist, while dealing with the verses of usury in Surat Al-Baqara in his book "Rules of the Quran"[50] said that the usury in the *Shari'a* has meaning where the application of the word "usury" was not in the language meant for it as such usury has become *Shari'a* appellation. This concept of Al-Jassas is based on the assumption that Arabs did not know

that the sale of gold for gold and silver for silver with an increase constituted usury while according to *Shari'a* it is usury. He goes on to say that God has annulled usury while was being practised as well as other kinds of sales calling them usury. From the context of the words it appears that what is intended by annulment of kinds of sales by God was through the *Sunnah* of the Prophet (PBUH). Thus God's saying "usury is banned" means a ban covering all because the appellation covers all through the *Shari'a*.[51]

Mohammad Ben Abdella known as Ibn Al-Arabi, a Maliki jurist, has mentioned in his book "The rules of Quran" when he dealt with the verses of usury of Surat Al-Baqara, determined that it is correct to assume that it is general, because the people used to exchange sales and practise usury which was known to them. A man used to sell to another with delayed payment for a term and upon the expiry of the agreed term the creditor used to say : will you pay or increase? God forbade usury which is in the increase.[52] Ibn Al-Arabi while replying to those who said that the verse is "inchoate" explained that the Prophet (PBUH) was sent by God to his own people and revealed his Book unto them in their own language for the sake of convenience : that the message came with absolution of the sale and trading which they carried on but forbade their dealing upon usury. His Messenger (PBUH) indicated to them more than the contracts or considerations they already had, which were not permissible. He pointed out to them the forbidden forms of usury in every food-stuff and the increase to the items of the same type.[53]

The jurists of the Shafi'i school of thought have different opinion. In "Al-Majmu Sharh El Muhazab" of Mohiyed Din Bin Sharaf An Nawawi, it is stated that our jurists differed about the stipulation of the Quran which bans usury in two respects. Firstly that it is an under-developed word which was interpreted by the *Sunnah*. All the rules brought about by the *Sunnah* are an explanation — each of delayed payment — of what is "General" in the Quran. Secondly that the interdictment stipulated in the Quran covers the delayed payment usury and the requirement for an increase in the money in consideration for extension of the term, which had been known in pre-Islamic times : then the *Sunnah* stipulated the usury in each which is in addition to the stipulation of the Quran.[54]

The Maliki school of thought carries almost the same opinion. According to the interpretation of Khalil's Summary the increase and the delayed payment usury falls within the frame-work of sales as being parts of usury. Ibn

Rushd,the Andalussian Maliki jurist, is quite clear about usury in exchange in all sales and in what is determined as a liability.[55]

Syed Mohammad Baqar Sadr, a scholar of Fiqh-e-Jafferia, in his book "Al-Bank La Ribbavi" (Interest free bank) has stated that the linguistic meaning of Riba means increase or addition which a lender receives from his borrower.

From the definition given above, it is clear that Riba (usury) is the increase. He has further stated that the increase which is not covered by any thing is not permissible in *Shari'a*. In his opinion the increase which is received against the sale of goods or services does not fall under the definition of usury. While further discussing usury he has classified it in two categories. Firstly usury which is received in the shape of increase in the shape of commodity of the similar nature i.e. Gold for Gold, Silver for Silver or Wheat for Wheat. This is generally applied in sale and purchase of the goods. Secondly usury means the increase which is received with the principal amount after an extended period. He has gone in details while discussing usury but we will confine ourselves to the meaning of usury at this stage.

The general trend of the Hanafi jurists who advocate an inchoate state, despite the contradiction therein, to the well-known facts relate to pre-Islamic usury.[56]

It would, therefore, be observed that those Hanafis who advocated an inchoate state in respect to "usury" have done so in order to maintain conformity of the application of the procedure rules of their school of thought. It is an established fact that in Hanafi school of thought a "General" word is absolute in its connotation to all its individual elements.[57] Had they said that usury is a general term it would mean that they are saying that every increase is banned, so long as usury is the increase. We are well aware that not every increase is forbidden, but what is forbidden is the increase which is considered to be an act of usury. Therefore, supporting the generality of the word "usury" will not correspond, according to Hanafis, with what they consider to be a connotation of the "General".

Nevertheless, most of the jurists of the various schools of thought expressly opined that usury takes place in sales and debts as we shall examine in the following section while discussing the juristic division of usury.

JURISTIC DIVISION OF USURY

(i) USURY ACCORDING TO VARIOUS SCHOOLS OF THOUGHT :

The jurists of various schools of thought, in regard to the division of usury, have argued two trends. One being the usury within the scopes of sales and the second where the usury takes place in sales it takes place also in other liabilities for debits and credits.

Most of the works of jurists who were influenced by those who advocated that the usury is an underdeveloped word have talked about the usury of two kinds : usury of increase and of delayed payment. However, Shafi'i school added on third kind of usury namely: Hand usury. All three kinds fall within the scope of usury of sales.

The division is generally found in Hanafi,[58] Maliki,[59] Hambali,[60] Jafari[61] as well as in Shafi'i jurisprudence in regard to third kind of usury.

There are quite good number of scholars who have discussed the division of usury within the scope of sales. But while studying the subject, it is noted in the discussion of this trend the matter of loan has been omitted. However, Shams-ud-Din Ar-Ramli, a scholar of Shafi'i thought, considered the loan usury to be among the increase usury. He is of the opinion : "A usury is either one of increase where either consideration exceeds the one or a loan usury, where an advantage is stipulated for the lender."[62] Yet another scholar of the same school of thought Al-Shibramulsi in his annotation *"Nihayat Al-Muhtaj"* has different opinion than that of Ramli's concept. He has classified the usury of loan as being covered by the increase usury. But, in fact, it does not fall within that classification because the stipulation of an advantage for the lender is tantamount to a sale of the thing lent for what exceeds it of its kind. It is therefore, an increase usury.[63]

In fact, it was due to this omission while discussing the usury loan with the usury in general that the jurists failed to find out of this kind of usury. Other scholars like Asqalani, Al-Bayhaqi do synchronize in their thought that "Every loan which produces an advantage is a form of usury and its justification is null."[64]

Our intention by quoting the opinions of various schools on the subject is to show the gap which may be opened in the door of usury, if it is confined within the scope of sales upon usury without considering the known pre-Islamic usury, which Quran has forbidden.

A study of the state of affairs prevailing in pre-Islamic days will no doubt reveal the suffering of Arabs and that of the society which is affiliated with widespread usury and will confirm that evil and catastrophe starts and spreads in society with the usury of debts. Most probably this deep insight of the subject was the motive which compelled Shaikh Ahmed known as Shah Waliulla Dehlavi to conceive in Hujjatulla Al-Baligha, Part-2, that usury is of two kinds; namely : real and carried on it; the real usury is in debts... and the other is the increase usury[65]...

The Indian Missive seeking an opinion on the Reality of Usury was printed by the Government of Hyderabad Deccan, India, seems to have excluded the loan usury from the scope of the banned usury which was caused basically by the imagination that the usury is confined to sales. This conception was based on the assumption of the concept that the usury was confined to sale and is under-developed word. In support of this conception the opinion of Hanafi jurists and those who concurred with them has been taken.

We, however, taking all its dimensions and objectives, do not agree with the opinion which confines the discussion on usury within the scope of sales only.

The various definitions given by the jurists of different schools of thought about the division of usury, according to its comprehensive concept, differed but generally there is synchronization of thought that usury exists in debts and sales. The consensus we can draw is that usury is of two kinds :

1. Usury which existed in pre-Islamic era i.e. where one man owes another a debt and when the debt matures the creditor asks the debtor, do you wish to pay or to increase? If the debtor delays the payment the creditor increases the sum of the debt and delays the payment.

2. The usury as explained by the Prophet (PBUH) is of two kinds :

   (a) Usury of increases where one dinar is sold for two.

   (b) Delayed payment of usury.[66]

In "*Mughni Al-Muhtaj*", it is mentioned that al-Mitawalli, a Shafi'i scholar, has added one more kind of usury i.e. loan usury, which stipulates for advantage.[67] This contradicts Er-Ramli who includes loan usury with increase usury thus rendering it impliedly within the frame-work of the usury of sales.

Among those who advocated this trend, Ibn Hazm, the author of Al-Muhalla, seems to be more prominent. According to him "Usury can only be in sales, loan or sale with delayed delivery."[68] The arguments of Ibn Hazm are based on the conception that usury exists in sales with delayed delivery and loans. The trend is most acceptable division of usury which crystallized in the view of Islamic scholars in modern times.

(ii) USURY AND MODERN THINKING :

By a study of writings of the modern jurists on the subject of division of usury, we find the general trend of jurists who viewed usury comprehensively. Thus the concept that usury is divided into two kinds has been established. The first being the debts or pre-Islamic usury which is banned in the Holy Book "Quran". The second kind is the sale usury — both increases or delayed payment, the ban on which is found in Hadis of the Prophet (PBUH).

Shaikh Muhammad Abu Zahra in his book "*Khatem An-Nabiyyin*" has explained the division of usury saying "The first division is pre-Islamic usury, which is the debt usury, where a sum is loaned as debt; the principal sum of the debt increased every time the maturity date is extended, where the surplus will be in consideration of the term of the debt; such increase constitutes usury, according to the verses of the Holy Quran which were revealed banning it." Further in the discussion on the subject he says: "It is the sale usury, which is the usury, because the Prophet (PBUH) called usury. The example of modern division of usury : Debts and Sales are also found in "Usury" by Abul Aala Moududy, "Major landmarks in the theory of Banking Usury" by Zaki Muhammad Shabana, "Modern Banks Dealing & Rules" by Abdur Rahman Ishaq, "Islamic Studies in Social & International Relations" by Mohammad Abdulla Darraz, "How Islam view usury" by Muhammad Bin Muhammad Abi Shahba and "Simplified Expose of the Question of Usury in Islamic Jurisprudence", by Muhammad Zaki Abdul Barr.

Although the consensus exists in regard to the two main divisions of usury the nomenclature, however, differs. To avoid confusion and for the sake of convenience, we may call the first division of usury as "Debts usury" and the

second division as "Sales usury". The "Debts usury" prevailed in the dealings of pre-Islamic era. It is the usury which is banned by a stipulation in Holy Quran. The Prophet (PBUH) referred this kind of usury in his sermon at the last pilgrimage where he said: "Every usury of pre-Islamic days must be abandoned. You are entitled to recover your capitals so that you do not oppress (by taking more) nor be oppressed (by taking less)."[69]

Some of the writers on this subject have called it "The Quran usury": but we may call it debt usury absolutely, it includes every increase to the principal sum of debt regardless of whether it has arisen from a loan or was the price of an item sold or otherwise. Every increase stipulated for payment in addition to the principal sum of a debt constitutes the usury which is banned.

The second form of usury is "Sale usury".[70] This kind of usury was unknown to the pre-Islamic era. We may divide this kind of usury in two categories :

(i) **INCREASED USURY:** which is realized where an item subject to usury is sold for its kind with an addition on either consideration over the other.

(ii) **DELAYED PAYMENT USURY:** which is realized in case of the sale of an item subject to usury for an item of its kind or of another kind where the cause is common to both items; usury is committed in the latter case if the payment of either consideration is delayed.

Besides the ban on usury in Quran, the *Sunnah* of the Prophet (PBUH) has also banned both kinds of sale usury i.e. increase and delayed payment.[71]

Concluding our review of the meaning, evidences and opinions of various jurists on usury, we may finally define the increase and delayed payment usury as follows :

Increase usury is the quantitative increase in either consideration in the sale of fungibles for fungibles, even where there is difference in quality and purity.

Delayed payment usury is the increase estimated by the difference between maturity and the term, if the receipt of either consideration of the same species is delayed, unless it is a loan and also where the receipt of either consideration of different species is delayed in both cases of currency exchange and barter.

MEANINGS OF PROFIT AND CAUSES OF ITS ENTITLEMENT

Ibn Manzur in *"Lissan Al-Arab"*, has linguistically defined 'Profit' meaning growth of trading.[72] "Al Mujam Al-Wasseett", an Arabic dictionary, gives the meaning of 'profit' as being a gain. Both the meanings, profit and gain,[73] are the same because gain is realized by negotiation of money by sale and purchase in trade or otherwise.

The holy Quran used this comprehension of 'profit' where God describes in Surat Al-Baqara, (verse 16), "Those who traded misguidance for the right way : their trade suffered as loss and thus they strayed from the right way."

At-Tabari has interpreted the above verse as "A trader makes profit if he exchanges the commodity which he owns for a more precious commodity or at a higher price than that paid for it : but he who exchanges his commodity for a commodity of inferior quality and lower price than that paid for it is a loser in this trade.[74]

There is no difference among the jurists as regards the general comprehension of the linguistic meaning of profit or of that used in the holy Quran. All the authorities on the subject consider profit as being the increase realized either through repetition of the purchase and sale operations, even if such commodities are re-sold in the same condition as that in which purchased without any transformation whatsoever (this was the prevailing practice in olden times) or through the purchase of materials, which are re-sold after being transformed (as is the practice in production and modern industry).

The scholars on the subject seem to have ignored the matter to cover the profit realized from the purchase of materials which are re-sold after being converted into equipment and machines like automobiles, refrigerators and television sets, etc. The introduction of the elements for transformation or conversion does not, however, conflict with the essence of the trading operations which are basically one of the principles of purchase of a commodity for re-sale at a price higher than the cost price of the whole or part thereof and making it presentable for sale.

There are different opinions of the jurists regarding what must be added to

the price of the commodity for re-sale with a gain. According to Maliki school of thought profit is : that which falls to a vendor in excess of the price and is divided into three parts, then he went on to explain that the part which must be included in the capital and receive a share of the profit is : that which has an effect on the commodity itself such as tailoring and dyeing.[75] These things were treated as forms of transformation. The other school of thought does not object to the adding to the capital the wages of a goldsmith, dyer, carpenter, tailor, commission agent and hire.[76] One thing is, however, obvious that the amount which is surplus to the capital cannot be called profit unless it is coupled with the work and unless the surplus was the result of an exchange which converted the capital from one state to another. For example, if a person had Rs. 100/- which he used to buy a commodity and then re-sold the same commodity, after or without transformation for Rs. 125/-. He would have realized a profit of Rs. 25/- for his work. In this case, the money had been transformed into a commodity and after re-sale the commodity was transformed into money.

Where the extra money generated from the use of money without any transformation whatsoever, the resultant of such use which leaves the commodity in its initial state is not called profit. It would be, wages, rental or fee, in consideration of an advantage where the revenue generated was the result of a natural increase or generated from the original, it would be a yield or advantage.[77]

As a result of above narration, it can be said that profit is closely related to work and represents the human efforts.

In the light of the above-mentioned it can be said that profit is closely related to work which is represented in the human efforts. Therefore, the importance and the appreciation of work in the Islamic ideology is the sole moral element of all the components of production.

A question here arises what is the position of work which is a cause for entitlement to the profit? The answer to the question is not difficult to be found, as the profit is the growth of the capital. It is either through ownership, work or guarantee (liability). The accrual of the profit is obvious because it is the growth of the capital and this would be for the owner thereof i.e. capitalist. That is why a capitalist is entitled to profit irrespective whether the business is of his own or he is a partner in the

business. The entitlement of profit through work is a legitimate right of an active partner in consideration of the work done. The entitlement of the profit through guarantee (liability) of an active partner of a partnership is for all the profit realized if he has been held liable for the capital advanced, where the profit would be in return for the liability. This is in conformity with the statement of the Prophet (PBUH) who said that the yield is in consideration of the liability if a partner guaranteed the capital advanced; he shall be entitled to the yield.[78]

The cause for entitlement, therefore, results *pari passu* with the capital regardless of whether the capital is owned or guaranteed. In case where a person owns the capital, offers the work and also manages his own property, all the profit will accrue to him, because the ownership and the work were offered by the same party. In the situation where the capital is provided by one party and work by another, as is the case of partnership, the profit must be shared by both the capitalists and the active partner of the partnership according to the definite share as has been agreed, for example, one half, one third or more or less of the profit.

Where an active partner deals in usurped money, such as when he usurps some money or property and uses it in trading, the usurper of the property shall be entitled to the resulting profits. There is, however, difference of opinion and some scholars thought otherwise. In this case, it is assumed that inspite of the fact that the active partner has usurped the property, he would be the rightful owner of the profit, because he was held liable for the capital to the person from whom he had usurped it.

It is, therefore, obvious that work is the true cause for entitlement to profit, which is treated to be a gain resulting from the management of property which does not grow itself. This is evident in regard to the active partner. As regard the capitalist i.e. the owner of the property; his work; if he manages his own capital, is the cause of his entitlement to profit. But where he gives the capital to another in a partnership, the capitalist's entitlement to the profit shall be according to the agreement stipulated in the partnership deed and not because of the growth of the capital.

In view of what we have explained in the beginning, we consider that the cause of entitlement of the owner of the property to the profit in a partnership is not the growth of his capital but the more proximate and commonest cause is represented in linking entitlement to profit with the

agreement concluded by the capitalist and the active partner i.e. the means is the partnership deed which regulates the relations of both parties. This also does not conflict with the case where the capitalist is entitled to the whole profit if the partnership becomes void because where the active partner has not usurped the capital his status shall, upon voidance of the partnership, be transformed into that the work of an agent is carried out on behalf of the principal and the profit would belong to the owner of the property and the active partner who managed it will be a wage-earner who deserves the wages of similar work in consideration of his efforts.

While briefing the subject we observe that the profit, according to the view of Islamic jurisprudence, is a kind of growth of property resulting from the investment of such property in a business activity and the element of transformation of capital from one state to another is noted in such business activity where profit is realized or a lesser sum where actual loss is suffered, as is the case of trading where the money is transformed into merchandise and then it is re-transformed into a larger sum of money.[79]

The above-mentioned acknowledged exchange of money which produces profit is no more than an experience of a human effort linked with man's management of property because the property does not increase itself. Were it not for the coupling of property with work, money would remain the same over the years. But it will multiply if the hand of an expert handles it by sale, purchase and other recognised means of exchange. Therefore, the solid manmade property does not grow except by investment : property does not breed property.

The rules of jurisprudence which clearly revealed the view of Islam to capital did not determine a right for money to obtain any profit unless it is joined in a partnership with human effort regardless of whether the result is profit or loss. This is visible proof of the moral element which is represented in the effort of man whom God revered. But the restless man did not appreciate such honour and will not hesitate to submit with humiliation to the legislation of the people of this earth. He does not even feel ashamed of himself when he encroaches, if he views the matters without faith, on the just and charitable legislation made by God to His servants.

Chapter 4

USURY AND ISLAM

....Oh Ye who have believed do not eat usury which is multiples and fear God hoping to win enjoyment and peace in eternal life after death....

Al-Quran;
Surah Al-Imran (Verse 130)

....Those who eat usury will only rise (from their graves) just like the rise of person who has been inflicted with mental instability by the devil....

Al-Quran;
Surah Al-Baqra (Verse 275)

CONCEPT OF USURY IN ISLAM

The holy book "QURAN" has banned RIBA at four places, the first of which is Surat Ar-Rum (Verse No. 39) wherein God Almighty said :

> "Whatever you give (in grant or as present to require an increase to the monies of donors will not derive credit with God : Whatever alms (Zakat) you give for God's sake you get double in return."

This Surat which was revealed in MEKKA is considered as the first which has dealt with usury saying that it will be credited with God but alms (Zakat) grow and multiply. Perhaps at this stage people who were addressed were not aware that the increase in monies will not derive the credit with God rather He will permit waging of war on those who do not yield and agree to abandon it.

The second place in Quran when God has addressed to the Jews in very strong words chosen for expression is Surat An Nisa (Verse 159-160) as:

> "Due to the tyranny of those who entered the Jewish religion we have banned them from good things that had been lawful to them; and due to their dissuasion from the religion of God and taking usury which is banned to them and by reason of eating the monies of people through illicitness we have prepared for the renegade atheist among them painful suffering."

Here the words "taking" has been used, instead of 'giving' which was used in Surat Ar-Rum. Though the Jews were aware of the origin of interdictment because they were believers in a Book but Quran differentiated between taking of usury... and eating the monies of people through corruption. It is apparent that God has the knowledge that Jews did manipulate the situation and some of them imagined that usury was permitted and charged to a gentile. (Bible — Verse 23/19).

Ibn Katheer while discussing the subject has noted the co-incidence in the Bible about usury and the contradictions of the understandings of its meaning as appears in Surat Al-Baqara (Verse 78). The Jews using various kinds of tricks and suspicions justified taking of usury by them, though God had banned them from committing usury.[80]

Al-Qurtobi is of a different view as regards banning usury in this verse. In his interpretation he said: God did not intend it to be usury of the *Shari'a* which was banned to us, but his intention was directed to the illegitimate property;[61] on another occasion he said... That the laws of the prophets who preceded us contain a ban is noted and mentioned in the Book of God which also spoke about the Jews, where He said :

"Their taking of usury although they were banned from practising it."[62] At-Tabari has considered the ban on the usury taking by Jews something which makes it nearer to pre-Islamic usury where he considered the intention to be "their taking of the surplus to the sum of their capitals in consideration for extension of the term of maturity."[63] According to him, the matter as long as it relates to the heaven's *Shari'a* is one of the same; that usury which was banned to the Jews is the same usury which is banned to the people of Islam; that the canonical laws confirm one another as each of them originates from God.

The third place is Surat Al-Imran God said:

> "Oh Ye who have believed do not eat usury which is multiples and fear God hoping to win enjoyment and peace in eternal life after death." (Verse 130).

This verse was revealed at the wake of the "Battle of Uhud" and these sub-revelation of the verse came in the course of comprehensive review operation of the causes of the defeat suffered by the Muslims on the day of "Uhud". This was the time when the moral of the nation was to be boosted and the victory of Badr, which was a miracle, was to be revived in the mind of the nation. The construction and internal preparation of the society was also needed on this occasion. Thus came the order banning the eating of usury and the order to obey God and the Messenger (PBUH). The purpose of this verse is to put a total ban on all kinds of usury which were known and understood by the people. The doubling and re-doubling was customary and a popular fashion of the day at that time.

From this verse of Surat Al-Imran we may conclude that the application of the ban began from the very early period when no one queried what was intendedly the usury or the "multiple of multiples."

It is the fourth place in holy Quran when God has revealed in Surat Al-Baqara and said:

> "Those who eat usury will only rise (from their grave) just like a rise of person who has been inflicted with mental instability by the devil and that is because they (who eat usury) said that trading is like usury and God has allowed trading and banned usury; he who receives a sermon from his God and desists (from eating usury) shall have what he had already taken(prior to the ban) and his absolution rests with God, and those who re-commit usury are residents of hell where they are eternal. God shall strip usury of all the blessings and increase the alms and double the merit; God does not like sinful renegades (who make usury legitimate). Those who believed, have performed benevolences, performed prayers and paid Zakat will be rewarded by God and there is no fear for them nor they shall be grieved. Oh ye believers fear God and abandon what remained of usury, if you are (real) believers. If you fail to do so be advised that God and His Messenger will wage war on you; if you repent you may recover your capital without taking an increase or recovering less than the capital sum; he who is in financial straits, let him wait for better times and if you give alms (discharge the liabilities of an insolvent) it would be better for you, if you know it is good." (Verses Nos. 275-280).

In these verses of Quran the ban on usury is confirmed in a very strong tone and does not carry any confusion, nor does it contain any loop-holes which permit the penetration of inclination.

After the revelation in the verses in Surat Al-Imran which banned usury the fate of both of those who practise the usury and the fate of usury of "those who eat usury" were determined. By a comparison of verses in Surat Al-Imran and Surat Al-Baqara we will come to the conclusion that they were like two paragraphs of the same legal articles. The first explained what is banned and the second determined the result and the penalties. We may sum up the two as follows :

1. Oh ye who believe, do not eat usury which is multiples and fear God hoping to win enjoyment and peace in eternal life after death.

2. Those who eat usury will only rise (from their grave) like the rise of a person who has been inflicted with mental instability by the devil.

Most of the interpreters like Al-Qurtobi and Ibn Attiya have different interpretations of the verses quoted above, but whatever the interpretation be, one thing is common that where a person disobeys God's order he is a miserable man in his worldly life (when there is no peace and security for him) and is equally a miserable man in the other world when people will rise and those in the graves will be resurrected. A miserable man described in the holy Quran as:

> "He who is in this (world) blind will also be blind in the other world and will have further strayed from the road of righteousness." (Verse No. 72 of Surat Al-Isra).

GUIDELINES WHICH DIFFERENTIATE PROFIT FROM USURY

We have considered both profit and usury carrying the meaning of increase to property, but increase in the case of profit is linked to management which transforms property, from one state to another, the increase in usury is either inherent to the property itself or to the result of an exchange of two items of the same class with an overt increase (increase usury), or that which is estimated by the difference of the maturity and the term (delayed payment usury). The legitimate increase is which results from the management of property and the other kind of increase is illegitimate. In this situation we are to determine the guidelines which differentiate the two cases.

The debts usury is obvious so long as the property is not transformed from currency into commodities or otherwise and *vice versa*, and in the absence of any sale or purchase operations, the increase received by either party is usury. A debt owing from a debtor is neither transformed nor is it the subject of a sale or purchase, it begins a debt, which grows in accordance with the conditions agreed. It is immaterial whether such increase is for one time or repeated times and whether it is of the same class as the principal sum of the debt or otherwise.

As far as sale usury is concerned it is intermixed with the profit resulting from the transformation of capital, especially where sale relates to two different items having a common denominator. The exchange of sale of items of the same class does not involve a transformation of capital, therefore, the exchange of sale of property of the same class can not be treated as real exchange of sale because the sale being an exchange of one property for another. In sale it is necessary that the properties be of different nature. Therefore, an increase which is received by either party as a result of sale by which an item of the same class was exchanged and there was not a transformation of the property; it was realized through an exchange of items of property of the same class notwithstanding a different description; it is an increase which was made to the property *per se* without consideration and consequently it resembled the usury in debts, in that case the property (capital) increases itself and which is payable by the debtor to the owner, it is illegitimate usury.[84] It is in conformity to the statement of the common denominator — the cause of two items of different classes create

a secret binding for them. This secret binding is the existence of an implicit difference between the maturing and term currency. That is why the exchange of sales of above items pre-supposes receipt by both parties and it would be meaningless to give preference to one item over the other. The same rule applies to the exchange sale of usury items, other than currencies, because of the absence of the touchstone of computation and hence to stipulation of mutual reciprocity of receipt.

The criteria of legitimate profit in exchange or sale of usury items pre-supposes the observance of the lawful elements — similarity and mutual reciprocity of receipt — where both element must be satisfied or the satisfaction of latter is imperative.

Keeping in view, we may say that the profit is the remuneration for work and is connected to such transformation of the capital which changes its class from one kind to another. If this transformation is confined within the scope of an item or items having a common cause the profit realized remains legitimate provided that the property is transformed and the above-mentioned two conditions are followed.

On the contrary where the increase is not the result of a transformation, which changes the identity of capital through real exchanges — from currencies into commodities and back into currencies — such increase is usury. An overt or implicit increase is deemed to be usury, if the exchange even if it is real, involves either two usury properties of the same class of item or two properties which lack the mutual receipt, the increase would be delayed payment usury because of the difference in time between maturity and the term.

We have discussed the meaning, division, and evidence of the banning usury, as well as items susceptible to and matters of difference from usury and its legitimacy in the above paragraphs and close the chapter at this stage to proceed to the next stage in which the areas where forbidden usury is practised in modern banking operations are to be pinpointed.

Chapter 5

BANKING OPERATIONS AND DEBTS USURY

....A Bank is debtor, it borrows and takes deposits against interest which differs depending on the kind and nature of the loan, as well as on the nature of the deposits account opened and the agreement made with the customers; when the bank is creditor, it lends its capital and significant part of the money deposited therein, against interest and sundry commissions.

Sami Hassan Homoud,
"Islamic Banking - 1985"

USURY IN RELATION WITH BANKING OPERATIONS

The distinctive feature of modern banking operations is mainly based on the idea of dealing in credits, as financiers, or trading in debts. The main function of a modern bank is of a fiduciary trader. The money borrowed by a bank is mostly utilized in lending and the other similar uses. As a matter of fact the bank is an intermediary whose role may be likened to that of a trader who collects goods from various sources to re-sell them to different people in different markets or areas. A bank being trader in debts the profit is earned by the difference between receipts from lending and payments for borrowings. Beside trading in debts, as its main function, bank renders other services also, which help banks to extend their scope of activities and dealings, enter new fields of socio-economic nature and attract the depositors, as well as borrowers. The banks, alongwith trading in debts and rendering various other services, also perform, with a difference, a specialised service, kind of trading activities which has its roots in the old banking operation i.e. the exchange of various currencies — foreign and domestic.

Thus we see that banking operations have a relation with debt usury in that they borrow and lend against certain specified revenue. These operations are also related to sales usury in that they deal in money according to the various forms which have been developed by the art of banking to keep in line with the advancement in services and technology. In this section, we shall examine both kinds of usury — debts and sales — in banking business.

BANK DEPOSIT TAKING

Usury exist in debts without regard to the cause, it is debt which carries a stipulation or agreement binding the debtor to pay to the creditor any sum of money surplus to the principal sum of debt. In banking operations where a bank is debtor, it borrows and takes deposits against interest which differs depending on the kind and nature of the loan, as well as on the nature of the deposit account opened and contract made with the account holder when the bank is creditor. It lends a considerable part of the money deposited therein against interest and sundry commissions.

In the modern banking operation it is obvious that the usury is mixed-up both ways i.e. taking and giving. This generalization, however, does not undermine the necessity of explaining how it differentiates between the dual nature of usury in borrowing and lending.

The modern interpretation of the meaning of deposit taking by bank differs from that of olden days where it uses to mean the safe-keeping of a deposit which is the meaning still prevailing within the frame-work of the civil legislation of various states. This difference was, however, not taken for granted at the beginning of the era where the lawyers began to view the taking of deposits by bank on the basis of re-formulating them in accordance with the spirit of the future civil law. The lawyers comprehended the difficulty in this regard but the French jurist, Ribert gave predominance to the concept of safe-keeping which renders the contract of deposit taking by banks closer to the deposit contract of the civil law. He, nevertheless, admits that what the adoptation he proposes had only a hypothetical value because such adoptation conflicts with the practical results of bank deposit taking. The most significant conflict being that the bank uses deposits for its own interest. For the foregoing reason the specific principles of the contract of deposit do not apply to bank deposit taking because except for cases where actual currency is deposited as such, which is rare in practice, the bank's intention when taking the currency is not directed at the safe-keeping but at the utilization thereof and on demand to return it in full.

Those who plead the exclusion of bank deposit taking from the frame-work of the civil legislation are of the opinion that a bank deposit is an irregular or inchoate one and thus it would be other than an ordinary deposits. In case of an inchoate deposit a depository acquires ownership of the deposited money and is bound only to return it in full which is unlike to the case of

an ordinary deposit, where depository does not acquire title to the property, which would be a trust entrusted into his care for safe custody only.

Dr. Ali Jamaluddin in his book "Bank Operations from the Legal Point of View" has objected to the concept of the inchoate deposit where he said "So long as a depository is permitted to use the deposit, his obligation of safe-keeping the same lapses, because a deposit perishes through use.[85] Dr. Ali Al-Barudi considers that in depositing the money with a bank a depositor does not want the depository to keep the money in his safe custody, he looks forward to taking advantage of the facilities made available to him by the bank, which will relieve him of the burden of carrying his money on his person, but do not deprive him of the right to use such money.[86]

Treating a bank deposit of a specific nature is not a solution which is worthy of adoption unless the issue proves to be incapable of being sub-ordinated to any legal adoptation other than the deposit contract stipulated in the civil law. Inspite of the conflict of the stipulation of the banking deposit contract with those of the civil law deposit contract it seems to be close to and in harmony with the lending operation. In case where the borrower undertakes to return something similar to, but not to keep safe, the depository acquires title to and bears the risk of losing by *force majeure* of the borrowed money.[87] According to French jurisprudence the depository (the bank) is a trader of the money who gives credit to a third party and is compelled to obtain something, which he can lend other than his own capital. Similarly the depositor has an interest which is embodied in the interest paid to him by the bank. Even if a depositor does not get interest it would be enough for him to enjoy the advantage of safe-keeping of his money.[88]

So many other countries have also expressly adopted the concept of considering a deposit — currency or so, which perishes through use to be a loan where it is allowed to be used.

The above-mentioned most elaborated concepts had been discussed by the lawyers prior to settling on the prevailing opinion of considering the deposit to be a loan. Here we are confronted with a question how the Islamic jurisprudence view the banking deposit contract or a deposit, the utilization of which is allowed?

Those who consider Islamic jurisprudence in regard to the basis which was adopted by jurists for shaping the various contractual relationships will realize that it is generally devoid of any indecision on the matter of shaping contracts. The reason for that is obvious because, according to the rules of jurisprudence that which count in contracts are the intentions and meaning and not the words and constructions.

Inspite of being generally defined by jurists as being a procuration or a deputation to safe-keeping the property, a deposit becomes a borrowing,where permission has been granted to utilize the thing deposited. Where such thing is money or a fungible which is perishable through use, the borrowing is transformed into a loan. Az-Zaylai has defined depositing as "giving authority to a third party to safe-keeping his money; a deposit is that which is left with a fiduciary.[89] Al-Bahuti in his book "Kashaf Al-Qina" has stated that a deposit with permission to use it is a guaranteed borrowing.[90] As-Samarqandi, the author of "*Tohfat Al-Fuqaha*" says that all that can not be turned to advantage except through being consumed is in fact a loan, but is called figuratively "borrowing".[91] Al-Kassani explained the issue by saying "for these reasons the lending of money is interpreted to be a loan, not a borrowing because the intended advantage cannot be realized except through the consumption of such money".[92] Shams-ul-A'immah As-Sarkhasi said: "The borrowing of Dirham, Dinars and Fulus is a loan, because the lending is a permit to turn to advantage : such advantage can not be realized in money except through consuming them and thus the borrower will have been permitted to do so.[93] Ibn Qudama in his book "*Al-Mughni*" has stated that the borrowing of Dirhams and Dinars by a man for spending is a loan.[94]

From all the opinions of jurists, as given above, it will obviously be concluded that the concept of the jurists which is based on considering the intent or not the words used in drafting the contract were characterized by certainty and were also devoid of the reluctance which was characterized of the French and English lawyers on this issue.

If it is determined that a bank deposit is a loan, it means that the increase paid by the bank over the sum deposited constitutes usury, what then does a bank pay to its depositor?

INTEREST PAID BY BANKS AND USURY

Depositors get increase in their money deposited with the banks which is calculated on the basis of the amount deposited; hence such sums are known as interest paid. The rate of interest varies from zero (on current accounts in many countries) to various percentage per annum in countries which are not legally bound by the specific rates of interest. Foreign markets which are not legally bound by a specific rate of interest have witnessed extraordinarily unprecedented rise in rates of interest in the last many decades, particularly from fifties to the current decade, are no longer stable as they used to be in the past. The rate started rising alongwith the fluctuations of demand and supply and the need for resources. The rate of interest in April, 1974 in England was 13% on the Pound Sterling sums deposited for a term of 6 months whereas it was 7%, even less, in the various western as well as in eastern countries.

In addition to the interest other promotional privileges were offered by certain banks in U.S.A., European and other countries on the special type of deposits account. In Pakistan Habib Bank introduced "Double Rupees Saving Account" Scheme in fifties in which the deposit beyond pre-fix limit, was insured to the extent of double the balance in the account, in case of death of the depositor. Again the same bank, in 1975 introduced "Prize Savings Scheme", the salient feature of which was the prize, by drawing of lotteries, given to the depositors of savings bank account. This business promotional device gained much popularity and was appreciated internationally. The scheme won the "Gold Coin", an international award of "Bank Marketing Association", Chicago U.S.A. In other countries too, like U.S.A., India and Egypt the depositors are being attracted by giving the prizes of lotteries to the saving account holders. In all such schemes the interest is the basis and the consideration which covers the various kinds of account.

The rate of interest paid differs according to the kind of account in various countries. The current account does not generally get any interest, whereas interest is paid in short terms deposit say: 7 days, 30 days notice account, 3 months and 6 months as may be consistent with the relevant law of the country. The accruing interest is booked in current account (where payable), term deposit and fixed deposits accounts.

The interest paid by the bank is fixed according to the nature of account, as in term deposits, or according to the general conditions of dealings, as is in savings account, where the conditions are different but applicable for all account holders. According to the advocate who needs not conceal the trend the definition of interest is "The price paid for the use of money is the interest."[95]

The interest paid as the price of the money was originally considered by the financial experts of the west to be usury. But the fast development of trade and industry resulting the increased demand of credit led to relaxation of the view and the restrictions imposed on charging interest made them to think consequently to change their definition of usury where the comprehension was thus directed at the increase taken in addition to what was permissible under the law or according to usage and practice. In the advanced learners dictionary usury is defined as "The practice of lending money, specially at a rate of interest considered to be high." This turned the wheel of history where the rate, which used to be considered in the past as usurious , become negligible in inter-bank dealings or dealing between the customers and the banks. According to John Ronlets in "Money & Banking", the history of the rate of interest was tumultuous because of the various opinions of the economist of the western world which conflicted either in regard to determining the rate and the significance thereof or to determine the most appropriate rate. Our evidences in support thereof are the several theories which thrived for some time and were then superseded by new ones.[96]

Islamic view of the above situation is quite different as it is not related to a fair or exorbitant rate. Islam, as a matter of fact, has got clear cut landmarks in this regard. In Islam every increase stipulated in a debt is illegitimate usury. It is immaterial whether it is 2 or more or less percent because there are no guidelines for deviation from the principle. This does not mean that we have to conceive that, according to the Islamic *Sharia*, the interest charged by banks is usury and stop short of carrying on with the dialogue. Instead we have to rebut the proof by a counter proof and present an alternative solution.

Inspite of the fact that the payment of interest is the important factor which induces the depositor to deposit and place their monies at the disposal of banks, it is an accepted situation that there are persons in our country who have deposits of considerable amounts in banks and do not take interest

thereon. In our country and in various other countries including England banks do not pay interest on current accounts even then they have got major share of their deposit carrying no interest (current account and call deposit).[97] In most of Arab and Islamic countries there is lot of people who refuse to take interest on their deposits. In Pakistan before the introduction of Non-interest Banking System there were quite good number of depositors who willingly refused to take interest on their deposits not because banks do not pay interest on these accounts, but because they believe that such interest is illegitimate gain. This attitude of the citizens of our country as well as of Muslim countries of treating the interest as illegitimate gain which is motivated by their religious belief though appreciated but does not solve the core of the problems. It is the right of depositors to derive legitimately the gain and the increase, beside development of the resources of the country, their capacity to bring good to themselves and to the society.

What should be then the solution to the situation where an individual, society and country should be benefited legitimately? This question in our opinion cannot be solved only by the change of words 'interest' substituting it with the word 'profit'. Such game of words might deceive some people; it would not deceive God of the people. The solution proposed is based on the participation in profit on the amounts deposited by the people for the purpose of actual investment which would be coordinated according to the modern banking system within the framework of rules inheriting the true spirit and intention of Islamic jurisprudence. The profit is countered by loss, but suffering of a loss is not a condition for rendering the operation legitimate as the risk of banking credits are spread over a considerable operations. The risk of well managed investment may be distributed in the same way as banking credits within the framework of the *Shari'a*. The *Shari'a* does not create hindrances for innovation of the means of avoidance on the human mind but esteems that the human mind will not follow the way to divergence from the righteous path.

USURY IN BANK LENDING

The main business of a bank, which constitute its main part, is the lending operations. The recourse for performing these operations are generated by the capital of the bank and raising the savings through various means. The aim for gathering all these resources is for entering the money market gradually and giving credits with the object in view to generate more and more profits. Bank lending, therefore, carries specific importance because of two elements :

(1) The profit of banking operation is mostly derived from lending operations which in size exceeds manifestly of all other elements.

(2) The major part of the profit of the bank falls within the framework of illegitimate usury.[96]

The systematic lending operation of modern bank does not carry much importance due to the size of current operations as compared with other investments which are carried out sometime by banks. The importance of such operations is that they are the basic means through which the funds are raised from the public so that they can be channelized into the national economy where there is always a great demand to absorb the vast supply of funds.

The bank lending is not restricted in one form only rather it has various channels to reach the sector of economy who are in dire need of funds. It is also not restricted to giving money only but created confidence and trustworthiness that is the reason for giving birth to the general term "Banking Facilities", or creditworthiness which in practice covers all forms of material and moral lending.

We shall in forthcoming paragraphs discuss both branches of banking creditworthiness i.e. direct lending or that which leads to casual lending. The distinction between the direct lending and casual lending is important because usury is definitely realized in case of direct lending whereas in casual lending the realization of usury only begins with and not before the actual lending.

DIRECT LENDING

The direct lending is characterized by the fact that the object thereof is borrowing money either through actual spot payment or by making the credit available to the borrower, when required, pursuant to an advance agreement.

Lending by the bank is either by allowing a general loan or by way of pre-sanctioning a credit line which entitles the borrower to draw the amount upto the sum agreed. This arrangement in banking terminology is called "Sanctioned Credit Line or Sanctioned Limits". These sanctioned limits are allowed by the bank after assessing the requirements of the customer (borrower) and the use thereof which is covered by the tangible securities (moveable or immovable). The bank lending may also be extended by discount of negotiable instruments which is effected by endorsement of the negotiable instrument in favour of the bank. In such case the bank becomes the rightful and legal owner thereof and the sum mentioned in the instrument is paid to the endorser.

The general loan or the temporary accommodation (overdraft) and the sanctioned credit line or the sanctioned limits are similar in that the relationship of creditor and debtor remains in existence, between the bank, on the one hand and each of the borrower on the other hand. In the case of lending through the discount of negotiable instruments a third party is also involved who is an outsider to the operation. When an agreement between the bank and the endorser is concluded the third party becomes the debtor and is liable on the discounted negotiable instrument to the bank in consequence of the endorsement to the order of the bank.

The above difference of the two situations necessitates the clarification of both forms of lending i.e. general loan (overdraft) or lending against sanctioned limits on the one hand and lending through discount on the other hand so that we can distinguish usury in each case separately.

LOANS AND CREDIT LINE

Loan is the simplest form of bank credit where the operation involves the delivery of money to the customer either directly or by crediting his account with the lending bank. The contract must stipulate the rate of interest, commission (if any) and the repayment. It is governed by the

general rules which apply to loans in general.[99] But it is not the method which is very common in business, because it is deemed to be inflexible. Furthermore it does not, in practice, satisfy all the commercial needs of the business community. A trader who obtains the loan may not need the money immediately upon the execution of the contract. He may need to have something available at his disposal to enable him to face probable future needs or the situations where the bank's financial assistance is required by him.[100]

Thus the method of sanctioning the credit line came into being as an appropriate means for commercial dealings. In this method of bank financing the customer is not obliged to draw unless and until he needs the money, thus evading the necessity of paying interest on a sum which he could not turn to advantage. The sanctioning a credit line by the bank to a customer, therefore, represents a contract concluded by a bank and a customer pursuant to which the bank undertakes to place a certain sum at the disposal of the customer during a specified period of time. Sanctioning of a credit line carries double advantage to the client where the credit is allowed in current account and the customer would be in a situation enabling him to re-draw that part of the sum which he would have paid in the current account, because such payment in the current account is not deemed to be a discharge of the debt on his part.

The general loan provides consistency of use and better profit for the bank investment but its use is limited because it generally relates to the needs of personal consumption for coverage of incidental expenses in order to repay the amount in equal monthly instalments within a period of time according to the agreement. A credit line, specially when it is in current account, is more appropriate and less expensive for the customer who is enabled to draw and pay and then re-draw, according to his needs and circumstances, without having to pay interest except on the sum drawn only.

The question of adoption of general loan does not involve any problems because this kind of contract is known and specified in civil legislation and nothing can be applied to it, in regard to the bank which is a party thereto, except that which relates to the commercial nature of the loan without regard to its subject.

There are various judicial rulings on the subject, few of them are given hereunder for the interest of the readers :

(i) Loan made by banks in the course of normal business are deemed to be commercial activities, regardless of the capacity of the borrower and the purpose for which the loan has been allowed.

(ii) In contracts involving opening financial credit, he who opens the credit must place some monies at the disposal of the person in whose favour the credit (beneficiary) is opened, who draws it all in one lot or in several consecutive lots, according to his needs within a specified period of time.

(iii) Whatever sum is repaid or refunded by the beneficiary during the contract term will be added to the balance of the amount placed at his disposal, save where agreed otherwise.

(iv) The opening of a credit necessitates the placing of means of payments upto a specified sum of money at the disposal of the beneficiary.

Whatever conclusion we may draw from the above judicial opinions, whether the conception is based on the assumption that the bank credit does not involve "the placing of money at the disposal of the beneficiary" or does it include "the placing of means of payment," the situation is, however, represented in that the bank which opened the credit pursuant to the contract executed with the customer vests a right unto the later to have his balance in the current account indebted (overdraft) upto a sum agreed by the parties to the contract.

The foregoing vested right is far from imaging the concept of allocation (specification) because the money is neither shares nor parts, but is nearer to the meaning of the capacity made available to the customer to enable his account to be indebted (overdraft) upto the sum agreed with the bank. The practical imagination is consistent with the concept to conceive that the basic objection of a credit contract is the creation of a credit position for the customer, which reassures him of having a standing right to borrow a certain sum out of which he may use such portion and at such time as he wished.

There are number of statements where legally the bank credit has been adopted to be a loan or a loan subject to a standing condition, or considering it to be a promise of a contract or a contract of a specific nature.

Those who considered the loan to be a contract of credit argue that the delivery is delayed, particularly in regard to the French legal rules which consider the loan a Corporeal Contract. Those who considered that loan is subject to a standing condition (stipulation) say that a credit contract is a definite contract and the advantage of the customer therefrom can be realized in practice on being available.

As regards the concept that banking credit is a contract of specific nature it would be undesirable to resort to it until all possible forms to satisfy the purpose have been discussed.

There are several legal experts who considered that the banking credit is "a promise of a loan" and is binding, because it is nearer to a commutative contract on the basis of "do ut des" that to a pure donation which justify the one-sided renunciation of a promise of other than a bank loan. Some scholars consider that the contract of a credit line is a definite contract which produce effects immediately on being concluded as the same is not barred. The contract referred to is, at the same time, preliminary contract for carrying on other operations which will be effected pursuant thereto.

The Islamic jurisprudence in regard to loan conforms generally to the French legal rules where it takes into consideration the receipt in the contract. The juristic rules are characterized by their flexibility in that they consider the receipt to be an effect of the performance, and not an element, of the contract. According to the rules of jurisprudence a loan is concluded by "Offer and Acceptance " and is consummated by the receipt."[101] Where the receipt takes place in the wake of an offer, before the acceptance is expressed, the latter shall be waived because the receipt which replaced it indicates consent. According to a story attributed to Abu Yousuf the acceptance is not an element of a loan but an offer is sufficient because loaning is a lending where the acceptance is not an element thereof.[102] Ibn Qudama has cited a form of a divided loan which is received by the borrower in instalments from the lender, the entire loan is payable, if the lender desired so, because the whole sum is matured.[103]

The above definitions and rules relate to general loan whereby a lender pays the money to the borrower on the condition of repaying it similar, regardless whether the payment by the lender is made "From hand to hand" or pursuant to a contract. But what is the view of Islamic jurisprudence regarding the obligation of he who makes a promise to give a loan? Would

the bank remain bound by its promise to enable the promisee to draw on the account to such an extent as is agreed in the credit contract? What would be the situation where the borrower pays into his current account? Would such payment be deemed to be a discharge? These are the questions we are to answer in our further discussion on the subject.

Regarding the first question, the matter relates to the view of the Islamic jurisprudence in regard to the extent to which the promise is binding in general : There are the following three opinions in the framework of this fertile jurisprudence in regard to this issue :

(i) Imam Abu Hanifa and Imam Ash-Shafi'i are of the opinion that he who promises another person to pay him money, whether it is specified or not, he shall not be bound to fulfil his promise but it would be more appropriate to fulfil the promise.[104]

(ii) From the legal point of view, the promise of a contract is binding on the promisor, if a cause is mentioned therein, provided that the promisee has, in pursuit of this promise, undertaken a financial obligation by commencing this cause in consequence of the promise. Asbagh, one of the famous jurists, of Maliki's thought maintained that it would be enough to be bound by the promise if the cause is mentioned — be it marriage or otherwise — even though it is not effected.[105]

(iii) According to a third opinion it is considered that the entire promise is binding if a judgement is enforced against the promisor. This opinion is attributed to Ibn Shybruma.[106]

It will be noted that the final opinion differs to a certain extent from the spirit and stipulations of the *Shari'a* which urge the performance of contracts and obligations, in general. The second opinion bases the liability on the promise on the notion of averting the damage which may be caused by the promise and that where the promisee had actually incurred expenses as a result of the promise. According to the Malikis' thinking the damage is taken into consideration even it has not been suffered. The third opinion of Ibn Shybruma coincides with the spirit of the *Shari'a* the considerations of interests and the stability of dealings and relations.

In the banks, where lending is the profession, mere execution of a credit contract would be adequate for considering the other party as having incurred an expense, specially if such party is a trader or industrialist, because a customer would normally begin arranging matters and making plan for the business by relying on the possibilities made available to him by the loan. That is only the concept of Malikis jurist, Asbagh, and that of Ibn Shybruma must be given predominance over other opinions, for the sake of preserving the stability of dealing and the supremacy of confidence in financial dealings and relations.

Whether credit allowed in the account of a credit contract would be deemed to be a discharge? The issue may be divided into two parts. The first part is that drawing on the account opened by virtue of the credit is deemed to be a debt owing from the borrower. The second part is that the payments made into the account are deemed to be a debt from the bank. Where both said debts have matured a set-off shall be effected. According to the interpretation of Islamic jurisprudence by "Mohammad Baqer As-Sadr", the conditions of a set-off have been satisfied, it must be effected without the need for the parties to enter into a contract, agreement or acknowledgement thereof.[107] Al-Khurashi has quoted the definition of a set-off made by Arafa as being "A waiver of a liability on an item similar to what he owes in consideration of what he is owned by the claimant as mentioned in respect thereof." However, the concept that the promisor keeps his promise to continue lending for an agreed period, and according to the stipulations of the contract tends to cancel one if the main conditions which conceive of an *ipso facto* set-off, because the debt resulting from the bank loan is the credit opened, has not matured. Whatever sum is paid by the borrower is, therefore, not a discharge on account of the loan, because it has no intention of doing so at all. Thus it would be a deposit which the borrower may draw at will and at any time.

The concept that whatever amount is paid by the borrower into his account with the bank must be considered a discharge, is applicable in two cases :

(1) Where the customer/borrower has exceeded the maximum overdraft stipulated in the credit contract, the payment shall be deemed to be a discharge on account of the surplus in the absence of a specific agreement in that regard.

(2) Where the term of the credit has expired, or where both parties have agreed or either party wishes to terminate the contract depending on the stipulations of the contract.

It is thus obvious that the agreement which maintains that a promise is a binding covers the possibility of not considering "a payment into the account" to be on account of discharge of the liability. Therefore, a general loan or credit line has, within the framework of Islamic jurisprudence, a place to contain it, from the legal point of view.

The Islamic jurisprudence and the positive laws, though carry similarity, in regard to both forms of loan do not go together till the road ends. The nature of loan has undergone the process of changes under positive laws. These changes have effected it to the extent that it has become a kind of commutative contract on the basis of 'do ut des' though it had been originally a donation contract. It has now been possible to enter into a contract stipulating for payment by the borrower of a consideration for the national advantage of the money lent. On the other hand the view of Islamic *Shari'a* in regard to the loan retained the deep rooted purity. The Islamic view considered this contract to be one for help not exhaustion. For this reason the author of "KASHAF AL-QINA" has defined the loan as "the loan is the payment of money to help he who takes advantage thereof and refund it in the full.[108]

As we have already explained the banks are companies which engage themselves in the business of lending. They do not lend their own capital only but also borrow the money from their clients (depositors) in carrying on their business. Therefore, the bank is like a trader who receives more than that what it lends to its customers and thus realize itself a percentage of profit. The profit realized by the bank, from its clients, constitute actually the major part of profit of the bank. The profit earned, in the banking business, includes the interest and commission. We shall consider the extent of usury in the bank profit after we have completed our discussion on the second significant source of income, besides the profit earned on loan and credit line, which is the discount of the negotiable documents which is quite considerable in the financial operation of a bank.

MEANINGS AND IMPORTANCE OF DISCOUNT OF NEGOTIABLE INSTRUMENTS

When a customer presents a negotiable instrument which has not matured in order to obtain the value thereof, has less interest and commission which a bank charge to such transactions, it is called discounting of the negotiable instrument.[109] The negotiable instrument, presented by the customer, is required to be endorsed to the order of the bank concerned. Generally such transaction is preceded by an agreement stipulating the conditions of the transaction between the customer and the bank, the rate of interest, the commission and the limit fixed for the total amounts which the customer is allowed to discount on account of the instruments presented. When the limit is fully utilized by a customer the bank suspends any further discount transactions until the outstanding value of some of the discounted instruments (bills) has been realized.

The significance of the discounting instruments to the bank is that it represents an important field of short term and self liquidating investment. Generally the term of negotiable instrument do not extend beyond six months. The liability on such instruments is not restricted to few borrowers but is spread over a number of borrowers and collection of their values on maturity is easy matter. Another advantage is that the bank may, in case of need, rediscount such instruments at the central bank.[110] The customer who gets the bill discounted with the bank is benefited in the way that it enable him to obtain such money which he actually needs. If this facility is not available to a customer his business may be affected adversely as his immediate need would not be met.[111]

Due to global increase in production of goods and machinery and the various methods adopted by the modern banking system the necessity of discounting facility of the negotiable instruments is getting more and more importance. The sellers of the items are extending the facility of credit sales to their customer thus creating the opportunities to bank for more short term investment which carries less risks if compared with medium and long term investment.

The importance of discount operations in commercial activities, however, depends on the economic system, capitalist or socialist, adopted by a country. In the Capitalist Countries the discounting or negotiable instrument is flourishing well and the banks are required to handle a large volume

thereof. But in the Socialist Countries the volume of domestic dealing in such instrument is negligible. After examining the definition and the nature of the discount operation our concern is naturally to see the legal nature of the discount and the assessment of the abstract nature of this operation according to Islamic jurisprudence.

The opinion given about the legal nature of discount operations had various trends, which may be summarised into two main classifications, namely :

(i) First considers the operations to be an assignment of right in that the endorser sells the right established by the negotiable instrument.

(ii) The second considers the operation to be a loan secured by the negotiable instrument which is fully endorsed to the order of the bank.

If we consider the objective of the operation, assignment of right by endorsement and the secured loan by the negotiable instrument, we can find that both the operations are so linked that it would be impossible to consider either of them separately.

When we move to the field of Islamic jurisprudence which bases its view in contract on intentions and meanings we find that the objective of discount is loan which is acceptable and closer in this regard. The Encyclopedia of Jurisprudence (preliminary edition specimen No. 3-Transfers) cites where it determines the view of the Islamic jurisprudence in regard to the discount operation. This operation of discount is null and void from the Islamic point of view. The authors of the Encyclopedia cited the causes of said nullity where they said that this operation is not valid as transfer due to absence of the element of equality between the assignment of a debt owing from him and of that owing to him. It may also be considered as a loan from the bank because it would be a loan which produced an advantage due to the inequality. Furthermore, it may not be considered a sale of a debt to another than the person liable thereon with him who ratifies it. In this case both considerations are money and it is not allowable to sell money for its specie (class) with an increase. In case of difference in of specie (class) reciprocal receipt must take place.

The bank had no intention of buying nor being the assignee of the right established by the instrument because the intention was directed at lending. The bank accepts the discounted instrument as a security. If none of the persons liable thereon pays the value of the instrument on the date of maturity the bank will have recourse against the beneficiary of the discount for the value. The bank will not take upon itself nor will it be willing to undertake any recourse action against those liable thereon to the last stages of recourse as being practised.

Even if we take for argument sake that the discount operation is a transfer of right or the sale of a debt established by the discounted instrument neither of these definitions satisfy the conditions and rules of transfer of right or the sale of a debt to another person liable thereon. Especially where the subject matter of the sale involves the sale of currency for a term in consideration of a lesser sum payable immediately. In such case it would be considered as being increase and delayed payment usury. There would, however, be no conflict where the money is coupled with the issue of a procuration because when an attorney receives the value of the discounted instrument a set-off will take place between the debt owing to and that which is owed by him consequent upon the receipt made for the account of the principal.

From the above, it is obvious that the discount of negotiable instrument is like a general or credit line loan, all of which are permissible in principle by Islamic jurisprudence. But what is argued in regard thereon is the usurious gain which is realized by the lender bank.

INCOME OF THE BANK AND USURY

The income of a bank mainly constitute of two elements namely; interest from intended lending and commissions. Interest is a relatively ameliorated usury. Our discussion will, therefore, not cover it more than unveiling its usurious nature, which satisfies all the elements of usury. But commission has a different identity, in that it is a wage i.e. rental, fee and remuneration, for the work done. Nevertheless it is not entirely free of usury in certain aspects and cases. Both of these types we shall discuss in details.

INTEREST CHARGED ON LOAN IS A TYPE OF MULTIPLE USURY

While discussing the usurious nature of the interest in foregoing related section on the subject we have come to the conclusion that according to those who advocate interest and have defined it as "Being the price paid in consideration for the use of money," its low rate which is acknowledged by law or usage distinguishes it from usury. The bases of this criterion rest on the international money markets. The reasons of this collapse are attributed to the demand and supply theory of money, as well as the need and speculation. In 1974, the world has experienced unprecedented rises in the rate of interest. In this year the rate of interest on inter-bank dealing reached as much as 35% which is a record percentage unknown in the history of modern banking, whereas in late 1980's the world has tasted an unusual fall in the rate of interest in the international money market.

Regardless of the rise or fall of the percentage from the point of view of abiding by what is known in regard to usury is to confirm that interest as a price for the use of money is banned usury. It is immaterial whether the percentage increases or decreases that which is illegitimate remains so, would be beyond a limit mind to set rules for controlling that which is beyond knowledge and limits which have been a subject of command or ban by the Creator of Universe.

Interest is usury, because, as determined by economists, it is taken as price for the use of currency. The currency is not like a building, machine or something which has an advantage which is acknowledged by the *Shari'a*. It is said that currency is capable of deriving profit through management — it would equally be true that it is susceptible to loss. He who sees the profit must be prepared to suffer loss, otherwise it would be an oppression against the person who pays a share of the profit and bears the loss alone. Since the computation of interest is associated with the element of time, it is multiple usury which matter does not need proof. It is, therefore, obvious that the debt usury shall be illegitimate usury and in particular to the multiple of multiples type of usury if it is linked with the time as is the case in regard to interest.

COMMISSION AND WHEN DOES IT CONSTITUTE USURY ?

Commission differs from interest in that which is similar to wages (rental, fee, remuneration). The commission is charged for the real service rendered by the bank to its customers. We may, therefore, consider the commission as being a fee for an advantage and not a price for use of the money. According to Professor Dr. Muhsin Shafiq "Commission is not deemed to be interest so long it is countered by a real service rendered by the bank to its customer."[112]

The courts in France have ruled that where there is no service rendered by the bank in consideration of commission it will be deemed and governed by the rules of interest. According to J.M. Holden in the English legal system, the legal basis established the right of a bank to charge commission in consideration of service rendered by it, assuming that there might be an express or implied agreement between the bank and the customer in this regard. In the absence of such agreement, the bank has got right to determine and charge commission for the services rendered. The matter is based on the fact that where a person requires the service from a professional, the law requires, the applicant for the service to pay a reasonable sum in consideration of the service rendered to him.[113]

When we proceed to the framework of Islamic thought on the subject we find that the acceptable entry to commission as a valid fee is the link connecting it with the existence of an actual service on an indebted advantage capable of being evaluated according to the *Shari'a*. The view which considers commission to be a fee must not be taken in the absolute sense, so long as the matter relates to intended lending, least the commission be used as veil for usury under any nomenclature whatsoever. If it is argued that bank's commission is, in case of intended lending, the fee agreed for preparing the contracts and counting the currency notes paid in loan, how can the right of the bank be justified in collecting the commission for the following years where the contract had already been prepared or the sum is received? There can be no justification for the matter as it is called and entered in the books of the bank as commission. However, if it is inevitable to consider the bank's entitlement to fees in consideration of preparation of the contract or registration of agreement etc. the matter may be arranged on the basis of a commission being charged as a lump sum, for instance Rs. 50.00 or Rs. 100.00 and not on a preparation basis, such as 1%

of the loan value. The reason being the efforts of the bank in preparing the loan contract of a value of Rs. 1,000.00 or more, would, according to the theme of the preparational fee, means that the bank will charge Rs. 10.00 for the first contract and Rs. 1,000.00 for the second contract, for no apparent reason except that it is an income added to the agreed interest.

Similarly, the commission charged as fee must not be, besides fixing it as a lump sum, repeated except for the repetition of the service or advantage. The fee will not be collected every month or every year, but must be collected when the contract is prepared or a new operation is concluded as in the case of the discount of negotiable instruments.

Thus, it can be considered without any doubt that the commission is usury in all cases of intended lending, if it is charged initially, a percentage of the sum of the debt. Furthermore, it shall be multiple usury, like interest, where it is repeated according to time. Here we would like to refer the expression which was used in the classing resolutions and recommendations of the College of Islamic Research, Bahrain, in its second annual conference that "Bank operations, such as current accounts, payment of cheques, letters of credit and domestic promissory notes on which is based the business between the traders and the bank internally, are all within the permissible bank dealings and whatever charges are levied are not usury."

We, therefore, consider the linking of commission, as a fee, with the service rendered (commensurate with the labour and effort exerted) will bar the exploration of this opening to convert the resultant commission into a usurious income which is charged in consideration of advantage or a promise thereof.

Thus the conclusive criterion of the commission being a fee — wages — and not usury is that it must, first of all, be against a service, and its sum must be fixed in all cases of intended lending according to the effort exerted or the service rendered without linking it with the sum or term of the debt.

GUARANTEE AND THE BANK'S LETTER OF CREDITS

Though the main business of banking is based on giving or agreeing to provide money, as in the case of sanctioning the credit line, the banking business covers another kind of trust lending which is helpful to a customer when he requires the bank to act as intermediary in specialized kinds of

operations. This specialized kind of service is beneficial to the customer in that it provides for the customer and such other party with whom he wishes to enter into a contract an atmosphere of security and confidence created by such a creditable intermediary. In providing such service the bank needs not pay any currency to the person on whose behalf it intervened with the other party because, initially, lending is neither intended nor relevant in this type of operation. However, the bank may, some time, find itself compelled, due to the failure of the customer on whose request it intervened, to pay the amount it has undertaken to guarantee to the third party. The payment of such amounts by the bank is deemed to be a loan. This becomes a forced loan which is not intended loan for a certain specified term. It is casual timed loan which may be claimed from the customer immediately upon payment made to the third party by the bank in discharging its contingent liability.

The income derived from such operations represents as being commission in most cases, and interest, in other cases. These operations are, therefore, different in the way that intended lending is not the object of the bank where interest is notably and largely predominant over commission.

Our further study of the subject will, therefore, be focused on the casual lending or forced loan on the same pattern as was discussed in intending loan or providing a credit line. We should first talk about the adoptation of relations thereof between the customer and the bank and about the usury in revenues which accrue in such cases.

There are three factors involved in case of unintended lending i.e. customer, bank and the third party in whose favour the guarantee is issued. It is the bank whose intervention helps its customer to enter into contract and execute transactions. It would have not been possible to perform the transaction without the intervention of the bank as guarantor or liable intermediary. The most salient form of such operations in banking dealings is the bank guarantee, including letters of guarantee, bank acceptance and documentary credits.

According to civil law, a guarantee is defined as "A contract whereby a person guarantees the discharge of an obligation, by undertaking to the creditor to discharge the said obligation should the debtor fail to do so."

A letter of guarantee is "A definitive undertaking issued by a bank at the request of its customer to pay a certain sum, or capable of being determined, as soon as the beneficiary requires the bank to effect payment within a fixed period of time."

The comparison of a guarantee and a letter of bank guarantee will show that in both the cases the objective is a form of security aimed at helping a customer to reinforce his credit position towards the person requiring the guarantee or the beneficiary of the letter of guarantee. In fact, the bank guarantee, in general, is free of the restrictions of a legal definition, especially in regard to the obligation undertaken by the bank issuing the letter of guarantee to the beneficiary where the relationship of the bank and the beneficiary is governed solely by the terms of letter of guarantee. This relationship is, further, considered to be fully independent of the relationship existing between the applicant for the letter of guarantee and the beneficiary. It is the most important thing which keeps the distance between the bank's letter of guarantee and the guarantee which is regulated by civil law. In civil law the obligation of the guarantor is subsidiary to that of debtor guaranteed, in regards to its validity and nullity. When bank undertakes it is required to pay at any time, between the validity of the letter of guarantee, without regard to the situation of the person guaranteed or the outcome of the contract between the bank and its customer and the result of the relationship between its customer and the beneficiary of the letter of guarantee.

A bank guarantee, in fact, is the alternative acceptable in the business for cash reassurance. A businessman instead of paying in cash a deposit as security to discharge his obligations produces bank guarantee in the required value. In doing so he shall not need to freeze the deposit sum from his assets and at the same time will reassure the party interested that it may obtain the required sum at any time if so wished within the validity of the letter of guarantee issued by the bank.

There are various uses of bank guarantee in business dealings among which most common are, the submission of bank guarantee instead of depositing cash to participate in Government and similar bodies tenders and auctions. The guarantee for the performance, according to the terms of the contract after the final award thereof. The guarantee in favour of Customs and Tax Department as security for the duty or tax accruals or those which may accrue in certain cases. The shipping guarantee on the strength of which

shipped goods may be received at the port of arrival, where the vessel has arrived before the documents relative to these goods have been received.

The bank letter of guarantee contained three types of relations namely, the relation of the customer with the beneficiary, the relation of customer with the bank and the relation of the bank with the beneficiary. The relationship of the customer and the beneficiary is governed by the contract or undertaking between them for which the bank guarantee has been issued. The relationship between the bank and the beneficiary is governed by the unconditional obligation undertaken by the latter, except within the limits of the stipulations of the guarantee concerning the objective for the bank guarantee had been issued. The relationship of the bank and beneficiary is governed by the contract or the application presented by the customer applicant to the bank pursuant to which the issue of the bank guarantee was requested. Of all the three foregoing relationships we are only concerned with that which relates to the customer and the bank which will be point for consideration in our further discussion.

The request for the issuance of letter of guarantee is initiated by the client who presents an application stating therein the stipulations which are consistent with the objective specified in the application provided the same is irrevocable by the applicant. In such case the closest legal adoptation to which the above situation would apply is the relationship of an agent with his principal. The irrevocable nature of the letter of guarantee by the principal, who is the applicant, is due to the fact that the stipulations thereof involves the right of the third party who is the beneficiary. This fact is confirmed by the following two things :

(1) Where the applicant wishes to cancel the letter of guarantee before or after the issue and prior to delivery thereof to the beneficiary: his application will be honoured by the bank so long as the right of the beneficiary of the letter of guarantee has not been involved.

(2) When the payment by the bank of the amount stipulated in the letter of guarantee is deemed to be no more than a mere payment of a sum of money upon the request and for the account of the applicant: that the sum so paid is subject to an amicable or judicial accounting between the applicant and the beneficiary, where the latter is not entitled, wholly or partly, thereto.

The actual status of the letter of guarantee is where the beneficiary accepts and takes possession thereof instead of cash deposit. The beneficiary would also insist on keeping the letter of guarantee with him so that he is enabled to exercise such rights, as are stipulated therein, which could have accrued to him from the applicant, as a result of the relationship which existed between both the parties.

As far as the relationship of the bank, which issues the letter of guarantee, and the applicant is concerned that is of principal and agent. The bank's rights of recourse against the applicant for any amount paid on his behalf will not be impaired because, according to the general rule, bank is entitled to have recourse against his customer for such accruals which would have been paid on his behalf. The customer is liable to pay whatsoever sums which were paid by the bank in the ordinary course of performance of the stipulations of the letter of guarantee.

We are now faced with the question what is then the attitude of Islamic jurisprudence in regard to this dealing in the light of the above adoptation.

GUARANTEE IN THE LIGHT OF ISLAMIC JURISPRUDENCE

The Muslim jurists while discussing the "Guarantee", as security, have classified its various forms according to the relative subject financial liability and personal guarantee. The guarantee as financial liability has been defined an undertaking to discharge a debt, on behalf of a third party, and that which is for the delivery of a commodity. At first instance it looks that in most cases where a bank guarantee is used are mostly considered to be within the scope of the debt liability guarantee and does not include the Letter of Guarantee, which is submitted to the shippers or their agents, instead of the documents representing the goods which had been received. In such case the subject of the letter of guarantee is some sort of liability for delivery of the commodity, in this case the bills of lading, because it also involves a liability for the consequence of the delivery of the goods i.e. where it transpires that the receiver of the goods is not the person entitled thereto.

According to Islamic view — a guarantee is "Adding one liability to another liability." However, there is difference as to whether such addition must be restricted to a claim only or must cover the debt also. The author

of "*Al-Hidaya*" said on the subject, "that it is adding liability to another liability in claiming, and it was also said 'in debt', the former is more correct.[114]

Ibn Al-Hamam, the author of "*Fathul-Qadeer*", in his comment has stated "the debt would not be established to be the liability of the guarantor contrary to Ash Shafi'i, Malik and Ahmed[115]..... Then after reviewing the opinions he determined .... but what is chosen is that which we have mentioned, i.e. the liability is just on claiming and not on the debt. Although it is possible under the *Shari'a* to consider both — the debtor and the surety — as being liable on the debt, yet no judgment may be entered of the happening of everything possible except pursuant to a cause and the cause does not exist here, because the confirmation results from the claim.[116]

If we compare the view that the guarantee is the addition of one liability to another liability, in claiming the confirmation thereof, with the actual intended purpose of the letter of guarantee it would be obviously concluded that the explanation of the author of "*Fathul-Qadeer*" is the nearest to the intent lying behind and the reality of a letter of guarantee.

Another juristic opinion conforms to the relationship which exists between the bank issuing the letter of guarantee and the beneficiary is that a bank's obligation is created by an offer made by it although the beneficiary had not expressed his acceptance. This is illustrated by what "Ash-Shalabi" quoted in the commentary of "*Tabyeen Al-Haqa'iq*" where he said .... Abu Yousuf in his final statement did not consider that "the acceptance" is an element. He considered that a personal guarantee of financial liability is consummated by the guarantor alone. This opinion is said to be also the opinion of Malik, Ahmed, and Ash-Shafi'i. They differed in regard to Abu Yousuf's statement to the extent that a guarantee is valid if made by one party only provided the applicant allows it or it may be valid and executory and the applicant is entitled to respond.[117]

The right of recourse which is open to the guarantor against the guaranteed, where the guarantee was issued at the request of the latter, the guarantor is entitled to have recourse against him. Some scholars have gone further and formed the opinion that the right of recourse may be exercised in accordance with the custom or usage and the dealings of both the parties i.e. the guarantor or the guaranteed.

Ibn Al-Murtada, the author of *"Al Bahr Az-Zakhar"* says if "A" requests "guarantee for me" or "pay for me" the addressee is entitled to recourse, but otherwise will not be entitled to recourse, except where both have been dealing with one another repeatedly, or if they are relatives, in which case the recourse is permissible as being preferable rather than being according to the rule.[118]

Regarding timing of guarantee, As-Samarqandi in *"Tuhfat Al-Fuqaha"* said "that the guarantee may be for a definite term or the month, year or otherwise, is not a matter in dispute.[119]

Ibn Jazzi while discussing the matter of the guarantee which is given before or after the incumbence of a right said that: "the guarantee is permissible after the necessity of the right, if spent, as well as prior to necessity, contrary to the explanation of Al-Qadi, Sahnun and Ash-Shafi'i.[120]

The above few opinions taken from various Islamic jurisprudence reveal that the letter of guarantee will, inspite of its several relationships and objectives, find a place within the framework of the fertile jurisprudence of Islam.

Where a bank guarantee is deemed to be on a power of attorney, it does not seem to be in conflict with the view of Islamic jurisprudence on the subject within the framework of the guarantee which is undertaken pursuant to an order, where the guarantor is entitled to recourse against the person who ordered him for the sum so paid, just like an agent who can have recourse against his principal, because of guarantee made pursuant to an order is an authorization to pay.

The above concept of considering the bank guarantee to be a power of attorney may justify that a bank is entitled to receive a fee in consideration of the assignment entrusted to it. The power of attorney may be against a fee and as such will be governed by the rule of rent. This is contrary to the opinion of the jurists in support of the right of the guarantor to charge a fee except that which the Imamites conceived in regard to the permissibility of charging a fee for the guarantee where it is considered to be some kind of remuneration.

BANK ACCEPTANCE

"Bank acceptance" may be defined as another form of the trust lending which is carried out by the banks as intermediary agency between a customer and a third party.

United Kingdom is the birth place of this kind of bank dealing. This type of financial operation was confined to the regional territory where there were finance houses specialized in this kind of dealings, called "Acceptance Houses". During the period when England dominated the trade of the world and the fame of the big England merchants became widespread this form of dealing took its organized framework. The small as well as big traders had to resort to the famous names while dealing with the foreign traders so that they could have their names mentioned on the promissory note made out in favour of the foreign traders. The opportunity was availed very efficiently by the well-known merchants who began these operations of acceptance and charged a certain commission. Later on this business developed into a specialized profession for granting what is known as "Acceptance Credits".[121] With the passage of time Acceptance Credits business was converted into Merchant Banks. The main business of these banks then became the financing of external trade by accepting commercial drawing in favour of the customers.[122]

Bank acceptance means that a bank accepts to be a drawee and as such accept the instrument drawn on it by its customers or such other party with whom the customer deals.[123] When the bill of exchange is accepted by the bank by putting its signature of acceptance it creates the confidence which facilitate the negotiation of the bill of exchange or discounting it at another bank. Where the accepting bank pays the value of the accepted bill of exchange the value thereof is debited to the customers account and the amount paid on the bill deducted from the value of the credit.[124]

It is, therefore, obvious from the foregoing definition and the method of operation that in accepting a bill the bank plays the role of an intermediary and does so upon the request in favour and at the responsibility of the customer of the accepting bank. Therefore, we may consider this operation to be a procuration of power of attorney, with an order to accept the Bill of Exchange drawn on behalf and on account of the customer concerned. As such the bank's acceptance will be similar to the status of the letter of bank guarantee, in regard to the customer's relationship with the bank.

DOCUMENTARY CREDIT

In the international commercial dealing documentary credit plays an important role as a modern means for establishing the links between the importer and the exporter. Its significance becomes more important when it safeguards the interests of both the parties. The banks help the importer and exporter, because of their international relations and their branches which are maintained in various countries, through this method of international dealing which has become available and semi-stable, at least, from the usage point of view. The reason of this is the non-existence of legal regulations for the documentary credit except the rules laid down by the International Chamber of Commerce which are used as the basis of dealing by stipulating them in the opening of documentary letter of credits which are exchanged by banks. We may, therefore, define the documentary credit as follows :

A credit which is opened by the bank at the request of a person, called the applicant, in favour of a customer of said applicant. The method of performance is immaterial, be it by acceptance of the instrument or discharge of the value thereof, provided that it is accommodated for by possession of the documents of the goods which are enroute or ready for despatch.[125]

The other definition of the documentary credit which is more compact is that "it is an undertaking by a bank for discharge or acceptance of the drawings which are presented by the beneficiary of the documentary credit according to the stipulations therein stated.[126]

From the above definitions we may conclude that a documentary credit represents a tripartite link of a relationship whereby the bank performs the role of a trustworthy intermediary which carries out the instructions of its customer and undertake, through the correspondent bank, vis-a-vis the beneficiary who in turn has a relation with the person who initially opened the credit inspite of the fact that their relationship falls outside the scope of the role of the bank in the credit opened through it. As we have discussed previously in regard to business of the same nature. Our interest in this respect is in the tripartite relationship and the legal adoptation of the relations of the opener of the credit with his bank.

Internationally the lawyers have advanced several theories as regards to the nature of documentary credit contract. The result of this attempt was that

each such theory was unable to comprehend separately the diversified sides of the relations of this peculiar method of contracting. It was stated that the contract is based on the theory of agency or power of attorney. It was also said that it is based on stipulating in favour of a third party. Certain court's decisions have interpreted the documentary credit as the guarantee. It was also interpreted that this operation is in accordance with the concept of substitution or reciprocation of will through mediation or the idea of the one-sided will.

The defect in every theory or the concept made to make every theory congenial to the various relations provide the cover and the link of the documentary credit. This is, no doubt is a difficult matter especially because the identities, colours and purposes of these relations are different. The documentary credit takes one side of each theory. It is gathered from the different opinions that it takes from the agency (power of attorney, procuration), the obligation of the principal (applicant for the credit) to repay what has been paid by the agent i.e. bank, in compliance with his request, plus the commission agreed. It carries the stipulation of the interest of a third party, the creation of direct right in favour of the beneficiary, effective from the date of the accord made by the applicant for the credit and the bank. From the substitution it bans adducing the rebuttals which were open to the substitute. From the theory of abstract obligation the independence of the bank's obligation of the contracts of sale which was the cause therefor is taken.[127]

Out of all the versions we are only concerned with the version which is suitable for the adoptation of the relationship of the opener of the credit with his bank.

The bank vis-a-vis the opener of the credit, is that of an agent to his principal. A third party is involved in the operation of documentary credit is the beneficiary. The action of the bank becomes irrevocable except with the consent of the beneficiary. So it is obvious that the theory of agency is, within the limits of adoptation of the relationship of the customer with the bank, suitable to govern the relationship which exists between both parties, regardless whether it relates to the letter of guarantee, acceptance or the documentary credit. The bank by receiving fees for its services has a status of wage-earner. Should all the income of the bank, which have been mentioned above, be deemed to be a wage (fee) resulting from the activities of an agency? We shall, therefore discuss in the following section the element of usury in the income of the casual lending.

USURY IN THE INCOME OF CASUAL LENDING

The income derived by the bank from all the cases mentioned above i.e. letter of guarantee, acceptance and documentary credit may be divided into two kinds as far as usury is concerned.

The first kind is the commission charged by the bank to the customer at the time of issuing letter of guarantee or the acceptance of the amount of negotiable instrument or opening the letter of credit agreed to be accepted by the beneficiary. At this stage of the operation when it begins there is no debt therefore there will be no cause for the bank to charge any interest to the customer in such cases. That is what happens in the actual practice in the business where the bank does not charge any interest so long as the bank does not give a loan.

The second kind of income is the interest and the supplementary commission charged by the bank to the customer. This happens when the bank has paid any amount on behalf of the customer, regardless whether it is a letter of guarantee, an acceptance of bill of exchange or a documentary letter of credit opened by the bank, and the funds in the account of the customer are insufficient to cover has liability to the bank. Here the customer will become indebted to the bank and interest will be computed on daily basis, in some cases a certain percentage of commission is added to the interest (overdue commission) pursuant to the agreement and according to the arrangements practised by the bank in its dealings.

There is no doubt, whatever form or nomenclature may be the interest, commission or any additional amount, shall be usury where the cause of its accrual is related to the existence of the debt because it is a sum which is charged in excess to the maturing debt. It would be irrelevant to consider whether it is a lump sum charged by the bank one time only when the contract of the intended debt is executed or the negotiable instrument is discounted. The reason for this being that the fee (wage) for preparing the formality had been collected at the time of signing the document. Thus the interest and commission which is charged subsequently would satisfy the full description and elements of usury.

So far the matter has been very clear and we do not find any difficulty to understand the two kinds of income generated by the operations connected with the usury of letter of guarantee, acceptance and documentary letter of

credit. The element of usury involved had also not been a matter of dispute in such operation. But while examining the practical facts of the matter we are, yet, faced with a situation where the bank does not in practice bear any additional charges on account of payment of the value of claims or documents presented against the documentary credits opened, or the claims received in regard to the letter of guarantee and the accepted bills of exchange. The reason is that banks collect, in most cases, a cash deposit (margin) averaging from 5% to 100% as in the case of certain type of documentary credit, letter of guarantee and such deposits are kept by the bank until the operation is completed. Such deposits sometimes are constantly increased by payments arising from the continuity of the operations. It has, therefore, been noticed that insofar as documentary credits are concerned, which are mostly the subject of definite claims, the total unpaid values of the bills of lading are mostly equal to the total deposits effected by the customers. This means that the customers provide automatically the resources of their indebtedness with their own funds. The bank is, therefore, neither entitled to interest nor to commission for or in consideration of lending the bank may demand the increase in cash margin which it maintains so that it will not have to resort to use its own funds where the claim exceeds the normal level. Such operations neither call for nor necessitate usury or that which may be suspected to be usury. By determining that a bank is not entitled to charge interest, the interest of the people will not be disrupted.

As regards to the commission charged at the time the operation is initiated the absence of the element of debt helps to free the commission charged from the bondage of usury. Such a situation will have to be viewed from a different angle i.e. what is the consideration of this commission which is considered to be a fee (wage, rental) for the work done in consideration of an advantage.

The liability of the bank, in such case, to charge commission, is presumed to be a fee based on the work done by the bank which represent rise vis-a-vis the customer, a valuable intended advantage.

Whereas the vast scope of Islamic jurisprudence allowed for some jurists to argue that the listening to the singing of nightingale and the enjoyment of looking at the beauty of peacock are all intended valuable advantage, it would seem more appropriate to consider the advantage which a customer would obtain from a letter of guarantee, the acceptance of bill of exchange and the opening of a documentary credit.

Were it not for the letter of guarantee which is made available to him a contractor would not have had the opportunity to bid for and be awarded a contract. Were the banks not to accept a bill of exchange on behalf of a trader, he would not be able to consummate a commercial transaction with a third party who is far away from his place. Similarly an importer would not, without the intervention of a bank which opened a documentary credit in his favour, be able to import goods from overseas while sitting in his office in Karachi or London. All these advantages are intended valuable and valid, as such, are more acceptable and reasonable.

As regards to the duplication of the commission charged by the bank on letter of guarantee and documentary credits for fixed terms, say for each three months or fraction thereof — regardless of whether or not such duplication gives the commission an imprint of usury. The answer to this is represented in tracing back the matter to the fundamental point which we adopted from the very beginning i.e. that which must be considered, in the absence of lending, is the availability of an advantage which is a consideration for fee, or the availability of work. These two elements are present in the above-mentioned three cases.

A contractor, for example, has an interest in and obtains an advantage from the continued validity of the letter of bank guarantee, because where the bank fails to extend the validity term of the letter issued in favour of the contractor's transaction, the party which entered into contract with said contractor would have to suspend dealing with him. The same thing applies to a documentary credit where, for instance, the bank fails to extend the term of the credit, which has not been used by the beneficiary within the first three months, the importer will lose the transaction and would then be unable to complete the operation because the term of the credit has expired. Besides the foregoing, the bank does work in case of extension as it has to correspond, most entries in its books and otherwise.

From the above discussion it is concluded that debts usury is present *ab initio* in the banking business, where a debt has actually been incurred, where the operation is free of any debt, the criterion of entitlement to fee would be the validity of the advantage and its recurrence when charging the wage (fee, rental) is duplicated. The computation and method of computing the wage (fee, rental), if free of usury, would be based on the usage, provided it does not involve an unknown which leads to a dispute.

Chapter 6

MUDARABA - ITS SUITABILITY FOR COLLECTIVE INVESTMENT

....Relation of the depositors with the bank, that they have - as a group, not individuals - are deemed to be financiers and the bank to be absolute active partner in Mudaraba, which is entitled to appoint a third party to act for it in the investment of the depositor's monies, and in regard to realization and distribution of the annual profits, in every financial year or a shorter term, where the banking usage reckons a shorter term than one year, the bank must carry out a comprehensive settlement of the profits and losses of the investment enterprises in which the deposited monies and some of the monies of the bank's share-holders had been invested; the bank shall then deduct from the balance remaining its general expenses and the remainder will be shared by the bank and the depositors....

Professor Mohammad Al Arabi;
"Bank Dealings and the Opinions of Islam on them"
PP. 79-123, 1965

ORIGIN AND EVIDENCE OF LEGALITY OF MUDARABA

During the pre-Islamic and Islamic era the Mudaraba was known to the people for the investment of funds by entering into a contract whereby one party provides the money to another party who invests it against a share of the profit resulting thereof. The dealings in Mudaraba were based on the bilateral contract, between the parties thereto, regardless of whether either of the parties was one or more than one individuals. That might be the reason that we do not find in the books of jurisprudence enough material on the investment of funds as collective form of Mudaraba with multilateral resources and the various investments. We shall, therefore, try as much as possible to familiarise ourselves with this kind of contract, as it was known to the Islamic jurisprudence, by defining it, elucidating the elements and reality thereof. Our endeavour will be to judge the extent of the suitability of this method for the regulation of collective investment according to such form which brings us nearer to the form of modern banking investment.

As we have already explained that Mudaraba is an agreement between two parties whereby one party provides money to other party for investing it mostly in trade. The profit being a common share thereof in general what is the origin of this contract, what is the proof of its legality and the elements which had been determined by the jurists for its validity, will be the subject of our discussion in the following section.

Mudaraba, as a word, is a noun derived from the word strike (Daraba) on the ground, meaning walking thereon. That is the base for naming this contract "Mudaraba" because active partner *Mudharib* (Commendit) goes out trading with the aim of earning profit.[128] From the juristic study it is also concluded that this nomenclature was given because each of the parties seeks a share of the profit or because it involves trading in and the change of the property.[129] He who provides the property is called capitalist (Financier, Commenditaire) and the manager, the investor thereof, is called the active partner *"Mudharib"*.[130]

The use of Mudaraba was common among the Hanafis, Humbalis and Zaydiya,[131] but the Malikis and Shafi'is[132] call this contract *"Qirdh"* which according to the book *"Nihayat Al-Muhtaj"* is derived from *"Qaradha"* (Gnaw), which is cut off, because the proprietor cuts a price of his property

to the active partner (Operator) to dispose of it as he wishes against a piece of the profit.[133] It was also said that it is derived from "*Qard*" with return of the good or bad *(Muqarada)* that is equality i.e. taking equal parts of the profit, or because the property comes from the proprietor and the work from the active partner.[134] According to Ibn Al-Murtada the owner of the property (Commenditaire) is called "*Al-Muqarid*" (the cutter) and the active partner is called "*Al-Muqarad*" (the taker of the piece).[135]

The origin of dealings on this contract dates back to the pre-Islamic era. Ibn-Hisham has reported in the biograph of the Prophet (PBUH) that he left for Damascus carrying property belonging to Mrs. Khadigea which he took in Mudaraba, [136] that was before his mission. During the life time of the Prophet (PBUH) the Muslims used this kind of contract. The evidence being what has been narrated from Al-Abbas b. Abdul Muttalib that when "he used to give property in Mudaraba, he stipulated on the recipient not to travel with the property by sea, nor to cross a valley or to purchase with it live animals and if he did he shall be held liable. Al-Abbas referred to Prophet (PBUH) seeking his opinion, the Prophet (PBUH) allowed it.[137] Ash-Shukani has stated that the dealing in Mudaraba continued during the time of *Sahaba* (Companions). He has cited what Al-Imam Ash-Shafi'i reported in the book "The difference of the Iraqia" quoting the Caliph Omer Ben Khattab (R.A.) as saying he had given the property of an orphan in Mudaraba.[138] In "*Al-Musannaf*" (literary work) what Iman Ali (R.A.) said in regard to Mudaraba that "the loss will be suffered by the property and the profit shall be according to the agreement."[139] This statement of Iman Ali (R.A.) has been cited by some Hanafi writing on jurisprudence as Hadith of the Prophet (PBUH) which states "The profit as stipulated and the loss to be borne by the property owners." This is reported in "*Al-Hidaya*"[140] and in "*Tabyeen Al-Haqa'iq*".[141] The author of "*Naasah Ar-Raya*" said this Hadith I said it is very strange: it is contained in some books of the Companions, attributed to Iman Ali (R.A.). Other Muslim jurists like Jamaluddin Az-Zayla'i[142] and Kamal b. Al-Homam[143] have stated in their books that this Hadith cited in *Al-Hidaya* was not identified in the Hadith books and some Sheikhs attributed it to Ali b. Abu Talib (R.A.).

Investigations have, however, revealed that neither the Quran nor the *Sunnah* contains a stipulation on the Mudaraba contract which explains the intention and elements thereof. All that is known about it is that it was a form of dealing among the people of pre-Islamic era which survived after

their conversion into Islam and the Prophet (PBUH) did not ban nor imposed any restriction on this kind of dealing rather approved the relevant stipulations that had been referred to him, which Al-Abbas b. Abdul Muttalib used to place on the recipient of the property for being used in the Mudaraba.

In the light of what has been mentioned, one of the best statements worthy of consideration, in regard to legitimacy of this contract is the preponderant opinion which attributes the proof of the legality of Mudaraba to the consensus of the *Sahaba* which can be inferred from their dealing in it without any denial by them nor by their followers.[144] This consensus is based on the silence acknowledgement *Sunnah*, because the Prophet (PBUH) was aware of and acknowledged it.[145] This assumption is based on the fact that He (PBUH) lived his life in Mekka, the centre of trade at that time, until the emigration (Hijra) and that prior to the prophecy he himself practised Mudaraba trading.

As regard to the consensus of the interpreters as cited in "*Ar-Rawd An-Nadheer*", Ibn Hazm has stated that 'All chapters of jurisprudence have an origin in the Quran and the *Sunnah* but "gnawing" (the Mudaraba) for which we were unable to find any origin therein. But it is a valid absolute consensus of the interpreters. We are positive that it prevailed in the era of the Prophet (PBUH), who was aware of and acknowledged it."[146] Ibn Qudama expressing his opinion on the consensus of interpreters said : "Scholars were unanimous about the permissibility of Mudaraba in general — this was mentioned by Ibn Al-Munthir.[147]

The author of "*Al-Bada'i*" has indicated that the permissibility of Mudaraba is inferred from God's saying "And others travel in the land seeking from God's bounty (verse 20 of Surat al-Muzammil).[148] This is unknown talk because travel in the land meaning to endeavour and seek God's bounty is not confined to the case of a person who goes out trading with his own property.[149] All the foregoing lead us to determine an essential fact having important affects on this issue, namely, all matters discussed by jurists in regard to this contract, regardless of whether they agreed or deferred are built on opinions of independent judgments which have been determined or discovered in the light of what had been known about the dealings prevailing among the people during the life time of the Prophet (PBUH) as well as in the life time of his *Sahaba* after him, and followers.

It would, therefore, not be queer that a Mudaraba, the elements of which had been determined, bears this imprint of independent judgment which is based in a source stipulate neither in Quran nor in *Sunnah*, which has been narrated precisely.

COMPONENTS OF MUDARABA

The author of "*Tuhfat Al-Fuqaha*" has mentioned two main components of Mudaraba, viz : Capital and Profit. While elaborating the above two components he says that the capital must be an absolute price and profit must be a common part to all. There should be severance of the financier's relation with the capital. The amount of profit should be notified.[150] We shall, therefore, talk about the conditions of each of the said components in the following paragraphs.

The conditions relative to the capital of a Mudaraba may be summarized as follows :

The first condition of capital is that is must be in cash. If it is other than cash, such as goods for example, the jurist differed as to whether it is permissible to be a component of Mudaraba. Al-Kassani while explaining this condition says that according to all scholars the capital of Mudaraba must be in Dirhams or Dinars i.e. in cash.[151] Professor Shaikh Ali Al-Khafif elucidates this matter by saying that "The capital of Mudaraba must be the property which validates and concludes the deed of partnership, thus the capital must be minted gold or silver or more correctly currency. A Mudaraba may not be formed where the contribution of capital is a real property or movable, even where the latter is fungible.[152]

The author of "*Tabyeen Al-Haqa'iq*", mentioned that Ibn Ali Layla conceived "A Mudaraba in weighables and measurables is valid", because they are fungibles as the capital may be assessed with the similar or that which has been received.[153] He has further commented on the capital of a Mudaraba by contributing goods saying that capital of Mudaraba with contribution other than coin (currency) yields profit of an unwarrantable, because it is trust in the hands of the active partner and its value may appreciate after the contract. If he sells on the basis of sharing profit, which is realized of what he had not guaranteed where the active partner is entitled to his share without having guaranteed anything, unlike the coins for which he becomes liable as soon as they are paid for purchase.[154]

The author of *"Bidayat Al-Mujtahid"* has advanced the argument of the advocates of the validity of contributing goods as capital of Mudaraba as such contribution is to be considered to be some sort of risk, because the active partner receives the goods of a certain value but when they are returned, the value might be otherwise and thus the capital as well as the profit would be unknown.[155]

Whatever the case may be, this matter does not carry much importance in modern time, especially, in regard to the object we are discussing because dealing in currency is common among people and is the sole thing in regard to bank investment of currency deposits.

The second condition is that the capital must be a liability debt on the active partner. The intention of this condition is that at the commencement of the partnership the creditor must not tell the debtor that you owe me the sum in trade. "Al-Kassani" says that where a creditor says to the debtor "work with the debt you owe me, in Mudaraba against one half (of the profit), this Mudaraba is without dispute null and void.[156] According to Abu Hanifa if the debtor acts on these instructions this liability of the debt remains unchanged, he will be entitled to the profit and suffer the loss. Abu Yousuf and Mohammad consider that what is purchased and sold by the debtor will be for the owner of the money who will be entitled to the profit and suffer the loss. Al-Kassani explained that the difference between Abu Hanifa and his two friends is due to the fact that according to Abu Hanifa, a man may not appoint another to buy for him with the sum of the debt due from such agents, where the order to buy with a debt owing is invalid, the addition of the Mudaraba is consequently invalid. The agency is valid but not the Mudaraba.[157] Ibn Rushd has interpreted the above difference in the matter of appointing a man to receive a debt from another and then after the receipt of the debt to invest it in Mudaraba, he said..... they differed on the matter where "A" orders "B" to receive a debt owing to him from "C" and to invest it for trading in Mudaraba. Malik and his friends considered this impermissible because he considered that such action has increased the cost of active partner i.e. the cost of collection and this, according to its origin,is that he who stipulates an additional advantage to the "gnawing" is null.[158] He then cited the proof of the jurist who made the same permissible and said that he had considered that the owner of the money appointed the person ordered "B" to receive the money but did not make it a condition thereof.[159]

Al-Kassani has discussed the investment of the deposit in Mudaraba where a depositor tells the depository of his money "Invest what you have in your custody in Mudaraba on the basis of one half and said there is no dispute that this is permissible.[160] He went even further and said it is permissible where "X" gives "Y" a sum of money half of which is a deposit in hand of the active partner and the other half is to be invested in Mudaraba against one half of the profit, saying..... the money in custody of the active partner is as directed, because the deposit and Mudaraba money are a trust and thus do not conflict.[161]

The point discussed by Al-Kassani as above is deemed to be of great importance in regard to investment according to the banking system, in that the variation of the investment accounts according to the percentage of what is permitted to be account as deposit to meet cases of emergency withdrawals from the account.

The third condition is the capital must be definite (known). The contract will not be valid if the sum of the capital has been determined.[162] The intention in such case is the determination (identification) of the money to be used in Mudaraba, because the money paid will, on liquidation of the Mudaraba, have to be refunded, if it is not definite (known) a dispute may arise.

The fourth condition is that the money must be delivered to the active partner. The Mudaraba shall not be valid if the money remains with the dormant partner.[163] The intention lying behind delivery is either payment by handing over and taking over or enabling the active partner to take possession thereof.

All the above four conditions are not strange to the modern society which depend on currency in their dealings and negotiations. These conditions seem, furthermore, to be in harmony with the banking system investment which is based on deposit taking for investment purposes.

CONDITIONS RELATIVE TO PROFIT

There are two basic points around which revolve the conditions relevant to Mudaraba profit:

(1) The amount of profit must be definite (known).

(2) The profit is a common part of the total.

The first condition that the amount of profit must be definite means that the part of the profit, at least, which devolves to the active partner must be stated. Such clarification is deemed to be adequate to eliminate the ignorance which leads to dispute. Suppose the dormant partner tells the active partner "You will have one third of the profit. This naturally would mean that the financing party will take two third of the profit. As advocated by As-Samarqandi where the amount of profit is not known the ignorance necessitates the nullification of the contract, because every condition which makes the profit unknown nullifies the Mudaraba.[164]

According to Al-Kassani such determinability needs not necessarily be by explicit words. It would be enough if the same can be informed from the context. For example, where a dormant partner pays to the active partner one thousand Dirhams, provided both the parties will participate in the profits even when the sum thereof has not been specified, the Mudaraba is valid and the profit will be shared equally because a partnership necessitates equality.[165] In this case it is assumed that the payer's authorization of profit is a statement of its quantity in this respect.

The Mudaraba becomes invalid unless the profit is a common part thereof and not a specified sum. The author of *"Tabyeen Al-Haqa'iq"* has stated that this point rest on the basis that the partnership is realized thereby. But where specified amount has been stipulated for either party the partnership is null and void. Because such stipulation invalidates the partnership due to the assessment that the profit does not exceed the sum stipulated.[166] In the course of our discussions about the specific stipulation of the profit a point worthy of consideration arises whether the share of the profit which devolves to each party to a Mudaraba will be profit accrue to the parties alone without involving a third party in the profit inspite of their agreement in this regard. Will it be permissible for them to agree on allocating a share of the profit to a party or person who is not related in any way to the partnership? To elaborate the point further, suppose the dormant partner said to the active partner "I contribute Rs. 100/- in Mudaraba provided half of the profit is paid to me and you take one third and the remaining balance is paid to "X". What would be rule in regard to the distribution of the profit?

There are different opinions of the jurists on this issue. Some of the schools of thought considered that profit must be allocated to the contracting parties only, while others argue the possibility of including a third party in the profit so long as the profit has been specified is a common share for each contracting party.

Ar-Ramli in "*Nihayat Al-Muhtaj*" has maintained that in a Mudaraba the profit must be allocated to its parties only. Therefore, it is forbidden to stipulate part of the profit to a third party except where it is stipulated that such third party must participate in the work with the active partner.[167] It is reported in "Fath Al-Aziz" that it is a condition that profit must be allocated to the contracting parties.... where some of the profit has been stipulated for a third party, for example, where a dormant partner says "One third is for you, one third for me and one third thereof for my wife, sister, or mother the Mudaraba is not valid because such third party is neither active nor the owner of the money. But where the dormant partner stipulates that such third party must work with the active partner, in such case it would be Mudaraba with two persons.[168] Ibn Hazm in "*Al-Muhalla*" has argued that stipulating a part of the profit to "X" is not permissible because it is a stipulation that does not figure in the Holy Book and thus it is null and void.[169] The Maliki school of thought do not consider that the whole of profit must be divided among the contracting parties and no other party should share it. It is, however, permissible to allocate a share of the profit to a specified party or to persons other than the contracting parties.

According to the interpretation of Al-Khurashi, "It is permissible to stipulate that all the profit of the Mudaraba money goes to the financier (dormant partner), the active partner or otherwise. Because this would be a kind of donation and to call it Mudaraba would be figurative.... both of them must discharge such stipulation, provided the beneficiary has been designated. It was said that the abstaining obligee will be adjudged to pay[170].... It is obvious that where it is permissible to stipulate the whole profit to a third party it would be more so if part thereof is stipulated.

Ibn Al-Murtada in his book "*Al-Bahr Az-Zakhar*" has differentiated between whether the stipulation is in regard to some of the whole absolute profit or is fixed to be from the share of either contracting party, where he said :

".... Where the contract stipulates some of the profit to an outsider, the Mudaraba is null, where such outsider contributes neither money nor work, except where he is slave of the owner (dormant partner) in which case he owns what his master owns .... but if the owner (of the money) on the active partner stipulates some of his share in his property, which he may dispose as he pleases. But where the owner stipulates that such share be payable by the active partner, the partnership should be void for foregoing reason.[171]

Jaffar ben Al-Hassan ben Said Al-Hazli, alias Al-Muhaqqi Al-Hilli in his book *"Shara'i Al-Islam Fi Al-Fiqh Jaffaria"* forward the argument of the validity of stipulating a part of the profit of a Mudaraba is another aspect of the Imamitees, which shows the content of the *Shari'a* of Islam.[172]

In *"Sharh An Nil"* Ibadhiyya allow the stipulation of one third of the profit to the dormant partner, one third to a party as a gift and donation. It is immaterial whether the stipulation is made by the active partner and allowed by the dormant partner or by the dormant partner and allowed by the active partner or whether it was stipulated by both the active and dormant partners or where a third party mentioned it to them and they allowed it. The rule is the same in all the above such cases.[173]

It concludes from the argument which restricts the profit to the contracting parties — even though they have agreed to give a share to another or a third party — involves an unreasonable restriction, so long as the share of each of the active and dormant partner has been determined. Inspite of all the differences the juristic horizon has provided a vast canvas which eliminate the tightness and leave the door open for the investigator to choose from all these opinions — all of which are from the legacy of Islam — that which suits the situation.

THE SCOPE OF MUDARABA

The jurists have got different opinions about the nature of the Mudaraba and its classification within the scope of the contracts. Some jurists considered it to be the same kind as rent and on the strength that argued that it is contrary to the criterion because the rental (wages, fee, remuneration) thereof is not definite. This argument is based on the consideration that the active partner of the Mudaraba does not know the wages (fee, rental) he will receive, not to say that he will not get any, due to the fact that the profit has not been realized. Other jurists considered Mudaraba to be a kind of partnership and as such it is not contrary to the criterion. There are different views also as to the coverage of the work of the active partner of a Mudaraba. Whether it is confined to trading and related activities only. Does it extend beyond that as to cover such activities which would realize the intended objectives, even where the same is achieved through manufacturing of the commodities or otherwise. In the following sections, we shall discuss these two viewpoints:

NATURE OF A MUDARABA

Most of the jurists of the various schools of thoughts (Madhaheb) were inclined to consider Mudaraba a kind of a cumulative contract just the same like rent (lease). They argued that the indefinitiveness of the wages (fee) renders such contract to be otherwise than the criterion. Their circle of discussion was, therefore, narrowed and they failed to go deeper and confined themselves to such arguments which were similar to Mudaraba.

The other group, which is a minority, considered Mudaraba to be a kind of partnership and that if Mudaraba carries the meaning of rent (hire) it would be considered to be lease in the general sense of the word as stated by Sheikh Al-Islam Ibn Taymiyya.[174] This group of jurists considered that agreements similar to Mudaraba were valid and permissible. In doing so they are more liberal in their views and in a better position to enable them to be benefited from the *Shari'a* of Islam.

It will be most proper at this stage if we hereinafter cited captions which reveals the point of view of both these people with some brevity but without prejudice to what is intended.

Al-Kassani argued that when put to the test, according to the criterion, a Mudaraba contract would not be permissible because it is a lease in consideration of an indefinite, say non-existent wage (fee) and for an indefinite work. But we have abandoned the criterion by the Holy Book, the *Sunnah* and consensus.[175]

Ibn Rushd (the grand-son) says that "gnawing" .... is excluded from the indefinite lease (rent) and that the licence (permission) for that is to be kind (to prevent cruelty) to mankind.[176]

"At-Tawdih" mentions that "gnawing" is excluded from the indefinite lease (rent) and from advances against an advantage.[177]

Ar-Ramli said, the "gnawing" is a licence for its exclusion from the criterion of lease (rents), as well as from the sale of that which has not been born.[178]

Inspite of the differences of the schools of thought, which are generally similar, we find that the jurists of Ahmad's school of thought are in contrast with this trend. These jurists have thought another criterion for this issue.

They consider Mudaraba to be a kind of participation (partnership) and not that of commutative contracts. Consequently this contract would not be an exception of the criterion.

While considering the issue Ibn Taymiyya determined the Mudaraba and similar contracts such as *"Musaqat"* and *"Al-Muzara'a"* to be a kind of participation (partnership) or commutative contracts, he said in this regard: "He who said Mudaraba is a lease in the general or more general is correct and who said it is a lease in the specific sense only is wrong."[179]

After discussing the Hadiths narrated in regard to *"Al-Muzara'a"* and *"Al-Musaqat"*, he concluded that both are permissible, assuming them to be a kind of partnership, he then went on to uncover the whole issue. In the conclusion of the discussion on the general and specific of the word lease, where he said, "that was why Imam Ahmad allowed (validated) all kinds of participations (partnerships) which are similar to *"Al-Muzara'a"* and *"Al-Musaqat"*, just like where a man gives his riding animal or vessel to another person to use it for sharing the rental.[180] He assumed that such contracts are, in the more general sense, a kind of lease.

Ibn Al-Qayyem has also agreed with the point of view of his Sheikh Ibn Taymiyya who conceived that the *Shari'a* does not contain an order which is an exception to the criterion. He explained that those who argued that Mudaraba and similar contracts are an exception to the criterion have thought that these contracts are of the same class as lease that the consideration and payer thereof must be definite. So when they saw that worth and profit in said contract are indefinite, they said, "they are an exception to the criterion". This is one of the mistakes. These contracts are a kind of participation (partnership) and not of the class of pure commutative contracts where the consideration and payer thereof must be definite. Participations are a different class to commutative contracts, although they contain a blend of commutative contract.[181] He has further differentiated the kind of work which we quote hereunder because of its importance and excellent precision in defining the various cases. He said the work is of three kinds namely:

(1) Work must be intended, definite and capable being delivered. This is legally binding lease.

(2) Work must be intended but is indefinite or hazardous. This is the wage (remuneration).

(3) Where the work is not intended but the intention is directed at property (money), which is the Mudaraba. The dormant partner is not interested in the work of the active partner, like person who hire a wage-earner for the work to be done for him.[182]

In the light of this distinctive permissiveness in Imam Ahmad's school of thought in the field of contracts and conditions, the Hambali jurists rectified many cases of contracts which they considered to be permissible partnerships. While other jurists were unable to match with them because of their reserved view of considering Mudaraba itself to be an exception to the rule (origin) which constrained them to conceive the impermissibility.

Professor Sheikh Mohammad Jawad Mughniyya in his book on the Jurisprudence of Imam Jaffar As-Sadiq has dealt with the matter of participation in consideration for a share of what is obtained from the work on a capital asset. He considered such agreement permissible thus taking a different view to that adopted by the jurists of the Imamite school of thought. He has cited an example of a contemporary fact where a man has motor car and he delivers that motor car to a driver to carry fare paying passengers and what the driver gets as a result of that will be divided among them equally or otherwise: Would such partnership be valid? Professor Sheikh Mughniyya said on this issue: "The jurist of Imami school of thought have agreed, as stated in *"Miftah Al-Karama"* that the partnership cited in the above-mentioned example is null and void. It would be valid if both the partners — not one — contributed money. This agreement is not a Mudaraba nor a lease (rent) or wage because the wage (fee, rental) is not definite.[183]

He has, however, later commented on what had been cited by the jurists of the Imamite school and expounded his views on the matter saying: "in fact this agreement is valid and permissible. It is not necessary that it should conform to a specific contract, such as partnership, lease and wage, as the mutual agreement could be sufficient, provided there is no legal impediment by the *Shari'a* or reason. The indefiniteness of the wages of the driver does not constitute an impediment to validity so long as to wage, in practice, is definite where the partners would finally be able to know the amount and kind of the wage after the work has been done.[184]

Whatever the opinion of the different school of thought may be one thing revealed to us clearly that is the concept of the jurists of the school of Ahmad Ben Hambal regarding the reality of Mudaraba and that it is a kind

of participations, rectification of many agreements, regardless of whether or not they are called Mudaraba. We have no alternative but the recompense to those who offered to this jurisprudence regardless of whatever they concurred or differed.

However, the thing which attracts attention is that the spirit of wealth and vastness have — within the scope of dealings and agreements — is still predominant in the school of thought of Imam Ahmad, who is considered to be among the jurists of the school of Al-Hadith which denotes that the inhaling of the breeze of *Sunnah* has enabled this Imam, who is an adherent to tradition, to know the door which other jurists were unable to reach, inspite of the fact all of them obtained their information from the same source.

THE WORK COVERED BY MUDARABA

It is gathered from the opinions of the various schools of thought that the general trend was that Mudaraba is work specific to the field of trading, where no professional works may be included, for example, tailoring cloth into shirts and sale through for sharing of the resulting profit as stipulated or the smithery of gold into jewellery for sale and other similar joint work which combines work on the thing and trading it in sale with the intent to derive profit.

Inspite of the existence of this dominant trend the matter was not devoid of glimpses of reprieve which radiated this time from the horizon of the Maliki school which also inhaled the aroma of the *Sunnah* in the vicinity of Al-Madina Al-Munawara.

Having gone through the concepts of various jurists, advocates of both restrictions and tolerance, we have taken the statement therefrom for our further discussion of the subject. We shall also not ignore that the affluence which is a clear title in this permissive *Shari'a* call upon us to tackle matters in a spirit of openness and reassurance as regard to the doors of tolerance which are the yield of eminent Imams. Whatever has been chosen from the ingenuity of these minds is meant for the guidance of the Muslim nation to enable to retain the splendour of a bride inspite of the sanctity of ages.

In the subsequent paragraphs our focus will be what did those choosen ones of human race conceive about the work involved in a Mudaraba?

To start with it would be better to differentiate between absolute and restricted Mudaraba. Where it is absolute the active partner may dispose of the Mudaraba property as he pleases in the various kinds of trading. As-Samarqandi, author of "*Tuhfat Al-Fuqaha*", said: "in the restricted Mudaraba the active partner must observe the restrictions imposed by the dormant partner, in regard to the place of work, kind of trade or other things which do not fall within the scope of the restriction which is prejudicial to what is intended.[185] The absolute Mudaraba is, in fact, inspite of what the nomenclature may be, confined to the commercial field.[186]

This is obvious from what Al-Mirghinani has reported where he stipulates .... if absolute Mudaraba is valid, the active partner may sell, buy, appoint an agent, travel, trade in and deposit, to make the contract absolute, the intent being to obtain profit which is not realizable except by trading. A contract is valid in regard to the various kinds of trade and activities of traders.[187]

While explaining the work intended to be performed in a Mudaraba and that it is confined to trading, which aims at realizing profit through sale and purchase and not from the trade or occupation, Ar-Rafi said .... where "A" lends "B" in Mudaraba to buy, grind and make bread of wheat, the food to cook and sell, and profit is shared by them the contract is null .... he further went on to orientate towards what the *Sahaba* conceived, saying that .... cooking, making bread and similar controlled work may be done by hired personnel will eliminate "gnawing". The gnawing is that which do not require labour to do it, which is trading, the amount of which can not be controlled and the need presses for entering into a contract in respect thereof where the indefiniteness of the two considerations is tolerable on ground of necessity. The same criterion applies where the financier (dormant partner) stipulates that the active partner must buy yarn to be woven or the cloth to be dyed ... among the form of null Mudaraba is : where the financier (dormant partner) lent money to the active partner to buy palm trees, animals of drought or that which yields crops and hold them for their fruits, yield or crops and the benefits shall be shared by them, this contract is null. The reason being that this contract is not an anticipation of profit through trading. The trading is disposal through sale and purchase and these benefits result without need for money and not through its disposal.[188]

Ibn Al-Murtada has also mentioned that a Mudaraba shall be null and void where it involves a combination of work and trading, such as where a financier gives the active partner money to buy cereals which he has to grind and make into bread, because this is not deemed to be work for "gnawing", even where the active partner has acted in this manner of his own accord without a stipulation. The contract is also void where the profit has been realized from work and trading and the shares have not been identified.[189]

Against this confinement and restriction, we find in the vastness of the jurisprudence of Imam Malik where the radiation of tolerance is in its clear cut form. Malik Ben Anas has elaborated the subject matter further in the form of questions and answers and conclude that if a man pays money for "gnawing", with which he bought or hired land and planted a crop thereon from which he makes profit or sustain loss, will be not an aggressor (acted *ultra vires*). The reply to this question is yes, unless he had risked the money in a wrong place. But if he had used the money justly and with due care he will not be liable. In, yet, another question he said: what about if the money is given "gnawing' which is used for "*Al-Musaqat*", i.e. plantation of palm trees is undertaken for a share of the profit, the money is spent on the trees from the gnawing money. Will it be an act of aggression or will it be deemed to be "gnawing"? In reply to this question he said: I have not heard from Malik on the subject and I do not consider it to be an act of aggression rather I see it to be similar to sowing.[190]

If the clear examples which are cited in "*Al-Mudawana Al-Kubra*" in regard to Maliki school of thought are coupled with the cases already cited by us concerning the kinds of Mudaraba, which according to Hambalis, are permissible in the field of industry and in the transportation sector it would seem obvious that the investment of the Mudaraba money need not be confined to trading so long as the intention lying behind the Mudaraba is to derive profit, which may be realized by any other means, beside trading, such as in industry, agriculture and other known form of economic activity. There seems no acceptable justification which necessitates the confinement of all the investment activities which may be more urgently needed by the nation for the benefit of the common masses and the country.

There is another point of difference in the opinions relating to the restriction and the tolerance concerning the coverage of the investment (work) in Mudaraba. The question is whether an active partner may give

the money (property) of the Mudaraba to another person also in Mudaraba. Some of the jurists argued that it is absolutely permissible, provided that the dormant partner gave his consent. They maintained that the first active partner would be entitled to his share of profit which is the difference between what was stipulated for him and that which he stipulated to his active partner. Other jurists argued permissibility with a proviso that the first active partner would not be entitled to any part of the profit. Still others considered such act impermissible because it would be outside the scope of the contract where an active partner gives the money also in Mudaraba to a third party.

The absolute permissibility was advocated by Hanafis but with the condition that the consent of the owner of the money is obtained. Al-Kassani has reported that if the financier authorizes the active partner to use his discretion he may give the Mudaraba money to third party in Mudaraba also because the owner of the money vested him the discretion. Therefore, the active partner may legitimately do so if he considers the same expedient.[191] The matter of sharing the profit has also been dealt by other jurists. They have distinguished the case where a financier does not attach any conditions to the division from that where he assigns it to the active partners. If the financier fails to attach any conditions to the sharing of the profit, and does not assign it to the active partner "A", who gave the money to another "B" stipulating one third of the profit to "B", having made a profit, "B" will be entitled to one third of the whole profit. One half goes to the financier (dormant partner) and one sixth thereof goes to "A", who would be entitled to this share of the profit. The reason of this sharing is that "B" invested the money on behalf of "A" and thus "A" may be deemed as having invested the money himself.[192]

Al-Mughni has argued restricting the permissibility of giving the Mudaraba money to a third party, even though it be with the permission of the owner of the money, is relevant to the issue of the profit, he has stated :

> "Where the owner of the money allows the giving of the money in Mudaraba it would be valid. Imam Ahmad stipulated this and we are not aware of any deviation on this issue. The first active partner shall, in such case, be deemed to be the agent of the financier. It would be valid if he gives the Mudaraba money to a third party without stipulating any share of profit for himself because he contributed neither money nor work in order to be entitled to profit, one of these elements must be satisfied.[193]

Al-Muhaqqiq Al-Hilli has interpreted that if a Mudaraba (active) partner "A" gives the Mudaraba money to another "B" with the approval of the money owner and stipulated that the profit be shared by the second active partner "B" and the owner the contract would be valid. But if "A" stipulates part of the profit for himself the contract would not be valid because he did not work.[194]

The Shafi'is have two arguments on this issue. The more correct being the non-permissibility. Ar-Ramli has stated that it would be more correct to say that where an active partner gives the Mudaraba money to a third party in Mudaraba it would be permissible, even though the owner's permission has been obtained because giving in Mudaraba is an exception to the criterion in order to be valid. A Mudaraba partnership contract must involve two parties i.e. one who is owner with no work and the other one the active partner (worker or more than one worker) who do not own the money.[195]

The argument of the jurists who conceived that the first active partner "A" is not entitled to any share of the profit is based on the fact that he contributed neither money nor work. The Hanafi jurists, however, have different view on the matter. According to Al-Kassani the work of the second active partner "B" was carried out on behalf of the first active partner "A" and would thus be considered as though "A" did the work himself.[196]

Az-Zaylai is of the opinion that work of the second active partner "B" was carried out on behalf of both "A" and "B". Nevertheless later on he says that such dealing is deemed to be "good trading" where the first active partner "A" is entitled to receive one sixth of the profit while doing nothing.[197]

Hanafis consider that the cause of entitlement to profit, in the case under review has an origin. They consider that profit accrues through property, work or liability. Having studied the various views on the subject we are inclined to consider liability as being the cause of entitlement to profit in such dealings. We would discuss this point in more details further in the chapter while discussing the scope of joint Mudaraba.

In the foregoing paragraphs we have tried what Mudaraba is, its conditions and limits, as expounded the jurists of the various schools of thought on the basis of the then existing conditions and considerations in dealings. Now we will examine how can our modern requirement take advantage of this

kind of contracting which people of ancient times used in their dealings, considering it to be a lawful means, to use currency by an owner who was unwilling or incapable of using it himself? This is what our following section to be confined.

THE SUITABILITY OF MUDARABA FOR COMMON INVESTMENT

The obvious conclusion which we can draw from the foregoing discussion is that Mudaraba is nothing more than one of the means that were known to the pre-Islamic people. It was acknowledged by Islam as being an acceptable system for the investment of cash pursuant to contracts concluded by a person who owns the money and the one who invest the money. It was further revealed that the stipulations laid down by the jurists and the differences as regard to the reality of this contract and the work covered thereby were the result of their various interpretations where they considered that such contract conform to or conflicts with the basic rules and guidelines which they considered would realize the intentions of *Shari'a* to humanity. The above means were available for the needs of the societies of those ages but considered less capable of coping with the needs of the modern age. This led the people of our times almost to give up dealings upon such type of contracts.

The cause of this change is due to a number of various other factors also. The most important factor being the fact that the contractual form of the said means failed to keep pace with the needs of our modern life as did most other forms prevailing in modern dealings.

Alongside the private companies which were for the contracting relationship of a limited number of the partners who knew one another, different new kind of companies came into existence. Such companies have a different form to the old forms which is based on the communal meeting of a large number of partners who hardly know or see one another. What is intended here is the joint stock companies the capital of which is made up of shares offered for sale to the public through subscription. In these companies the liability of the share-holders is confined to the face value of his shares. Professor Sheikh Ali Al-Khafif has explained that all kinds of legal companies, joint stock companies included, may be listed with the jurisprudence companies. He has further said the various rules and the laws governing them are framed keeping in view the pre-requisites of develop-

ment and the requirements of the interest of the people. Such rules are acceptable under the *Shari'a* provided they do not conflict with any of the overall foundations of religion.[198]

The modern developed banking system responded the need through means which reconciled the wishes and requirements of the present times, but the field of financial investment remained outside the Islamic framework. The new banking system prevailed while the old system which had been known to and used in dealings by the people during the centuries still lagged behind. Obviously a question would arise here. Would the rules that had been formulated for the Mudaraba system be able to serve the needs of modern financial investment in such manner which would match the new banking system?

The answer to this question is obvious. Every one has its own technology. For example, if vehicle which was most beautiful at its time would be unable to match the speed of a train even when twenty horses are provided to put it.

To support our concept on the issue we shall review the main issue which will demonstrate that to change the private Mudaraba which is incompatible with its established rule would be ineffectual. For the sake of fair play such rules must remain dominant in the field for which they have been formulated. In doing so we shall be searching for a new form of contract which must be suitable for modern requirements provided it does not conflict with the intention of the *Shari'a*.

Mudaraba is first and foremost a bilateral contract between two parties where first party provides the money and the second party invests such money in accordance with the stipulations regarding the investment and the sharing of the profit.[199] It is not permissible to take third party as financier who wants to provide fresh money in partnership when the investment of the Mudaraba money begins. It would also not be valid for the same financier of the Mudaraba to provide at a later date fresh money to his active partner who invest the money on his behalf only. It is not allowable to mix two sums of two separate contracts even when it involves the same persons except where the first sum still existing or it has been realized into money as it was in the first place.

Professor Sheikh Ali Al-Khafif has explained the matter and says, "it is not allowed to mix the two sums in Mudaraba, even when there is a stipulation in that respect. If the payment of the second sum has been made after the first sum had been utilized the second lending in Mudaraba is not allowed. If the mixing of both sums has been stipulated the financier may lose in second sum and thus would be bound to recuperate the loss from the profit of the first sum where the matter relates to two separate contracts. It would be allowable if the second contract is concluded after the first sum has been realized into money because the both sums would form the capital of a new "gnawing" contract which is governed by new conditions."[200]

It is reported by Al-Bahuti that where financier pays to the active partner, two thousand on two different occasions but did not mix them, without leave to do so by the financier, because he allocated each one thousand for one contract, thus concluding two contracts. The loss of either contract may not be recouped from the profit of the other.[201] But mixing is allowable if the active partner has not yet disposed of the first money that had been paid to him or where the commodity has been reconverted into money after being disposed of by buying goods and later selling the whole lot provided the financier has permitted the active party to do so. The cause of the above is the fact that the stipulations of the first contract have been performed and then the loss or profit is related thereto. The joining of the second contract to the first makes it incumbent to recuperate the loss of either contract from the profit of the other. But if the same is stipulated in the second it would be void.[202]

If we realize the financial investment in the banking system basically rests on the consecutive mixing of the monies deposited where matters remain unchanged. That explain the difficulty of reconciling the matter with the facts to which it must be adopted, if we wish the Mudaraba to enter the field of joint investment where at any time, the money is intermixed unconditionally. Let us go a further step where the financier, in the Mudaraba, impose on the active partner such conditions as deemed appropriate for safeguarding his money against loss. He may also refuse to him to give the money in Mudaraba to another. It is more important that he may, according to those who mention that Mudaraba contract is not binding, rescinded the contract and require the active partner to reconvert the capital into money.

Ibn Rushd (the grand-son) explained this matter saying that the scholars are in consensus that it is not requirement of the Mudaraba contract to be binding. Either party may rescind the contract, except where the active partner has started the Mudaraba business. They differed about the case where the active partner has started the business. Imam Malik said, the contract is binding. It is a contract which is capable of being inherited. Imam Shafi'i and Imam Abu Hanifa said, each party may rescind the contract if so wishes. It is not a contract capable of being inherited.[203]

In the opinion of Al-Kassani the financier is entitled to confine the work of the active partner to a certain specified place, such as requiring him to carry on business elsewhere. The financiers, as well, confine the business to be carried on by the active partner to a certain kind of trade, such as purchase and sale of food. For example, the said jurist mentioned that the dealing may be confined to be with a specified person, such as where the financier tells the active partner "provided that you purchase from and sell to "X".[204]

We are confronted here with a situation that how we can create the common investment system whereby the financier may impose the foregoing stipulations, which are his right and he can impose them in a private Mudaraba contract?

As far as the sharing of the profit is concerned it would appear clearly that the private Mudaraba would not be compatible with the rules of joint common investment. Because the sharing of profits in a Mudaraba is based on full liquidation of the operation. The aim being the reconversion of the capital into money as it were, so that the financier may recover his capital, in the first place, and then the profit accruing will be shared after recovery of the capital. Basically the profit is a protection for capital. Profit exists only when the capital is safer for its owner. It is well-known that joint common investment is based on the notion of (1) Continuity or constancy of the investment and (2) distribution of profits periodically. Thus the overall liquidation would be an impossibility at the end of each period when the profit is distributed to the investors.

It is not a secret that the juristic view of the matter originates from the concept of liability in the dealings where the parties may carry out the liquidation and accounting etc. to apply the rules based on this consideration which is specified in a case with determined effect.

As-Samarqandi while explaining the rules governing the division of the profit and the capital by the financier says that sharing of profit before recovery of the capital is not valid even where the profit has been shared and the capital perished while still in the possession of the active partner. In such case, the share of the profit taken by the financier shall be computed as part of the capital, where the financier may have recourse against the share received by the active partner upto the recovery of the whole capital. If then a surplus remains it shall be deemed to be profit and shared by both the parties.[205] Ibn Rushd has also agreed with the jurists who are of the view that the financier takes his share of profit after converting all the capital into money.[206]

It may be argued that the evaluation may replace the realization of the goods. In this connection it would be adequate to cite the concept of Imam Ahmad Ben Hambal, who made the most extensive research in the field of dealing in contracts and conditions, he says that while finalizing the accounts of the Mudaraba goods the accounting shall be made on what has been converted into money. Because the price of the goods may appreciate or depreciate.[207]

Our intention for citing the issue while reviewing the matter was not to prove that this kind of contract is unsuitable for modern requirements but to demonstrate that the juristic rules of the Mudaraba are not more than the framework of a bilateral contract between the owner of the money and the person investing it i.e. active partner, as now the practice in dealings of these times. In the modern days, where the change of conditions and circumstances are more frequent, there is need to find new kind of multilateral collective contract where the business would not be effected by the admission of a new or withdrawal of an existing person. It would not be prejudicial to the above-mentioned rules if remained in force within the specific framework of the contractual dealings dealt with and regulated.

To retain the tolerance of the originally formulated said rules we should maintain the relationship with the framework for which they were formulated because if an attempt is made to apply them to a framework which was not originally formulated for them would be crossing the limits. Whereas there is no limitation to the forms of contracts nor is there any restriction to a deviation which is kept within the scope of the guidelines and rules prescribed, we do not find the reasons for confining ourselves within the limits of the forms of bilateral contracts of Mudaraba which had been

discussed by ancient jurists. The new conditions and circumstances make it incumbent to create a new branch within the scope of this form of contract which would be suitable for joint common use.

It was due to the above reasons, we focused our attention to search for such form of Mudaraba which would suit the requirements of common use. We considered following the line to that which was known to the Islamic jurisprudence regarding the wage (rental) where the jurists differentiated between a private wage-earner and a common wage-earner who hires his services to any one requiring the same. As discussed by the Islamic jurisprudence the active partner of a Mudaraba partnership is a carrying on business and governed by the stipulations of the owner of the money, the matter would in our age, require the formation of another form of Mudaraba. In this new form the active partner is a participant (subscriber) who collect money from all participants, just like a common wage-earner, to be used in accordance with such conditions which are regulated by common active partner so that the use may be steered with ease and safety.

Having prepared ourselves to introduce the necessitated change we shall devote the following chapter to the collective Mudaraba, assuming it to be a new system which suit the multilateral common use, which is consistently changing and where the money is kept in continuous circulation.

Chapter 7

MUDARABA AS A JOINT SYSTEM FOR INVESTMENT

....Through common Mudaraba, it would be possible to provide all the privileges which the new banking organization was able to provide for satisfaction of the new requirements and needs of both the owner of and the person who needs the money....

Sami Hassan Homoud,
"Islamic Banking - 1985"

DISTINCTIVE FEATURES OF A COMMON MUDARABA PARTNER

Before we enter into the discussion on the subject it would be desirable to have a bird eye view on the modern banking system and the Islamic point of view in this regard.

With the change of circumstances and conditions attendant on the lives of societies modern banking from its very beginning has been characterised by its ability to cope with developing needs being intermixed with usury the banking system was capable of inducting itself, even on societies the majority of which cling to the religious values and comprehensions which consider dealing upon usury to be an evil, coupled with a feeling of disgust not to say suspicion. The great success achieved by the modern banking system, in the field of financial investment, was mainly due to the developed means provided by this system to the owner of the money and the person needing it to take advantage of the opportunity of organised work. This also provided the security and stability to the former and satisfied the later.

In the present banking system a person who holds a sum of money, large or small, feels that a bank is ready to receive this money from him. He has also a choice to keep his money in a non-interest bearing current account or in a fixed term account earning interest, however, small or large it may be. Similarly the people considered that depositing the money in the bank is better than entering into personal partnership, the fate of which would be unknown in these days where the morale of people is low and the moral links of people have shrunk.

For the borrowers also it was more convenient to approach the banks who had vast resources and were more enduring and better organized for this purpose. This system was given the preference than entering in partnership with a financier who will dominate him and his work and may consequently act arbitrarily in regard to his work and efforts. For big enterprises the banking system proved to be the only capacity which is enabled to provide funds which in most cases are beyond of an ordinary individual. It may, therefore, be said that the secret of success achieved by the modern banking system is due to its capacity to mobilize the funds. These gathered funds are then directed into the channel of investment in operations. These opera-

tions are far from the personal character which involves severance and difference of criteria and considerations.

From the Islamic point of view the shortcoming of this system is that it depends on dealings on interest. Though this system is generally coping with modern needs of the societies, yet it is incapable of satisfying the aspirations which hope to live with a feeling of safety and harmony with the teaching of Islam.

For the reasons as mentioned above which is needed is an alternative form, for this new banking system, capable to achieve the objectives and play its role in a manner which is beyond illegitimate usury. It would be a form assumed to process the same characteristics as those of banking system but without deviation from the incumbencies of the Islamic relation. It should be a parallel form which must link it with deep-rooted, closely co-ordinated and lightly built formations and rules of the Islamic jurisprudence.

We should, therefore, attempt to apply Mudaraba according to the form, the landmark of which had been determined, to suit the needs which prevailed in the times of juristic interpretation, would involve, in fact, some sort of exaggeration by ignoring the considerations needed for common dealings which cannot be governed by the rules which had been laid down for individual dealings. If we follow the trend of those who advocate the application of private Mudaraba to the cases of common investment it would be resorting to an uncontrollable violation of the established rules of jurisprudence of this kind of contract. It would mean that the title chosen of the matter has consequently become devoid of its substance.

Dr. Mohammad Abdullah Al-Arabi determined in his investigation, which he presented to the Second Annual Conference of the Cairo College of the Islamic Research, that the relation of the depositors with the bank, as a group and not individuals, are deemed to be financiers and the bank to be absolute active partner in Mudaraba, which is entitled to appoint a third party to act for it in the investment of the depositors monies. From this it would be revealed to us that the concept conflicts materially with the juristic guidelines of the Mudaraba contract. As regard to realization and distribution of the annual profits he considers that in every financial year or a shorter term, where the banking usage reckons a shorter term than one year, the bank must carry out a comprehensive settlement

of the profits and losses of the investments enterprises in which the deposit monies and some of the monies of the bank's shareholders had been invested. From the remaining balance the bank shall then deduct its general expenses and the remainder will be shared by the bank and the depositors.[208]

While appreciating the noble intention and motive of the above scholar, we would like to say that in order to explain the actual facts that the mixing of the monies of the depositors is a matter in respect of which no opinion or argument had been advanced by any of the known school of thoughts. The reason for this being the individual personal relationship which characterized the form of the Mudaraba contract which had been discussed in the books of jurisprudence. It is not only impermissible to mix the properties of various persons, except where such persons had agreed simultaneously to give the property in Mudaraba, but is also impermissible to mix the property of the Mudaraba with other property which belongs to the same owner except where the first property is in the form of cash.

The suggested accounting method also contradicts what had been determined in regard to linking the share of the profit with the reconversion of the capital into money so that the owner may recover his capital in the first place. What remains thereafter will be divided between the capitalist and the active partner. We shall discuss this point at a later stage in this chapter.

We are aware that these rules as described in the books of jurisprudence can not in practice be applied to collective investment in the modern banking system. However, the stipulations and the rules as advocated by the jurists can not be disregarded while finding out the solution to this problem. The scrutiny of these stipulations and rules must be made with careful consideration while formulating the rules for this new situation which differs from the form that had been known. We should be very selective in choosing an appropriate title to the new contents rather giving a title which has no contents or meaning.

Contracts and contractual forms are not regarded in Islam as being mere words and phrases but are intentions and considerations. It would not be inappropriate to have branches within the framework of the same contract where the stipulations differ according to the different situations. By examining the distinctive situation of the specific stipulations singled out from some of the schools of the Islamic jurisprudence in regard to common wage-

earner would probably help to elucidate the different situations of private contracts and of contracts involving a collective work which is not specific to one individual or a limited group of individuals. In this connection we may refer to the opinion of Al-Kassani where he stated that a wage-earner may be private i.e. who works for one person and is called one person's wage-earner and may be common wage-earner who works for any person requiring his services.[209] According to the intention lying behind it i.e. the obtention of a specified advantage for a definite consideration, wage (rent) was able to contain the stipulations governing a common wage-earner, so a Mudaraba, through keeping its intention which is earning profit on the money by way of a third party's investment thereof, would also be able to contain the stipulations governing a common active partner.

In our discussion on the subject we shall confine ourselves in defining the persons and features of a common Mudaraba, try to demonstrate the distinctive features of a common Mudaraba partner and lastly shall discuss the guidelines for realizing and sharing profit within the framework of the common Mudaraba.

PERSONS AND FEATURES OF A COMMON MUDARABA

The persons of a private Mudaraba and common Mudaraba are different. A private Mudaraba, although involving several persons, does not extend beyond a bilateral relationship between the owner of the money and the active partner. But the common Mudaraba involves an interwoven tripartite relationship which is represented by the owner of the money, the person investing it and the intermediary. Furthermore, being a collective system it is characterized by a number of privileges which would not be available within the framework of private Mudaraba because of the restrictions inherent therein.

Common Mudaraba involves three partners whose relations differ according to the difference of the form of the contract concluded by the two partners. The first party is represented by the group of investors, each of whom provide the money for the investment in the Mudaraba. The second party is represented by the Mudaraba active partners group, each of whom takes the money in order to invest it according to his specific agreement. The third party is represented by the person or party whose duty is to mediate on behalf of the parties to co-ordinate and organize the taking and giving of the money to those of second party who wish to invest it in

accordance with the Mudaraba contract entered into with each active partner.

Although the intermediary, the third party, is the new entry in the common Mudaraba system, he plays the double role. He seems to be an active partner in regard to the investors and at the same time the owner of the money vis-a-vis the active partners of the Mudaraba. Therefore, the intermediary's dealing with the several parties of the first party who are not identified precisely, precludes him from being a private active partner and bring him nearer to be described as a common active partner. An active partner does not undertake to act for one or more specified persons but offers his services to any persons who wish to invest the money available at his disposal.

A common active partner vis-a-vis the active partners, seems to them as though he was the owner of the money, because he gives the money to each one of them pursuant to an individual contract. Thus the relationship of a common active partner with the investors would be like that of the person who invest the money, the Mudaraba (active partner) with the owner thereof. Yet his relationship is distinct from that of he who operates individually as a private active partner. However, the relationship of a common active partner with the active partners is similar to that of the owner with each of them without distinction.

The investors, vis-a-vis one another are deemed to be the partners in the profit which may be realized although no contract exist among them, because each such investor would be as having entered into a separate contract with the common active partner, which provided such stipulation which are appropriate for his purposes and consistent with the options made available to the public, through a standing offer open to any person who wishes to enter this field.

As regards the investment, profit or stipulations, the group of the active partners are completely independent of each other. This situation would be similar to that of the several Mudaraba active partners who receive money in Mudaraba from the same financiers, where each of them will be able to invest Mudaraba money independently of the others, where the loss of any one of them may not be recuperated from the profit of others, nor would the liquidation of the relationship with any of them have effect on the business of the others who may carry on, each according to the stipulation of his contract.

It would, therefore, be seems that the common active partner in Mudaraba is the new person who is required or the regulation of the modern form of the common Mudaraba (active) partner within the framework of the new form of the collective investment, what are the privileges of such regulation? We shall now proceed to discuss the privileges of the common Mudaraba.

THE PRIVILEGES OF A COMMON MUDARABA

If the requirements of the new banking system where the satisfaction and needs of both the owner and the person who needs the money are to be fulfilled it would be possible through the common Mudaraba. The common Mudaraba may be a safe and easiest means for investment for the owner of the money as well as to relieve him of so many problems which are part of our present day dealings. The owner of the money would not have to bother or search for an honest and trustworthy person to go into partnership with him. Other problem does not end here he would have to find out a profitable trade to be undertaken. He will also have to formulate such stipulations for the active partner of the Mudaraba which would suit his purposes. Furthermore the common Mudaraba would enable the person who owns small sum to enter in this field *pari passu* with the person who owns large sums of money.

On joining the collective Mudaraba, as investor, the owner of the money would not feel that he has embarked upon a financial relationship from which it would be easy for him to get back his invested money without carrying out proper accounting and liquidation. In a common Mudaraba the investment may be much on the pattern of banking investment where it would be possible to pull out the investment from the circuit. It would be possible because of the balance of payments and withdrawals. The retirement of the investment would not have adverse effects on the financial resources available for investment.

As far as the active partner of a Mudaraba is concerned he would meet the same readiness that meet by borrowers from a modern bank i.e. to accede to his demand. He will also not be subjected to personal feelings and the arbitrary conditions imposed by the dormant partner who is an individual person, which are encountered normally in the indirect dealings.

From the point of view of the national public interest we would find that the common Mudaraba carries all the capabilities of competing with the modern banking system where it would be possible to collect the personal savings of the citizens and employ this into the channel of investment which is beneficial to both the community and the nation.

Besides what we have discussed above a common Mudaraba exceeds over the modern banking system in the following two essential aspects.

The first aspect is the retention of the basic principles of Mudaraba which rest on the convergence of capital and the work unlike the situation prevailing in the present day banking system which rest on the convergence of capital with capital. In the modern banking system a proficient person who does not own money would not be able to find out the way for obtaining the money to start a new project. Whereas within the framework of the common Mudaraba system such person would find several doors open for every new productive activity. It would, therefore, be possible to provide the opportunities for productive work. It would, at the same time, help the state to overcome the problem of unemployment, controlling the rising tendency of inflation and the excessive wages.

The second aspect covers the capability of this system to provoke the influx of monies which are hesitant to come forward for participation because of the unrest felt by the owners about the usurious banking system where such investors are not very well protected inspite of the wide publicity and various incentives given by the banks. They still prefer to keep their monies in their own custody or invest in unsound/sound organisations. It would, therefore, be preferable for them to accept the channel of investment which carries the lessor risk.

It would be, therefore, necessary to find a new system which may replace the usury based use of money with the non-usury form. It should also be capable of being applied in accordance with the most modern means of the new banking system. If we achieve this goal it would eliminate from actual Islamic life the conflict and reluctance which befall many people particularly who are confused as to the motive and their tendencies. If they participate they do so imbued with fear and if they refrain they remain confused.

The Mudaraba may, therefore, be reconstituted in a new form as a system which may be the source of satisfaction and leads any person who wishes to pass worldly life without doing any thing contrary to his faith. A common active partner - it may be a non-usury bank, a post office saving bank, government saving centres or similar institutions - may prove to be a proficient equal capable of playing the role required in the field of modern investment practice.

The next question is, therefore, what are the distinctive features of a common active partner. This common active partner should be more capable than a private active partner to keep abreast of the developments and pre-requisites of modern life? This is what we shall deal with in the next section.

THE DISTINCTIVE FEATURES OF A COMMON ACTIVE PARTNER

There are two most important matters which draw the line of distinction between the common active partner and the private active partner. They are namely: The Stipulations (Conditions) and Liability.

1. STIPULATIONS (CONDITIONS): In a private Mudaraba the financier, who is the dormant partner, has the privilege of imposing conditions as he deems necessary, provided they are within the guidelines of jurisprudence. Such conditions may be of general nature. Al-Abbas Ben Abdul Muttalib used to impose on the active partner, i.e. "not to travel by sea nor to tread a valley nor buy a live animal[210], or requiring him to carry on his activities in a certain specified town." It is reported in *"Tahafat Al-Fuqaha"* .....even though he said: do not carry on business except in Kufa Market, if the active partner worked in another market, he shall be liable.[211] Conditions were used to be imposed on a certain kind of cloth or food. The author of "Al-Bada'i cited the examples of such conditions, saying where the financier tells the active partner ..... take this money in Mudaraba against one half of the profit, provided you buy with it flour, bread, wheat or otherwise, he may not utilize the money for other than that kind. There is no dispute on this.[212]

In a private Mudaraba these conditions are allowable and valid but the situation as regards to the common active partner seems to be different. This difference is due to regulatory controls required for the common work which renders impossible the imposition of such restrictions on the active

partner, like private stipulation which an investor may stipulate with regard to investment of the money provided by him. To explain our point of view further if we take an example of the transportation sector we will be able to distinguish the difference in dealing between cases of taking advantage of a taxi which is hired with a private driver and a vehicle used for public transport. In the former case the hirer of the vehicle may ask the driver to proceed to any place to which he wishes to go and may also ask him to change route at his discretion. But on the other hand a person using the public transport cannot ask the driver to change the route which is set from the beginning to the end.

It is, therefore, required that a common active partner should be given the powers to determine the conditions which conform to the nature of the common collective investments. This means that a common active partner should enjoy full freedom as regards to the stipulations which the investor, in the capacity of the owner of the money, was able to impose on a private active partner.

It may, therefore, be summarised that the relationship of a common active partner with persons who work for him remain governed by his right of imposing conditions necessary for safeguarding the money from loss, within the framework of the guidelines of the relevant Islamic jurisprudence, assuming that a common active partner is, in regard to the active partners, the owner of the property in his own right or as proxy.

2. **LIABILITY:** In practice the liability of a common active partner for the monies delivered to him for the purpose of investment is the most important factor. As a matter of fact the success of a common active partner works depends in his capacity of being an intermediary who has been assigned to carry on the financial investment. The intent lying behind that is that a person, who deals with a bank operating upon usury, does not find himself in a better situation than that which may be realized to him in his dealing with a bank which invest money according to the common Mudaraba system.

Mohammad Baqer As-Sadr attempted to build the liability of a non-usury bank for deposits delivered to it for the purpose of investment, on the basis that the bank volunteers to be liable, because it is not the money operative

but the intermediary between the financier and those investing it, on the assumption that "what is not permissible is that the active partner shall be liable for the capital ....." According to this scholar, who carries high repute in the Islamic jurisprudence, this would secure to the depositors the first element of the motive which urges them to deposit their monies.[213]

Although the argument advocated by Baqer As-Sadr that the bank is intermediary carries weight, nevertheless, it is an active partner thus incorporating the two capacities. It will not be sound to urge the assumption of liability for that which has not initially been guaranteed to be returned.

Professor Sheikh Ali Al-Khafif explained that "liability in its most general sense, according to jurist, is : Liability for money or work which must be discharged : that which is wanted to be established therein is required to be paid, according to the *Shari'a*, when the condition of its discharge is satisfied .... where he discussed contracts which imply liability, the Sheikh explained that "Deposit (fiduciary) contracts, such as Mudaraba, partnerships agency and safe-deposit liability is not incumbent in respect thereof, where the money perishes, although such contracts are valid and not void.[214]

It will, however, be apropriate if we consider a common Mudaraba as being governed by the some stipulations which has been determined — inspite of the conflict of opinions — for a common wage-earner in contrast to a private wage-earner. Although the intentions of both the jurists is same it is well-known that a private wage-earner, being a trustee for the thing he has in his custody but is not liable where the thing entrusted to him perishes without usurpation on his part. But the liability, in such cases, of a common wage-earner was the subject to conflicting opinions. A few of them are narrated below for the benefit of the readers.

Imam Abu Hanifa, Zufar and Al-Hassan Ben Zaid considered that a common wage-earner is not liable just like a private wage-earner.[215] Ibn Hazm also concurred with them.[216] The concept of Shafi'i is on line with the thinking of the above jurists.[217] These opinions have been endorsed by Imam Ahmad Hambal.[218] Abu Yousuf and Mohammad are of the view that a common wage-earner is liable except where the thing perished by a matter which cannot be provided for (*force majeure*). Ali b. Abu Talib (A.S.) and Omar b. Al-Khattab (R.A.) used to hold a common wage-

earner liable.[219] What Al-Kassani meant by "a matter which cannot be provided for", is fire or obstinate thieves.[220] The same thing was cited by Ibn Al-Murtada where he maintained that a common wage-earner is liable, except for what is overwhelming (beyond control), i.e. which cannot be evaded.[221] Ibn Rushd said that the essence of Maliki school is "that a common wage-earner is liable, regardless of whether he works for or without wages. Ibn Rushd further said 'Ali b. Abu Talib (A.S.) and Omar b. Al-Khattab (R.A.) maintained that a craftsman must be held liable, although the later differed from Hazrat Ali (A.S.) on that score.[222] In explaining the basis of this issue, Abu Ishaq Ash-Shatibi the traditional jurist said "the elder caliphs adjudicated that craftsman must be held liable. Hazrat Ali (A.S.) said "Nothing will reform people except that the nature of the interest being that the people need the services of craftsman and as such they have to have the items, in most cases, in the custody of craftsman and more frequently they have to part with the custody of the items. Had they not been adjudged liable and owing to the dire need of their service either of two things would have happened, namely "abandonment of craftsmanship which would prove to be detrimental to the interest of people or to work, without being liable, claiming the perishing or loss whereby property is lost, caution deteriorates and cheating results. The result is thus to adjudge liability. That is the meaning of Ali b. Abu Talib (A.S.) statement. Nothing reforms people except that.[223]

The Malikis held the view that a common wage-earner must be held liable is based on realism and sound application for the equanimity of interests. That was the reason which led to the preponderance of the opinion of Abu Yousuf and Mohammad on "liability" that the Fatwa applies to their concept, contrary to Abu Hanifa's concept which was reported in *"Majma Az-Zamanat"*. The author of this book "Al-Baghdadi" explained the difference within the Hanafi school of thought regarding the liability of a common wage-earner, which existed between the concept of Imam Abu Hanifa and that of Abu Yousuf and Mohammad, after having cited the two opinions that the Fatwa in both their statement is "because of the change of the people's conditions, by that their property will be safeguarded.[224]

If the elements which caused the Malikis to consider the common wage-earner liable one that he himself and no other performs the work for which he had been hired and if the perishing is preponderant as a result of an

assumed negligence it would seem that the situation of a Mudaraba active partner, vis-a-vis the investor will not be less similar to that of common wage-earner because a common active partner is solely responsible for the management of money and giving it in Mudaraba as and when he pleases. Had he not been liable, he would, in seeking quick gain, give the money to gambling active partner without reservation or check of the balances. This will result in that the money as well as public confidence will disappear and the consequences would be the abstinence of people from payment of money for investment and damages and loss would hit the entire community.

Although in the cases of Mu'araba the liability of a private active partner is implied but a thorough study of juristic books will reveal that the issue had not been reviewed clearly. If we take the juristic point of view into consideration the consensus will be that it is not permissible to stipulate the liability of the person who uses the money himself. There are also the differences over the effect of such stipulation on the contract. Ibn Rushd has taken the notice of such differences and according to him :

....Malik said that "gnawing" is not permissible and is void. Ash-Shafi'i conceived the same thing. Imam Abu Hanifa and companions said that the Mudaraba is permissible but the stipulation is void.[225]

Ibn Rushd mentioned the consensus that an active partner who gives the money in Mudaraba to a third party is liable. But this statement does not carry the confirmation in the writing of other jurists. It would be probable that what Ibn Rushd mentioned was based on the writing, which did not reach us. Besides there is an alternative, which we shall discuss after citing the relevant material from *"Bidayat Al-Mujtahid"*, where it would be possible to find a case for the statement which validates the liability of an active partner who gives the money in Mudaraba to a third party.

Ibn Rushd reviewed the statement relevant to the rules of contingencies of a Mudaraba. He mentioned *inter alia* the difference of Imam Malik, Imam Ash-Shafi'i, Imam Abu Hanifa and Al-Layth on the issue where an active partner mixes his money with that of the Mudaraba money. He then continues his discussion.... the aforementioned famous jurists of the cities (it is obvious from the text that the reference is to Imam Malik, Imam As-Shafi'i, Imam Abu Hanifa and Al-Layth) did not differ on the issue that an active partner (A), who gave the Mudaraba capital to another active

partner (B) also in Mudaraba, shall be held liable, where a loss is suffered. But if a profit is realized, he will get his share according to his stipulation and the other active partner will enforce his stipulation against (A) who must pay him his share of the remaining balance of the money.[226]

In the search of the proof in support to the profit through liability we come across with the opinion of Al-Kassani also who said :

.... the proof of that is that a craftsman accepted work against wages, failed to do the work himself but accepted it for a third party at less than that, he shall be entitled to the surplus. There is no other cause for this entitlement to the surplus beside liability.[227]

While reviewing the issue of the profit which accrues to the first active partner (A) due to the difference of the percentage stipulated for him by the owner of the money and that stipulated for him by (B) (for example, one half less than one third, the remainder being one sixth) we find the statement of Al-Kassani who said that the first active partner (A) is entitled to one sixth .... because the work of the second active partner (B) was done for the first active partner (A) and thus considered as having been done by him. This is like where a man (A) hires another (B) to tailor a suit for him in consideration of a certain amount. The wage-earner (B) instead of doing it himself hires the services of a third party (C) to do it for him, in consideration of one half of the amount settled by (B). The surplus will be the entitlement of (B) i.e. the difference. The reason for this is because the work of his wage-earner (C) was done for him and thus he (B) would be considered as having done the work himself.[228]

Both the examples cited above (of the craftsman and the tailor) are relevant but Al-Kassani's argument in the second example contradicts in first argument where he says .... as though he did it himself.... It would have been more appropriate if he would have confined his argument he had made on the case of the craftsman where he said.... there is no cause for entitlement to the surplus other than liability....

Az-Zayla'i has expressed his view on the same issue and said that the work of the second active partner (C) was done on his and the first active partner's (B) behalf, therefore, both are entitled to the profit by reason of the work. Although the first active partner (B) did not do any work but the matter would be interpreted as giving the Mudaraba money to another active partner which is deemed to be good trading practice where the first

active partner (B) would be entitled to one sixth of the profit while sitting.[229]

A sitting person would not be entitled to receive profit unless he has contributed money, work, or liability, whereas in the case under review neither money nor work is involved. There remains only the liability as a cause for entitlement to profit. Thus, what was cited by Ibn Rushd would be in conformity with the Hanafi concept which deems liability to be a cause justifying profit in general.

The abovementioned cause for entitlement to profit has found a basis within the framework of private Mudaraba, where the active partner does not himself use the money paid to him in Mudaraba, it would seem more appropriate to determine that a common Mudaraba (active partner) would be liable, who follows all the same method on behalf of all the people, when he manages singly the money entrusted into his care.

In the light of the proof we have reviewed with regard to the concept under which a common active partner (Mudarib) is liable in the same manner as had been determined in regard to the liability of a common wage-earner. it will no doubt help us to consolidate the elements of the common Mudaraba as both being a system capable matching and rendering the same privileges to the depositors which are being provided by the modern banking system.

As far as the profit is concerned the organization of investment of money in co-operation with the active partners would facilitate the realization which shall not be less, if not more, than the interest paid by the banks. Moreover such profit would be free of usury which rendered the banking system a cause of misfortune to the world and to the mankind.

If our above view is justified then what should be the system which would be appropriate for realization and division of profits according to the continuous collective organization of common Mudaraba. This system should also be capable where there would be no necessity for the liquidation of the various Mudarabas so long as the wheel of the investment is in full swing and circulation.

That is what our topic will be in the following section.

Chapter 8

GUIDELINES FOR REALIZATION AND SHARING OF PROFIT

....Entitlement to profit in the professional partnership is a result of a stipulation to work, not the existence of the work....

Al-Kassani,
"Bada'i As Sana'i Tartib Shafi'i
Part-6, P-3546 (undated)

THE RULES OF A PRIVATE MUDARABA

In the same way as the nature of a private Mudaraba and a common Mudaraba differ with each other the guidelines as regards to realization and sharing the profit are also different in the nature and the relationship of the parties involved. It would be, therefore, logical to start with the reviewing the guidelines of the private Mudaraba first. In so doing we would be enabled to comprehend the points of similarity which will facilitate the application of such guidelines. Furthermore it will also help to demonstrate the points of conflict which need special treatment suitable to the new situation.

From the concepts and opinions studied in relation of a private Mudaraba it would be concluded that the jurists consider the profit to be a safeguard for capital. This means that the safety of the capital was their main concern because this is the base on which the profit rests. Therefore, if the basis is not safe how the sharing of profit can be expected thereof.

Let us, therefore, examine the meaning of the profit the various jurists have defined. "*Al-Mughni*" has defined the profit as "the surplus to capital : that which is not a surplus does not constitute profit. We do not find any difference in this regard among the jurists.[230] Az-Zayla'i conforms this statement and says, "that profit is subordinate to capital. The profit is not safe if the principal is not safe."[231]

On the basis of this precise view the private Mudaraba is deemed to be an integral unit, according to Islamic jurisprudence, for the computation of profit and loss. Ibn Rushd (the grand-son) has stated: .... that an active partner who suffered loss, may recoup such loss, if he traded once again realized a profit."[232] The reasons for this seem to be fair and reasonable. Because if the loss is charged every time to the capital and the profit is shared, according to the stipulation of the agreement, the frequency of loss and profit would lead to the perishing of the capital. The result of such a situation will be that the active partner would be the only person who will receive each time his share of the profit (if any).

The view of jurists seems very convincing and practical as regards to the safeguarding the capital. They did not consider that profit has been realized except when the capital has been reconverted in its original forms i.e.

currency which must possess the same quality as that in which it was paid. The reason as stipulated in "*Al-Mughni*", — that the capital must be reconverted into its original form.[233] To explain the cause for that is that where the capital paid was in silver, in ancient times or Pound Sterling, in modern times, it would not be acceptable to refund the money paid by gold coin or U.S.A. Dollars of an equal value. The purpose behind that is to ward off the risk of the differences of the rate of exchange. This is an accurate and sound view. Ibn Rushd has determined it without dissension and stated.... that the active partner takes his share of the profit after reconverting the entire capital.[234] Ibn Qudama has also extracted the same sense that an active partner shall not be entitled.... to take anything from the profit until he delivers the capital to its owner.[235]

As stated in "*Al-Hidaya*" that where the profit is shared while the Mudaraba remains the same the payment of profit will be deemed on account. Moreover it would be incumbent on both the parties to refund the share of profit received on account of all or part of the Mudaraba money perishes. The reason of this interpretation is that sharing of profit before the recovery of the capital is not valid because the capital is the base and the profit shared is built thereon and subsidiary thereto.[236] The author of "*Majma Al-Zamanat*" has explained the sharing of the profit before the capitalist recovers his capital is suspended. If the capitalist received the capital the sharing of profit is valid otherwise it is void. According to him the profit is surplus to the capital and can not be realized until the principal is safe.[237]

Az-Zayla'i has, however, stated that the contracting parties may make the sharing of profit definitive either by rescinding and liquidating the existing Mudaraba and then reconcluding it or by making an account.[238] Imam Ahmad b. Hambal has considered the matter as to be "accounting like receipt."[239] On comparing the above opinions we do not find any difference between the two cases because of the rescission and conversion of the capital into currency and making an account thereon.

Ibn Qudama has quoted as having heard from Imam Ahmed b. Hambal regarding an active partner who makes a profit and suffers loss several times. According to him Imam Ahmed b. Hambal said: "he will set the loss against the profit until the owner of the money has received his money and then returns it to him saying inviting the capitalist to invest it a second time. Do not recuperate to loss of the first Mudaraba from the profit you make as I have not desired to take anything from this. But what has not been paid to

him remains they make an accounting like the receipt .... it was said to the Imam "How would the account be like receiving?" The Imam replied he must reconvert the capital into money and come to the owner of the money and make an account in respect thereof. The owner of the money shall receive it if he so wishes. It was said to Imam Ahmed: Will they make an account of the goods? He said: They shall not make an account except on what has been reconverted because the price of the goods may appreciate or depreciate.[240]

In the light of the abovementioned reasons it is obvious that the profit is considered as having been realized and which is a surplus to the capital after the latter had been converted to the same state as that which existed on commencement of Mudaraba. This is the situation which is observed in regard to the continuous Mudaraba. But where the Mudaraba is rescinded on valid grounds, Ibn Qudama, has explained that Mudaraba is permissible contract which is rescindable by either party, by reason of death, insanity and being accused of incompetence.[241] The Hambalies allow the estimation of the property because where the Mudaraba is rescinded when the property is still in goods it may be agreed to sell or share the property. It is stated in *"Muntaha Al-Iradat"* where the Mudaraba partnership is rescinded and the property was still in goods and Dirham or Dinar or the opposite and the owner accepts to take the same, he shall evaluate it and pay his share and property.[242] Ibn Qudama says that the right does not go beyond them.[243] Az-Zubaydi mentioned that the permissibility to adopt evaluation in such cases is a form adopted by the Shafi'is.[244]

What is the extent to which these guidelines may be applied within the framework of the common Mudaraba?

THE PROPOSED APPLICATIONS FOR A COMMON MUDARABA

The difference between a common and private Mudaraba is that the common Mudaraba involves two kinds of relationships. One of which covers the relationship of the active partner and the common active partner whereas the other covers the relationship of the investors and the common active partners. As regards the relationship of the active partners and the common active partner there is no difference between private and common Mudaraba as far as the juristic guidelines governing the realization

of profits is concerned. Because of the relationship of every active partner with the common active partner is entirely like the status of the relationship of a private active partner with the investor (dormant partner).

According to the guidelines established by the jurists the profits which are realized, as a result of the Mudaraba contracts entered into by the common active partner and the several active partners, the capital must be recovered and the surplus profit will be shared as agreed according to the accounting principles as stipulated. It would be irrelevant to consider the estimated or assumed profit while the Mudaraba partnership is continuous in existence. The profit can be established by allocation to the partners only. The profit sharing will not be valid unless the capital had regained its initial form i.e. realized, so that it may be recovered by the common active partner who is the representative of the owners of the money who are several active partners.

The situation, however, differs in regard to the relationship of the investors and the common active partner. It would not be imaginable that all the existing Mudarabas be liquidated simultaneously at the end of the financial year nor for the common active partner to refund the capital to the owners so that the surplus profit can be shared in the manner prescribed for the sharing in a private Mudaraba partnership.

The common Mudaraba is by its nature continuous which neither stops nor is liquidated unless the entire work is liquidated. Therefore, it should be given the different treatment from that of a private Mudaraba which is suspectable of liquidation at any time. At the same time we have to keep in mind that guidance must be sought from the important considerations which had been observed by the jurists.

According to jurists who considered the profit to be a safeguard of capital the realization and sharing of the profit were related in a co-ordinated form. Apparently they calculated that the sharing of the profit before the reconversion of the capital to its initial state would lead, if the property of the Mudaraba is not sold for the sum equivalent to the capital, to giving the active partner a part of the capital (to which he is entitled) instead of taking part of the profit.

If the relationship of the investor and the common active partner is examined the result would be that the collective capital belonging sever-

ally and jointly to them is very well protected through the collective organisation in which the common active partner becomes liable for the capital. In such a case the necessity which led the jurists to determine withholding the permissibility of sharing the profit so long as the Mudaraba continued in existence is not relevant to the common Mudaraba. The capital of a private Mudaraba is liable to decrease where the active partner is not liable. This situation is unlike that of a common active partner who in all cases will be liable for the capital. The sharing of the profit which is actually realized through the continued existence of the common Mudaraba does not, therefore, conflict with the guidelines setforth by the jurists. The aim lying behind the said guidelines of the jurists was the protection of the capital where such protection is realized in a common Mudaraba by another method.

We shall now proceed further on the subject to illustrate the method of sharing as well as the base, which may be deemed appropriate for the common Mudaraba.

As far as the sharing of the profit realized is concerned the continuity of the work in the Mudaraba for an indefinite term renders it appropriate to effect the division periodically. For the sake of a proper system it would not be objectionable if the sharing is carried on an annual basis just like joint stock companies and a method is devised to pay the periodic return to the investors on certain specified dates. With a view of allocating the profits realized at the end of every year a computation shall be made proportionately to the monies set aside for investment. According to this new method it would not matter whether such monies belong to the investors or are the common property of the investors and the common active partner, who is a non-usurious bank, or any financial institution carrying on business in the investment sector. Some people may, however, raise a question whether it would be permissible to have this mixing of the common Mudaraba profits where the monies invested will intermix with the current operations such as would be impossible to sort out the amounts of such monies which were actually invested in realizing the profits to be shared at the end of the year.

The answer to this question may be found out if an attempt is made to review the guidelines laid down by the jurists for the entitlement of profit. The jurists differentiated precisely between a partnership in property and the contractual companies. The yield of the former is viewed as being a growth of the share owned whereas in the latter the profit is deemed to have

been the result of the contract concluded by both the parties and not a legal growth of the property contributed by the contracting parties.

According to Al-Kassani there is no dispute regarding a partnership in property that the increase thereto would be commensurate with the size of the property, even where both partners of a cattle partnership stipulate for either of them a surplus of the calves and the dairy produce. This is not allowable by a consensus judgment.[245] This situation differs from that of a contractual company where it is obvious — that the mixing of the two monies of the partnership may not be stipulated — that the entitlement to profit is not related to the investment of the money as much as it relates to the agreement of allocating this money to the investment for the objectives of the company. As reported by Al-Kassani, the partnership where one partner contributed silver dirhams and the other gold dinars shall be valid and both will be partners in the profit. Even where each one of them bought with his own money separately because the surplus which is the profit reverts to the partnership.[246] Ibn Qudama cited the difference regarding the stipulation of mixing both monies in the partnership and said : Where the monies have been specified and produced by both the parties, it would not be a condition to mix them. This view was also held by Imam Abu Hanifa and Imam Malik, but the latter considered that the money must be in their possession on the spot, either by investing them in a shop or handing them over to their agent. As-Shafi'i said : It would not be valid until they mix the money because if the mixing is not effected part of either party's property may perish or may grow and thus the partnership will not be valid.[247]

The above quotation reveals to us an important aspect of companies, in general, that the profit will not be for the money *per se*, but would be in consideration of the willingness which is represented in allocation of a sum of money for the partnership. The money would be considered as having been placed at the disposal of both parties for the purpose, even where a partner bought separately with his own money. Al-Kassani has interpreted this as — they will nevertheless share the profit.[248]

There seems a similarity if we apply this theory in the case of professional partnership where one partner works but the other does not work, the profit is nevertheless to be shared by both. The reason, as explained by Al-Kassani, being "entitlement to profit in the professional partnership is a result of a stipulation to work, not the existence of the work.[249] Ibn Al-Murtada has quoted Mohammad b. Yehya who has reported in

"Jawahir Al-Akhbar", that Imam Zayd narrated from his forefathers from Imam Ali b. Abu Talib (A.S.) that "Two men during the life time of the Prophet (PBUH) entered into partnership. One of them worked with diligence in the market and trade while the other attended at the mosque and prayed all the time. When it was time to share the profit, the man who traded said I must have a larger share of the profit because I attended to the business. God's Prophet (PBUH) said "you were bestowed with profit because your friend attended at the place of worship.[250] The same thing applies to a company of property, where entitlement to profit is not related to the growth of the property (money) but is based on the more availability of the property (money) for disposal, in accordance with the company's deed, whether or not the money is used for purchase and sale.

Therefore, simple handing over the money to the common active partner, irrespective whether or not the money was actually invested, entitle the owner of the money to a share of the profit realized as would appear during the time limit specified which, owing to the continued existence of the common Mudaraba, may be determined for one financial year as in the case of joint stock companies. Thus the profit declared at the end of every financial year shall be distributed only to the amount which remained in the company from the beginning to the end of the year. Therefore, an investor who invested in a common Mudaraba recovers all or a part of the amount invested before the expiry of the year, and before the profit has been declared, the amount recovered shall not be entitled to a share of the profit which is computed and declared at the end of the year.

The same thing may be applied in the case of a private Mudaraba. Ar-Ramli says that "if the owner recovers some of the Mudaraba money prior to the declaration of profit or loss the Mudaraba money reverts to the remainder, because the money left in Mudaraba has become as though it had been given initially.[251]

This form of computation on the lowest balance is in practice in modern banking system. Some banks calculate the profit on the average balance in the account. Any one who withdraws his investment will not suffer any loss or damage because he has withdrawn his investment before the declaration of the amount of profit. Where the money has been withdrawn after the expiry of financial year the investor would be entitled to the profit realized even though it has not been declared. As we have already considered that what the jurists mentioned regarding the entitlement to profit by decision

is due to the fact that they considered profit to be a safeguard for capital. Whereas protection is realized without profit there would be no conflict with the argument that entitlement to profit is by appearance i.e. when known, as conceived by the other group of jurists.

Az-Zubaydi mentioned the difference on the issue of ownership of the profit according to Hanafi school of thought and whether it is acquired on mere appearance or would depend on division? The interpreter explained that the ownership of the profit depends on the division is the more correct view. Then he cited what can be considered as reconciliation of two arguments and said "if we consider him proprietor on mere appearance it would be unstable ownership, as it is a protection for the capital from loss. If we say that he does not own he has a confirmed right.[252]

We consider that what is mentioned by the aforementioned interpreter conforms to what we have explained on this issue.

We are now confronted with the issue of an important operation in the field of common Mudaraba i.e. where the investor provides money for investment within the financial year. Will such sum provided be entitled to participate in the profits realized during the same year? To answer this question we will have to go back to what we have discussed regarding the cause which justifies profit in a contract company where the mixing is not stipulated. This is because the only cause which justifies profit is the making of the money available for disposal in pursuance of the objects of the company. But there is a time difference between a person who has his money available from the beginning of the year and he who gives his money as of the mid-term, thereafter or before.

As the amount invested is guaranteed by the common active partner the criteria for differentiation of entitlement to profit due to improbability of loss being suffered in this regard remains related to the amount of sharing in the profit. This assumed contribution depends on the time when the money is invested at the end of that year. In the modern banking system the bank's accounting method known as the Figures and Numbers System is a mathematical method for determining the interest of an amount which moves up and down daily in most of the cases. By multiplying the daily balance by the number of days of such balance. This is based on the simple method of calculating interest. Therefore, the resultant figure would represent the interest for one day and the other figures may be added within

the time limit set for the account. The Figures and Numbers System calculation may be adopted based on the months instead of days. This system we need because non-usury investment is for production which rest on the actual profit which can not be realized with the speed of banking investment which is based on usury where the movement of the account attracts interest.

We have completed setting out most important cases which are likely to take place within the scope of common Mudaraba in regard to the realization and sharing of profit after having taken into consideration as much as possible the differences of the specific rules of a common Mudaraba.

As a result of the discussion we had so far in this chapter we are now in a position to identify the main lines of the common Mudaraba as a collective system, which carries the flexibility, an aptitude to satisfy the object and requirements of modern banking investment of multiple resources money, which by nature moves up and down. But it is not all we need we still have to examine how this flexible collective system — in the management and investment of resources — without having adopted the course of usury where some people may, in the absence of a sound alternative, think that there is no way out to get rid of the usurious system which holds a strong grip on the mechanism of modern investment.

Chapter 9

OPERATION OF COMMON MUDARABA AND MODERN BANKING

....According to Ibn Qudama there are two conditions of Mudaraba, valid and void. A valid condition is where a trade or person of Mudaraba is specified. A void condition is where the commodity or a specified person is not common in the market. Imam Malik, Imam Ash-Shafi'i and Imam Abu Hanifa conceived the same thing. Ibn Rushd, however, has pointed out that the former two Imams two Imams considered such stipulation to be a kind of tightening imposed on active partner which makes the damage greater and Imam Abu Hanifa thought that the inherent damage is slight....

Ibn Rushd,
"Bidayat Al-Mujahed", Part-2, P-238

INVESTMENT OF CIRCULATING MONEY

The financial operation in modern banking system enabled the transformation of mobile resources by, adopting the accounting method where the balances are capable of being increased or decreased, into a source of financing. Such transformation created the resources which are invested in the commerce and industry according to their requirements as well as other fields of economic activities in various countries. As such the modern banking system succeeded in creating a pool of assets which otherwise would have scattered in different places like houses, private safes and pockets. Modern banking system has successfully been able to convert these assets into a huge force for financing public and private projects. The execution of the development plans which aim at the growth of revenue and providing more jobs of works to those capable of it has also become easier because of centralising their resources.

The essence and philosophy of investment of the assets, however, depended on usury. It became the tool to deepen the gap of social mutual oppression to such an extent that its effect is more widespread than had been during the ancient pre-Islamic usury. The modern banking system having secured a relative success in convincing people to keep their monies into the banks and depositing their savings with them. This situation has steered the coarse of financial investment towards the permanent convergence of capital with capital and has led in frustrating the labour to meet with the capital on the basis of a partnership which opens the way to labour to obtain gain in consideration of the work done without associating itself as a wage-earner.

In the pre-Islamic days a trustworthy and honest person could find someone to provide him the money which he needed to travel from one place to the other for trading, on the basis of obtaining a share of the profit where the financier would bear the loss, which was very probable in distant days. Nowadays we find that a skilled worker, a professional, an engineer and a shop-keeper are being denied the opportunity of obtaining funds which they can utilise on the basis of a legitimate partnership. As a result they have no alternative but to hire out their services. This leads the state and the other sector of the economy with heavy burdens. On the other side we find financiers who seek growth of their money having proper security commensurately with the size of their wealth and properties.

While discussing the matter our intention is not to favour any one class and being against the other one. What we intend is to demonstrate that money is like water flowing in the river which if compounded in a pool becomes stagnant and spoils the crops if stagnant exceeds the limits. What is required is to regulate the supply of water so that a piece of land will not be flooded with water, while other parts remain without water like an arid desert.

There is no doubt that the modern banking system has successfully played its role in investing the money and not leaving it idle and restrained. But the method of investment is far from the great justice of God. In the modern system of investment the capital has monopolized the results, in all cases; and renders the human efforts a commodity which must be estimated at cost. Therefore, the modern system of the efficiency and skill are rendered ineffectual.

In the modern banking system it was natural that a gap between the capital and labour is created which led to deepening the gap which existed among classes of the same society. The standards and controls faded away sowing the seeds of hatred in the desperate souls and as a result led to the break out of revolutions and various disorder at the cost of blood, dignity and decency of the people. This is not a matter of surprise rather it is the result of deviation from the rules and guidelines of the *Shari'a*. Our object is, therefore, the rectification of the divergent course by following obediently the commandments of God and to adopt the measures to help the humanity to enjoy life when the causes of this artificial misery have been eliminated. It goes without saying that in doing so we shall not overlook the developed technics provided by the modern banking system which could serve as a useful means of realising the great hope.

While we consider the common Mudaraba would be suitable for utilization of the collective multilateral resources, as an appropriate framework and origin of money the mixing of this Mudaraba with the banking system will require the adoption of a distinctive method where such Mudaraba would seem nearer to that of the banking system. The consideration of keeping the common Mudaraba in the proximity of the modern banking system will be necessary as it carries the nature of flexibility and continued renovation. The allocation of resources for investment in banking made it incumbent on banks to use distinctive forms and means of operations the innovation

of appropriate forms of Mudaraba participations (partnerships) and other similar forms. It must also be flexible and have the capability to develop.

For the reasons as mentioned above we deem it appropriate to begin with the reviewing of the means which in our opinion are suitable for operating within the scope of a common Mudaraba which depends on the investment of circulating capital according to banking system. After reviewing the means we shall proceed to talk about the framework within which the invested resources may be managed and lastly we shall examine how the profits realized may be shared. That is what we shall be explaining in details in the subsequent section.

Circulating money means the money which is free of any fixed ties. In other words where the owner of the money is entitled to receive his money in cash i.e. in the same form in which he delivered, in accordance with the arrangements agreed with the common active partner. It would be on the same pattern as that practised by a modern commercial bank.

The role of a common active partner in a common Mudaraba is deemed to be the similar of an alternative for the intermediary's role practised by a bank which acts not only as an intermediary but is a link between the capitalist and those need the money for utilizing it in the various productive channels. Therefore, the various means of the investment must be organised mostly on the basis which are capable of playing the role of intermediary for the active partner and not the user of the money. If this stipulation is provided it will enable the active partner to maintain the true nature of his role and at the same time provide the required safety needed by the owner of the money owing to the fact that he would be investing the money which may be recovered on specific dates. Therefore, the direct investment of money must remain within the limit of the amounts of money owned by the common active partner or for which he is liable, where he is a borrower, to the exclusion of the monies deposited with him for investment in his capacity as a common active partner.

In a country like Pakistan where exists an average society in terms of availability of money and labour the method which are suitable for investment of circulating money may be classified into three main categories, namely :

(i) Mudaraba - on the basis of a specific transaction.

(ii) Musharika - participation which ends in acquiring ownership.

(iii) Buy-back arrangement - buying commodities requested by a customer on the basis of cost plus pre-agreed profit.

1. MUDARABA - ON THE BASIS OF SPECIFIC TRANSACTION :

In the opinion of the jurist Mudaraba may be absolute or made subject to certain conditions. Ibn Qudama says "The conditions of a Mudaraba are of two kinds valid and void".[253]

A valid condition is such where the active partner is required not to travel or to travel with the money or to trade only in a certain specified town or kind of trade or not to buy except from a specified person. All the foregoing are valid stipulations regardless of whether or not the kind is common among people and whether the person has many or few quantities of goods. Imam Abu Hanifa conceived the same thing. Imam Malik and Imam Ash-Shafi'i said "If the stipulation makes it incumbent not to buy except from a specified person, a certain specified commodity or something which is not common in the market, such as sapphire or piebald horses the Mudaraba is void because it bans the intention of the Mudaraba which is close examination and seeking profit, so it is void. Ibn Rushd pointed out the difference between the concept of Imam Malik and Imam Ash-Shafi'i and that of Imam Abu Hanifa and said, "that the former two Imams considered such stipulation to be a kind of tightening imposed on the active partner which makes the damage greater and Imam Abu Hanifa thought that the inherent damage is slight.[254]

As far as restricted Mudaraba is concerned we would like to suggest that the common active partner should take advantage of the situation, through restricting the Mudaraba to a specified transaction, to reach some sort of an estimated time limitation to end the Mudaraba partnership so that th money will not be converted into something resembling a permanent partnership.

In most of the various fields of business and commercial sector this kind of specific transaction of Mudaraba would fit in. It would suit to engage in business with individual, private sector or public sector enterprises. Due to the vastness of this field a common active partner would have wide ground to select his active partner from the various categories provided his overall

dealings spread within each separate sector. Such spread would help the common active partner to achieve two essential matters. The first point is represented in guaranteeing the spreading of the risk so that if a loss is suffered due to the incapability of attracting a buyer of a certain brand of goods, being traded in Mudaraba, it would be set-off against the profit which is realized from the sale of the other items of goods. For example if the Mudaraba partnership concluded for trading in iron goods suffers a loss it can be recuperated from the profit realized from the trading of wood, rice, cloths, etc. The second point which is favourable to a common active partner in dividing Mudaraba in terms of the same item to several active partners is that it will enable him in having some sort of control which is based on comparing the results declared by the various active partners. For instance, a trader who purchases wheat after harvest season, with the Mudaraba money, and sell at the end of the season and 'earns an average profit of Rs. 100/-, while another trader bought and resold within the same period of time made a profit of Rs. 200/-. This difference in the profit will help the common active partner to exercise more caution in his future dealing with the first trader and increase it with the second one.

Where a contract is concluded between a common active partner and an importer to finance the transaction and defray the costs of import this transaction would be a clear Mudaraba. But where the agreement stipulated that the common active partner shall provide the other half it would be a Mudaraba and a partnership. The combination of both Mudaraba and partnership, is possible.[255] The profit shall be shared according to the percentage agreed upon with the active partner, which would depend on the nature of the sale of, and the profit realized from the transaction, as well as the skill or reputation of the active partner. Computation of the profit shall be effected, as we have already discussed, after reconversion of the capital into money, unless the Mudaraba contract had, prior to such reconversion, been rescinded for any cause whatsoever, when the evaluation of the Mudaraba money will be effected at the market price.[256]

2. MUSHARIKA - PARTICIPATION ENDING IN ACQUIRING OWNERSHIP :

The operations which are generally revenue producing are covered under this mode of financing where a common active partner buys the items on the basis of a systematic arrangement to set aside part of the realized profit until it becomes equal to the value of the items. For example commercial or passenger vehicle is purchased by the common active partner and

delivered to the active partner who will operate it but not as a source of gain but on the basis of an arrangement to set aside part of the realized profit until it becomes equal to the value of the vehicle. The ownership of the vehicle will be assigned to the person who operated it for the period during which the entire value thereof has been repaid.

What we consider it is that the foregoing is a commercial act and is not deemed to be an act of investment in the banking sense. In our opinion a bank is neither fit to, nor must be, a trader because its real role is that of intermediary between the owner of the money and the active partner who is utilizing the money.

This kind of operation is in fact an alternative based on what had been permitted by the Hambalis, such as the hire out a ship in consideration of a certain specified part of the rent obtained. This we have already explained while discussing private Mudaraba. The situation in this case would be based on an agreement that the Mudaraba active partner will take his share from the net profit according to the arrangement agreed after deduction of the costs of the fuel, maintenance and wages paid to the active partner for his services as driver and the remaining part shall be set aside in an account entitled "Deposits" for the vehicle in question. The wages paid to the driver, in such a case, is against the stipulation of the estimated expenses. But according to Hambalis is permissible.[257]

It would, therefore, be appropriate so long as the common Mudaraba active partner is the owner of the vehicle, he also owns the wages, but will set aside part of the accruing wage as a balance earmarked for extinguishing the value of the original vehicle. After having recovered the entire price from the wages received the common Mudaraba active partner shall assign his title thereto to the driver who operated it honestly and faithfully.

This method of financing provide a secure and flexible means to the common active partner for using monies and obtaining a periodic profit all the year round and at the same time provide an incentive to the active partner (who is a driver in this case) to be honest in his dealing through this method. On the other hand the driver will receive a wage like any other driver but will ultimately obtain title to the vehicle which enable him to have an independent source of income where he will be making on his own property and not as a hired person doing work for a third party.

3. BUY-BACK ARRANGEMENT - BUYING COMMODITIES REQUESTED BY A CUSTOMER ON THE BASIS OF COST PLUS PRE-AGREED PROFIT :

In the modern society every individual wishes to satisfy certain needs, but the required price is beyond reach regardless of whether such needs are for personal or domestic use. A motor car or a television set may be needed for personal or domestic use, whereas a professional may need items like X-Ray machine for professional use. The banks operating upon usury were able to find a vast field for the use of money by means of discounting negotiable instruments representing the value of such things and material needed by people which have been sold on credit. With this facility available to the trader he is able to meet the requests of the purchasers, who do not have the price in cash, through credit sale. In such case he resorts to the discount of promissory notes made out by the purchaser to the order of the trader. The latter takes into consideration the costs of discount, by adding them without informing the customer, to the price for which he agrees to sell on credit. The price is repayable in instalments.

Practically this method of discounting the documents, inflates the price as the cost of discounting is added to the cost price. A trader, in such case, is threatened at all times if the bank refuses to continue him extending the facility of discounting the instrument upto the ceiling agreed, so that the trader would be enabled to bring and dispose of goods. There are, however, certain specified kinds of goods which a trader or industrialist is unable to market successfully unless he adopts this method, such as trading motor cars, refrigerators and so many other items, which are needed for the building and other industries.

Now the question is what then can a common active partner — of a non-usury bank — do in this field?

The scholars in their studies have presented the creation of a system of operation for Islamic banks. They are of the opinion that the Islamic bank may intervene in such cases to free the discount operation from the suspicion of usury by either of the following two methods :

(1) On a pattern similar to a "gnawing" contract where the bank shall substitute the creditor and share with the owner of the goods the profit derived therefrom.

(2) The bank would pay the entire value of the promissory note made out to the beneficiary subject to the following conditions.

We will consider the first method because the second one is no more than a service rendered by the bank according to the conditions stated.

The first thing which comes to our mind is "How safe it would be to consider this operation of discounting a commercial promissory note, to be according to a pattern similar to that of a contract of "gnawing", because such "gnawing" as we have already defined it, is the payment of money to be who trades in it in consideration of a common share of the profit. The discounting of a promissory note in the form stated is neither of this nor of similar pattern.

The above narration may sound well where there is profit, but what would be situation where the trader sells at a loss? Will the bank share such loss? Or the bank will confirm the dealings with the traders to the discount of promissory notes which earn profit only?

There is no doubt that such sharing, only in profit, is not fair because a partner must share the profit and the loss. If this is not the situation, then what is the use of a partnership to the parties dealing with the bank if the bank participates with them only in cases which earn profit?

The solution as proposed above is considered by us as impracticable for many reasons which are known to those who know the prevailing condition in the commercial market where the purchaser pays part of the value of the goods in cash and the bill of purchase is issued at a price followed by an agreed discount. The matter is not as simple as some investigators would like to think when they base it on an assumed theoretical criteria. Furthermore, it does not help to change the facts which lead to inflate the commercial confidence of this class of trader whose marketing of goods depends on credit sales. This will force them, for fear of bankruptcy or closure of business, to resort to banks dealing upon usury or to usurers, if the assumed Islamic bank fails to respond to their needs. Therefore, to counter the existing investment based on usury system we are to consider opening the door to a non-usury bank to assist in enabling a person to obtain the commodity needed against payment of monthly, quarterly or half-yearly instalments or other similar arrangement. However, this line of action begins from the consumer not the trader.

The interpretation of this is that a person who wishes to buy the required equipments for his newly established venture will approach the bank with a request to buy the required equipment according to the specification given by him with a promise to buy such equipments which are actually needed by him on the basis of resale with specified percentage of gain as agreed upon and will pay the instalments commensurate with his income.

This operation is based on the promise to purchase and resale with specifications of gain. It is not a sale by a person of something which he does not have because the bank would not in such case be offering to sell anything. The bank could be receiving an order to purchase a commodity and would not sell it until ownership has been acquired to what has been ordered and which must be shown to the person who placed the order to confirm that it conforms to the specifications of the item ordered. This operation does not involve profit without liability, because the bank in purchasing the items becomes the owner thereof and will bear the liability for their perishing. If the item purchased sustained a defect or breakage, prior to the delivery to the person who placed the order, such damage would be the liability of the bank and of the person.

It may be a form of brokerage by means of which a bank, which transacts business on non-usury basis, is entitled to carry on all kinds of business of commercial trust, thus competing with full force with all banks dealing upon usury. This matter was the subject of criticism until it was reassured by the existence of this type of contracting by Imam Ash-Shafi'i who said on the issue.... where a man shows a commodity to another man who said : 'buy this and I give you so much profit,' whereupon the person buys it. The purchase is permissible and he who says, I give you a profit by option, if he wished he may cause a sale thereto or may abandon the sale, and if he said, buy for me goods, which he described to him, or any goods you wish, and I shall give you profit. All these are the same things. The first sale is permissible and will be for what he had himself opted to pay. It is immaterial, in such case, that it had been described, if he had said 'buy it and I shall purchase and both will be by option in the other. If they renewed it, it is allowable.[258]

There may be an objection to the foregoing that what would be if a person defaulted from the purchase? Our answer will be what would be the percentage of such defaulter? It may also be provided the statutory cover by making the legislation according to the provision of *Shari'a*. Moreover, if

a driver met an accident once would be abandoned the driving for ever so that the accident would not happen once again? The matter requires the constant vigilance and study the results of which may be applied as and when needed. People are people, they have their reputation and goodwill in the society. Some are honourable, others faithful and otherwise. It is a responsibility in business to carry out research or analyses and to undertake the calculated risk.

The great satisfaction which we can derive from the proposed method is that it does not result exaggerated fame which is claimed by the economist due to the great role of banking dealings upon usury in financing credits and brokerage etc.

By a mere look at all that can be alone in this regard it is clear that this field has no limits, except to the extent of the financial capability of the Mudaraba bank, regardless of whether the required commodity is a small TV set, a bicycle or a power generating station which a government or a private person wishes to buy and repay the price by instalments from the periodic revenues of the government. All the foregoing may be purchased for a person who orders the purchase on the basis of resale with specified gain.

The most important factor is that a trader who exhaust himself as well as others by imposing conditions and restrictions on credit sales fearing that the bank would return to him the promissory note unpaid and charge him interest for the days of delay in payment. Such trader would be master of himself once this heavy nightmare is heaved from his back. The purchaser will also feel at peace when he pays for a resale with specified gain, at a lower percentage, rather than being charged by the trader all that had been charged by the bank and more.

It will, thus, be revealed that the main landmarks of the broad lines of the operations can be carried out by a non-usury bank as a common active partner. From the foregoing discussion we may draw the following two important conclusions :

(1) Mudaraba is no more than a source of investment without usury, yet it is not the only outlet. So the Professors and Investigators who have confined all the arts of Mudaraba within the door of Mudaraba only would in doing so have narrowed a vast door and thus have forced to contain themselves with no reason for such narrowness.

(2) The object of the banking investment may be achieved without having to adopt the usury system, as keeping a distance from such system would help to render the fair distribution of the investment of the money. In doing so the situation would generally conform more to the pre-requisites of a balanced development for all classes of society.

People may object to the forms of operation proposed above and say "These forms are not termed banking business. How then can we be standing in front of what is described as being an evolution of banking business?

Our reply to them will be :

We have already explained in the early stage of our discussion on the subject that the banking operations do have a unified sense nor a stable comprehension, but are operations which appear to serve new needs and that the form we know did not stem from Islam, where the situation when we came to know such operations, did not permit the creation of an alternative which is acceptable. If we remove the mask of imitation and look into the great legacy of the *Shari'a* and present forms which satisfy the needs and fulfil the intention would it require the permission, before freeing ourselves of this intentment, from the inhabitants of Lombard Street, London or Wall Street, New York?

The time has now come that we should stand on our feet and abandon the dependence on the other. We should not follow the doorstep fearing delusions which has been proved baseless and unaccountable. Such people who are being sought by amateurs of imitation lead, as we have seen in their societies, a most miserable life. They need to sit like students seeking knowledge and education just as their forefathers used to sit in Islamic Universities of Seville and Cordova of Andolusia.

Let us build our economy according to what we know of our religion so that all the world would be built on just rather than tyranny where the very dark night seems to be endless.

Having examined the methods of operation which seems appropriate to carry on business in the common collective field we shall now examine the method of regulation of relations within the framework of the operation of this multi-owned money, particularly in regard to sharing the profits which constitute the prime incentive to people to resort to depositing their monies.

MAINTENANCE OF ACCOUNTS AND SHARING OF PROFITS

In the capacity of a common active partner the management of the monies deposited by the owners for investment by a non-usury bank it is necessary that the accounts of the monies deposited should be properly maintained and organised in accordance with the relevant conditions. The object behind these arrangement is based on two main aspects :

(1) The option should be given to the owner of the money to choose the appropriate account the conditions of which would be suitable to the presumed conditions of the person who wishes to invest his money in this way.

(2) Establishing different criteria for the profits which will accrue to these monies in accordance with the conditions of the owner's account.

Before we discuss the realization and sharing of profits we should first talk about the bases proposed for the organization of the invested deposits.

PROPOSED BASES FOR INVESTMENT OF DEPOSITS

The bank dealing upon usury have got a large varieties of the accounts to be offered to general public like, current account, savings accounts, specified notice account and term deposit accounts. These banks pay different rate of interest on type of account, saving deposits carry different rates whereas the rate of interest depend on the terms and conditions in specified and terms deposits. In some countries the current account carries the interest and in other countries no interest is offered on these accounts rather some amount is charged to the depositor. The logic behind offering these types of accounts is practised as it would help the investor to choose the account which suits his willingness and preparedness to be bound by a long term or short term.

Where the investment is not based on usury the amount deposited is not suitable to be adopted due to the different criteria. In such case, the monies having been separated from the work would be the company's (Partnership) property. Insofar as funds are concerned, the company does not

differentiate the percentage of the profits, so long as it is governed by the same conditions. It can not be said that one third of the profit will accrue to one hundred Rupees and one half thereof will accrue to one thousand Rupees of the same amount. The percentage of the profit would be, either one third or one half, for each of the hundred and the thousand.

The time for which the money is deposited is the essence of the differential notion. If, for example, a sum is deposited at three months notice it would be entitled to receive a higher rate of profit than where the same amount is deposited at one or less than one month notice because in the former case the bank is enabled to allocate a large part of that sum for investment than that which it can utilize in the latter case.

To explain the matter further suppose that cash liquidity of the bank require the retention of 50% of the sum deposited, to provide for probable instalments, the sum of the percentage to be retained for cash liquidity in the second case, one or less than one month notice deposit, would be higher than in the former case (three months notice deposits). Therefore, to determine the different percentage of the profit commensurately with the deposits term is justifiable, because the invested sum in the latter case is higher than that of the former case. Therefore, it is necessary to take into consideration the term for which money is deposited.

To practice this method as a different criteria of the participation of accounts in accruing profits would lead us to a very important and useful factor. It enables the bank maintain self-liquidity in regard to invested monies as a part of each such account is left uninvested, to face any probable ordinary or emergency withdrawals to recover the deposits, so that the bank will not have to bear any charge as a result of such arrangement.

The adoption of this method will mean that part of such sum deposited for investment will be kept as a deposit and other part would be invested in Mudaraba, depending on the type of account chosen — its investment, saving, notice or term account - and there is no conflict in joining the Mudaraba and deposit because in both the cases money is a deposit. Al-Kassani has maintained that where "A" pays "B" money and says one half is deposit and the other is Mudaraba; this is permissible and the money will be in possession of the active partner as designated by "A".[259]

Our intention going in details was to explain that where the owner of one thousand Rupees wishes to invest for getting a higher return he must place it in a term deposit account for one year. However, if he thinks that he may need the amount at short notice he may place it in the appropriate account on the understanding that the participation in profit is less. It will be due to the reason that the bank would be unable to invest a percentage of the sum at one month's notice account which is equal to the account for one year, even when the amount is the same.

This solution is practical insofar as the type of banking dealings are concerned and does not contain any conflict with combining together all kinds of accounts which are consolidated at a certain percentage of the money to be kept as a deposit and another percentage to participate in an investment account because such joining together and regulation of account of the same kind is imposed by the nature of the work in the field of investment through common Mudaraba.

SHARING OF PROFIT

The profit which is actually realized as a result of the working of a common Mudaraba must be distributed during the pre-agreed time limit. The accrued, estimated or evaluated profit can not be taken into account for distribution. As we have already discussed the realization of such profit, on the various investments through common Mudaraba, is not difficult to be calculated within the afore-mentioned framework. Not only the profit earned on the investment through common Mudaraba is difficult to distribute even the profit earned through re-sale with the specified gain can easily be distributed.

Before we ascertain the profit to be distributed it would be desirable to take into account the component of the profit which are to be excluded first from the divisible profit. The following two most important factors need special attention :

(1) Ascertaining the expenses which are to be deducted from the profit before distribution.

(2) To form the bases for the distribution of the profit accrued in regard to the amounts which form the capital for carrying out investment operation.

1. DEDUCTIBLE EXPENSES :

The jurists differ as to whether an active partner of a private Mudaraba may stipulate the expenses for subsistence to be borne by the owner of the money. Some of the jurists have totally disallowed it whereas other have made it permissible subject to certain conditions or in some particular cases. Ibn Hazm is of the opinion that "an active partner may not eat legitimately any of the Mudaraba money nor to wear anything thereof neither in travel nor in settled areas.[260] As-Samarqandi, a Hanafi jurist, considered spending from Mudaraba money allowable in travelling but not in settled areas i.e. expenses incurred on his food, clothing and movement as well as anything unavoidable in travelling.[261] Imamites and Zaydis have also supported the thoughts.[262]

A place which is nearer to a city or town is treated as city or town, Az-Zaylai has defined the demarcation of the business place as the place from where the active partner can go back and forth to his house. This is deemed to be tantamount to a city or town because the market people who carry on their business in the market are able to sleep in their houses. But where the active partner is unable to return to his home his provision will be defrayed from the Mudaraba money because he will not be able to return to his home and thus the place of business will not be treated as the city or town where the business is being carried out.[263] The Malikis have, however, confined the travelling to settled areas — city or town — provided the money is enough. Ibn Jazzi has stated that "The active partner is entitled to travelling allowance from the "gnawing" money while travelling but not in settled areas, provided the money is sufficient.[264] Al-Khurashi while explaining the issue has cited in "Al-Mukhtrassar" : "Provided the money is sufficient: one of the elements of the allowance is that the money is sufficient"... no allowance will be permitted for a small sum of money.[265]

Az-Zubaydi has differentiated between the two kinds of travelling allowance. The first one relates to the Mudaraba money and the second one is that which relates to the person of the active partner. He said that the first kind is in the Mudaraba money, for example as moving the money from one place to another and the expenses which are incurred for protecting it from theft or such as the expenses paid by the active partner for folding and packing clothes and moving light goods from one place to the other, the active partner is not entitled to receive wages for such work but the moving of heavy goods must be defrayed from the Mudaraba money. Az-Zubaydi

has further condensed the foregoing matter and said, "whatever an active partner can not do himself, he may hire the services of others to have it done and pay the expenses from the money of Mudaraba because such act tends to complement and is in the interest of trading. But where the active partner does the work himself he shall be deemed as having volunteered his work and as such is not entitled to wages.[266] The same jurist has quoted the interpretation of Imam Shafi'i as having two methods of dealing with this matter. The more correct of them is that which is based on two arguments. The first is that no allowance occurs just as in the case of settled areas and this is because probably no more than that amount results, where the intention of the contract is breached. The second one is where it is a necessity.[267] The Hambalis view on the subject is that the allowance is permissible to be paid to an active partner in travel, as well as, in settled areas if it is stipulated. Al-Bahuti has stated.... An active partner is not entitled to expenses (allowance) from the Mudaraba money even when travelling with the Mudaraba money, because if he had added that he will be entitled to a portion of the profit, he would not be entitled to anything else.[268] It is further stated by him that it is permissible to estimate the expenses to evade a dispute. If the expense is not estimated and a dispute arises between both parties over the amount of the expenses, the active partner is entitled to such expense as is customary, such as food and clothing.[269]

The above discussion bring us to the conclusion that some of the jurists have insisted on the ban of non-entitlement to the expenses mentioned above while others have expressed moderation saying that expense is permissible during travel but not in settled areas, while still some of the jurists have argued permissibility thereof provided this expense is stipulated. It is, therefore, obvious that the expense which is permissible, according to those who advocated this concept, is limited according to usage. This argument is based on the assumption that a man's expense for food and clothing has limit which does not extend beyond the expectation and estimation which may be assessed and anticipated.

Now a question arises here whether it would be possible to apply these guidelines within the framework of the common Mudaraba, especially when the common active partner is a banking company?

Apparently the common active partner, who due to the nature of work, is not in a position to observe the same conditions as those observed by a private partner. He, therefore, may not stipulate the payment of such

expenses, particularly where such common active partner is a banking company and not a physical partner. It is due to the reason that a bank generally have its head office in a commercial center. The bank also required to incur expenses for the improvement of the standard of its services offered to its depositors which in most of the cases involves the sacrifices on its part in order to attract customers and expansion of the volume of its business in future. All these matters can not be put under the control which could be exercised by the owner of the money of a private common partnership who is in a position to assess the sum needed by the active partner as expense for food and clothing.

According to modern concept on the subject under discussion it has been considered permissible that a bank carries on business on non-usury system must deduct its general expenses inclusive of the wages of its members and employees which is in consistent with the concept advanced by the jurist of the various schools of thought due to the following consideration :

(1) The jurists who have allowed the expense to be charged to the Mudaraba money did so with the provision that it must be travelled in connection with the work outside the city or town. The ordinary expense incurred for travel is not permissible to be met from the Mudaraba money.

(2) The Hambalies have, however, allowed the expense, even for one who is resident in the place of work provided it is stipulated. The scope of such expense is limited to the extent of food and clothing. It is an expense which is controlled according to usage to what is known about the condition of the active partner. At the same time, according to Hambalis, the stipulation of expense relates to another matter of special importance i.e. trading the active partner as a wage-earner. In this case the active partner cannot take money from anybody else other than the owner who stipulates expense for him. Ibn Qudama has stated that where an active partner paid money in a Mudaraba and stipulated payment of expense and then "a man spoke asking him to take for him goods or a Mudaraba there is no harm in it." Imam Ahmad said: "If he stipulated expense he becomes a wage-earner and does not take goods from any other person."[270]

As far as the banking business is concerned the matter is a bit different. The expenses, be it the wages of the employees and worker or overhead and

general expenses. It is to be a high level of expenditure. As we have already explained earlier an ordinary person can not take into account, such cases, in terms of estimation which he considers to be reasonable. This situation is that which is different what the jurists who have allowed the expense to be charged to the Mudaraba money. These jurists have considered the active partner's expenses can be estimated in term of food, clothing and moving from one place to another. But practically charging the bank's expenses and the wage of its employees and workers to the profits might result in consuming all the profits earned particularly during the early years of the commencement of the business. The result will be that the bank will face lot of difficulties in attracting the investors as there will be no profit. The sentimental attachment only can not attract the investment money for establishing enterprise, firms and companies.

It is, therefore, proposed that no expenses, other than the preliminary expenditure, must be charged to the profit. This matter has already been explained while discussing the differentiation argued by Az-Zaylai, the author of *"Ilhaf Al-Muttaqeen"*. The overhead, wages of workers and the employees of the bank will be met from the bank's share of profit accruing to it as a common active partner. If no profit is earned the bank must bear the loss and its expenses. In this case the investor would have to be satisfied that no profit has been earned during the year.

In the case of active partner who do business with the bank, the expenses shall, in the Mudaraba contract with each of them will have to be stipulated in the agreement according to the prevailing circumstances within the framework of the opinions of the various jurists which we have taken from the Islamic jurisprudence and discussed in the preceding paragraphs.

2. BASIS FOR SHARING PROFIT:

The investors who own the invested money and the common active partner, the bank, which does not transact business on the basis of usury, are two parties who have right to sharing the profit earned from investment. The bank in sharing the profit will have two privileges as against the investor who have only deposited his money with the bank to use in the work.

The first entitlement of the bank, as active partner, in the profit will be according to the percentage declared and stipulated such as one half, one

third or otherwise. It must be in term of the net profit which is earned during the financial year in question.

The second entitlement in the profit of the bank will be as owner of a part of the money included in the Mudaraba irrespective whether such money is a part of the bank's own capital and reserves or part of the monies deposited by the respective owner in their account not as investment but to obtain banking services.

We, therefore, do not have any difficulty as regards to the sharing of profit in the first case because the bank will take its prescribed share which has been known before the commencement of the financial year. The advance declaration of the bank's share in the profit is a condition which eliminate the ignorance. As far as the creation of reserve is concerned the bank must set aside from its share of the annual profit a specified amount in general reserve to face possible loss which may happen in any year of its operation. This reserve, in most of the banks, generally exceeds the profit earned. This measure is mandatory because the bank, being a common active partner, is responsible for safeguarding the deposits made with it. Since the bank is liable for the deposits it must not be without material protection. While we were discussing the conditions relevant to profit we discover that according to some school of thought it is permissible to set aside a part of the profit for a certain specified party other than the parties to the Mudaraba. It would, therefore, be justified to set aside reserves created out of profit which will provide the protection to the monies deposited by the people.

The second entitlement, however, need the examination in details as it relates to the share of profit belonging to the monies invested because these monies are mixed and are subject to frequent movement, by drawings and deposits, all the year around. Mixing means mixing together of the money incoming from deposits and the money invested by the bank from its capital or reserves or the money of the depositor, other than the investment account, which a bank can invest.

If the bank can exercise the proper control over the money it allocates for the purpose of investment where the money will almost remain fixed, at a certain level, from the beginning to the end of the year the matter seems to be outside this scope as far as the investment is concerned. In such a case it would be necessary to examine the situation created by the deposits and the withdrawal from the account otherwise we would condemn this

innovated method as being rigid. What is required is to form an organisation which is suitable to the similar of the modern banking organization.

We are, therefore, required to discover the probabilities where we should be able to compete with the modern banking at the same time we should not deviate from the frame-work provided by the *Shari'a* on which we have firm faith. Having this as our goal, the following three probabilities come to our mind:

(1) In the first case the amount is deposited by the depositor for investment for the whole year i.e. from the beginning to the end of the year.

(2) The second situation may be where the depositor withdraws the amount deposited for investment, whole or part thereof, during the year.

(3) The third instant may be where a depositor wants to deposit fresh monies for investment during the financial year.

The sharing of the profit, in the first case is very clear and there is no difficulty to calculate the share of the profit. The method of calculation is simple and carries no complication as the share of the profit for the deposit had been fixed according to the percentage which is included in the investment, according to the nature of the account. The following method of computation may be adopted in this case.

Sum deposited x % invested according to the nature of the account ÷ 100. The result will then be multiplied by the sum accruing to the amount of the overall profit which will be allocated for distribution in proportion of the monies invested. The distribution of the profit will, however, be subject to the deduction of the bank's share. After deduction of the bank's share the remaining amount which accrue to the amount is reached by dividing the profit by the total of the monies according to the percentage thereof which has been included in the investment account.

In a situation where a depositor withdraws a part of the amount deposited before the end of the financial year he shall be considered to have the same status as that of the owner of the money of a Mudaraba partnership who withdraws the part of his money before the profit or loss is declared. He would, therefore, be considered to have chosen to reduce his capital by the

amount withdrawn from the common active partner before reaching the result of the trading i.e. profit or loss is declared. The computation of the proportionate profit shall, therefore, be effected on the lowest balance during the financial year under question.

In the third case we are faced with a situation where a depositor deposits the money into the specified investment account during the financial year. For example, if a deposit of Rs. 1,000/- is made in June and another Rs. 1,000/- is deposited during September. This case will need consideration.

As we have already explained previously such a situation does not have similarity in the private Mudaraba which can provide us the guidance as in the case of withdrawal which has been treated as reducing the capital. The reason being that in a private Mudaraba partnership, which is an independent contract, it would not be permissible, after the commencement of the work, to add fresh money to the capital already paid, so long as the situation of the Mudaraba partnership is not in the form of money. However, the guidelines we have determined while discussing the application relevant to common Mudaraba partnership, relative to the accrual of profit may provide us the guidance that mere deposit in the investment account is an allocation necessitating the accrual of profit just like that which accrues to the partner where the monies have not been mixed. In this regard, please refer to the quotation we have given from Al-Kassani and Ibn Qudama regarding the stipulation not to mix both monies in order to be entitled to profit in a contract company.

The same situation prevails where the money is deposited, during the financial year, in the investment account. Therefore, the depositor (the investor) would be the rightful owner to get profit. It would not be objectionable if he deposits the money during the year. It should also not be questionable if the bank makes an advance stipulation on such investor that the bank will not consider his participation, except from the beginning of the month or the two months following the deposit is made. The criteria behind this being that bank organise plans for investment in the light of resources available. This is unlike a bank which deals upon usury and is in a position to deposit its monies upon interest on the day following that on which it accept deposits from its customers.

As regards the difference in dates of those who deposited their monies for investment during the year the settlement may be effected in the same way as that in practice in the banking system for calculating the interest on the daily product i.e. by multiplying the sum by the number of days for consolidating the term on the basis of one day of the year. For example, if 'X' deposits Rs. 1,000/- in the middle of the year, he would for the purpose of participation in the profit be treated as having deposited Rs. 500/- from the beginning of the year. Assuming that Rs. 1,000/- is deposited in June, the calculation will be Rs. 1,000/- x 6 months ÷ 12 months = Rs. 500/-. This amount of Rs. 500/- will be treated as deposited in the beginning of the year for the whole one year and the profit will be paid accordingly.

In the above section we have made an attempt to explain the practice which may be adopted for sharing the profits as guided by the *Shari'a* at the same time keeping ourselves within the framework of the great Islamic jurisprudence.

We have not received the results and summaries which we were able to achieve but before we close our discussion on the subject we may say that we have been able to draw a framework which is appropriate for regulating investment in the common Mudaraba partnership according to the method which carries the development characteristics of the banking business and the guidelines which control the investment of money in accordance with the *Shari'a*.

With the awakening in the countries where majority of the Muslim population is inhabited the serious consideration are being given to do away with the usury based financial system and to adopt the Islamic system as provided by the *Shari'a*. A few of the countries have already gone completely on the Islamic system whereas other have partially introduced the new laws and quite others are studying the results and the progress of the countries of common faith with the intention to shift over to the system as prescribed by our *Shari'a*. Not only the Muslim countries are working on Islamic system but it has drawn the attention of the other non-Muslim countries also. The IMF have carried a study on the subject as will be evident by the study of the main point given in the following pages.

As we have mentioned a few countries have already shifted over the Islamic system and done away the usury based system we are giving in the following chapter the system as adopted by these countries i.e. Saudi Arabia, Iran and Pakistan.

Chapter 10

STUDY OF INTEREST - FREE BANKING AS PRACTISED IN VARIOUS COUNTRIES

....The equity based system being implemented in Muslim countries appears to have considerable merit from a purely economic standpoint.....

International Monetary Fund (IMF) -
Study on Interest Free-Banking-1985

INTERNATIONAL MONETARY FUND (IMF) — STUDY ON INTEREST-FREE BANKING

The International Monetary Fund has made a study of interest-free banking based on the Islamic tenets. This study is titled as "Islamic Interest-Free Banking : A Theoretical Analysis", and began with a description of the main precepts that guide Islamic Banking and Islamic economics.

It focused particularly on the view that which a "rate of interest is anathema to Islam, a "rate of return" is not.

"Whereas Islam clearly forbids the former, it not only permits, but rather encourages trade and therefore profits," the study said.

The study used these principles to develop a theoretical model systems that have been put into practice in certain countries.

The model is based on the principles to that nominal value of deposits in a bank is guaranteed neither by the bank itself nor by the government, and that the deposits do not receive a fixed rate of return on their deposit but are instead entitled to share in the bank's profits (or loss).

"The equity-based system being implemented in Muslim countries appears to have considerable merit from a purely economic standpoint," the study noted.

TRADITIONAL SYSTEM

As for the traditional banking system, the study pointed out that a fall in assets in the face of fixed nominal value of liabilities would create a disequilibrium between real assets and liabilities and could de-stabilise the banking system.

"There is rigidity in the traditional banking system that presents instantaneous adjustments", the study further said, "this rigidity can lead to possible instability".

DAR-AL-MAAL ISLAMIC TRUST

On the 27th July, 1981 "Dar-Al-Maal Islamic Trust" was founded as Trust in the Common-Wealth of Bahamas with an authorised capital of US$ One billion. The object of the DMI was to promote and development of an integrated Islamic economic and financial system of mobilization and utilization of the Muslim world's economic and financial resources which were increasing rapidly and changing the fate of millions of Muslims living in different parts of the world as a nation. The western style of economic and financial system was being practised in the countries inhabited by the Muslims and the majority of them was unaware that a system far better than the prevailing one was a part of the faith in which they believe. The first act of the DMI was supposed to diversify the existing system strictly in accordance with Islamic *Shari'a* and channelize the financial resources and potentials to carry out the financial business in accordance with the principles, laws and the traditions of the Muslims.

To synchronise the object, a network of the financial and business institutions has been established by the Trust in various countries which are playing an important role in bringing a revolution in the growth of Islamic financial system. The DMI Trust started its operation on 1st January, 1982 by acquiring the ownership of the ongoing business of Investment Company in Saudi Arabia.

At the same time contracts were also made in various Islamic countries to establish a number of Islamic Financial Institutions. Beside Islamic countries contracts were also established in other business and financial Key Centres of the world. As a result of these efforts, the DMI Trust, so far, has been able to establish more than 26 Islamic business and financial houses. These include MASSRIF (Alternative to contemporary banking), Takafol and Retakafol (Alternative to contemporary Insurance) and the business subsidiaries and their branch offices.

In major financial centres of the world the DMI group is represented either by its own network or international correspondents. It has provided the group, a direct access to provide an efficient, quality and comprehensive operation to a large variety of clients. To develop its investment and business operations the DMI Group has launched a series of Islamic financial instruments which has facilitated it to offer a wide range of Islamic

financial and business services. The funds mobilized through these channels are employed in viable and profitable operations in projects, trade and other investment areas of business.

The funds of clients are invested on a very selective basis where the yield is higher yet conservative outlets within the guidelines of *Shari'a*. The investment activities are spread over diversified fields of economic like Agro-industry manufacturing, construction, international trades, real estate, maritimes, leasing and venture capitals etc. Besides these activities, the Group provides the efficient and effective assets management and assists its clients in formulating their investments strategy.

The ownership of DMI Trust consists of its 1,500 Share-holders by possessing its equity participation certificates. The Share-holders are spread all over the Islamic world and outside. Many of the Share-holders keep the close link with the Trust by maintaining their Current Deposit Investment Accounts, "private portfolio funds and other business connections. Out of the profits earned by the DMI Trust, the major portion is paid to the share-holders in the shape of dividend while a part of it is retained to finance the further growth and for providing a base for the expansion of the institutional activities.

The operational construction of the DMI Trust consists of (a) Board of Supervisors, (b) Religious Board and (c) DMI S.A. The Trust has its Administrator and both the Management is headed by the Chief Officer of the DMI.

(a) **BOARD OF SUPERVISORS:** The policies and the strategy are framed by the Board of Supervisors of the DMI Trust. The members of the Trust are elected in the Annual General Meeting. The Board provides the guidelines and the corporate goal to the institutions of the Trust within the general framework of principles and objectives set forth by the founders of the DMI Trust. The Board also oversees the operations of the DMI Group of Companies and recommends to the Annual General Meeting the distribution of net profit and approves the budget for the financial year. To carry out the day to day operation the Board has delegated certain responsibilities to its Executive Committee consisting of the Chairman, Vice Chairman and some of its Board Members.

(b) **RELIGIOUS BOARD:** This Board consists of experts on jurisprudence and eminent international scholars. The Religious Board reviews and approves all investments and business activities undertaken by the DMI Trust and its subsidiaries, and certifies their conformity to Islamic *Shari'a*. The Board is also competent to examine and make any enquiry regarding the religious conformity of any operation of the DMI Trust or its subsidiaries.

(c) **DAR-AL-MAAL AL-ISLAMI S.A.** This Trust was created under an indenture which stipulates that its direct affairs are administered by DMI Saudi Arabia. The Administrator of the Trust is located in Crenera (Switzerland). Group strategy and planning, handling of group treasury, maintenance of its proper accounts, co-ordination of investments establishment and development of international relations, making available the technical assistance to the subsidiaries and arrange their Audit are the main responsibilities of Trust Administrator. The monitoring of the activities of its subsidiaries in accordance with the Group policies also falls under the jurisdiction of its Administrator.

The Group of the DMI Trust subsidiaries consists of the following:

(1) Islamic Investment Companies.

(2) Islamic Masaaref (Banks) alternative to Commercial Bank.

(3) Islamic Takafol, which is the Islamic alternative to conventional Insurances.

(4) Islamic business companies to channelize and utilise the funds of the DMI Trust.

(5) The subsidiaries in the field of Agriculture, industry, trade and the services which are remunerative and are in conformity with Islamic guidelines also gets the funds from DMI Trust.

Faisal Islamic Bank of Egypt, Faisal Islamic Bank of Sudan and Islamic Investment and Development Company, Cairo, Egypt are affiliated institutions of the DMI Trust.

ISLAMIC BANKING IN IRAN

Prior to the 1979 Revolution, the traditional interest-based banking was in practice in Iran. It was on Tuesday, the 28th August, 1983 when The Interest (Riba) Free Banking Act was passed by the Islamic Consultative Assembly *(Majlis Shoaraye Islami)* and approved by the Council of Guardians (of the constitution) on 30th August, 1983. But it began full operation on Islamic principles as per the Law with effect from 21st March, 1984. In preceding two years bank had already tested some banking transactions on Islamic basis and had trained a quite good number of staff to handle efficiently the transformation of the banking in the country from interest-based to interest-free system. Under the guidance of the Central Bank, banks held seminars and public meetings in most cities of Iran, distributed brochures and press releases etc. to educate the depositors and the borrowers of the forthcoming change in regulations. By the time the new law was enforced the public were already well advised about the changed methods applicable in Islamic banking. Naturally great efforts were required for the change and some times bank had to work within fixed time schedule for certain operations to be adopted to the changed system.

It was due to preparatory careful advance planning and preparations before the enforcement of the Law for usury-free banking in the transitory period which brought the fruitful result and made the transition smooth. The introduction of usury-free banking in Iran also provided an opportunity to the interested countries to draw on the experiences gained by this country in respect of every aspect of preparations, particularly training of personnel and educating the clientele. There is, of course, no doubt that no one can claim perfection and in every transition difficulties are bound to be encountered. In Islamisation of banking one has to take into consideration the fact that Islamic banking is only a part of the Islamic economy and banking system has much to depend on the customers behaviour and handling of related matters by other sectors of the economy, particularly trade, industry and agriculture. The tax and other social and administrative matters and procedures are important factors and constant efforts for co-ordination are essential.

DEPOSITS ACCOUNT UNDER THE ISLAMIC LAW

The main sources for mobilisation of funds for banks were saving and current accounts. The depositors of savings accounts and fixed deposits were paid interest. On savings accounts the rate of interest was lower, prizes were also distributed by lottery. The new Islamic law forbidding payment of interest, authorized banks to accept deposits under the following new type of accounts :

1. QARD-AL-HASANAH DEPOSITS :

(i) Current Accounts

(ii) Savings Accounts

Deposits received in current and savings accounts are accepted as "Qard-al-Hasanah (interest-free loans) or as (Alwadiah). The banks are liable for the repayment, on demand, if the principal amount is deposited by its customers in the Qard-al-Hasanah deposits accounts. These deposits do not participate in the profit and loss of the banks and are considered as part of the bank's resources. To encourage the deposits under this category banks are, however, allowed to grant, at their discretion, to such depositors non-fixed bonuses in cash or in kind or in form of concessions or exemption of commission/fees for the services or give priority in the use of bank services or give discount in bank charges to the depositors. Bank Markazi - Jamhouri Islami Iran determines the type, amounts, minimum and maximum of bonuses and prizes etc. The conditions of the current accounts are the same, with no change, except the legal confirmation by Law that banks are obliged to repay the principal amounts on demand as a repayment of Qard-al-Hasanah. In the first year of operations the new law, under Islamic system, i.e. from 21st March, 1983 to 20th March, 1984, while fresh deposits were received, under the title of "Qard-Al-Hasanah, savings accounts under new regulations, old balances in savings accounts, if any held until 20th March, 1985 received interest as per the previous regulations, this being a one year respite for savers. Most of the depositors adopted the new regulations well in time and unsettled old savings accounts balances automatically fell in the category of the Qard-al-Hasanah savings accounts with effect from 21st March, 1985.

During the succeeding years banks have given out prizes in cash and in kind. The process of announcing the prizes, based on the results of preceding year's working, has achieved considerable success. It is noteworthy that remuneration of small savers, though on unpredetermined basis, is still considered as an essential part of fund mobilization process under the new system as well.

2. TERM INVESTMENT DEPOSITS :

Term deposits are accepted by the banks in the following two forms:

(i) Short-term Investment Deposits against pass book entry, for a minimum period of three months.

(ii) Long Term Investment Deposits for one year and longer period against receipts.

Deposits are accepted by the banks according to law, as trust funds with power of attorney from the depositors to use them in joint venture, "MOZAREBEH", "MASAQAT", direct investment, forward dealing and "JOAALAH". Under the law the banks are permitted to undertake and to insure the repayment of principal of the term deposits where the banks have already given this undertaking to the depositors. Thus repayment of all the principal of all the term deposits are undertaken by the banks themselves. The funds deposited for utilization on specified projects are exempted. In such cases also insurance or undertaking of the repayment of the principal can be obtained from the receiving bank on mutual agreement.

The fixed deposits of different maturities, deposited under old system, which were due during the period from 21st March, 1984 to 20th March, 1985, followed the old rules. Fresh deposits renewed ones from 21st March, 1984 onward all came under the new rules. Minimum amount for a long term deposit is Rials 50,000/- The period of long term deposit generally is one year renewable, on agreement, for further period. It could however, be deposited for more than one year in multiples of three months. The receipt issued for long term deposits are not negotiable. Each commercial bank issues its own form of receipt.

The investment in short-term deposit was in fact developed for the depositors who wanted liquidity or access to funds in case of need. Such short-term

depositors can draw money from their accounts at any time without restriction. The required minimum balance is Rials 2,000/- and in order to participate in profit sharing the first deposit must remain with the bank for at least three full calendar months. The lowest monthly balances are taken for profit calculations.

As per the law the investments deposits constitute Depositor's Resources in banks. Profits derived by banks from operations stipulated in Article 3 of the law for usury-free banking are divided in proportion to the term and the amounts of investments of the investments deposits (Depositors Resources) and banks own resources in relation to the aggregate resources used in such activities. If the total financing is less or equal to the total investment term deposits (after deduction of statutory resources) the entire profit earned shall be divisible among the depositors. Only financing in excess of the net amount of Investment term deposit is treated to have been funded out of "Bank's Resources."

The banks are not allowed to use depositor resources for certain purposes i.e. term investment deposit. Such transactions include Qard-al-Hasanah loans, purchasing of claims and financing any other permissible transaction not stipulated in the note under article 3 of the Law for usury-free banking.

At the end of 20th March, 1984 total deposits of the private sector with the private banks amounted to Rials 5.600 Millions. One year after the enforcement of usury-free banking law i.e. the end of 20th March, 1985 it reached Rials 5.918 Millions. Two years after, at the end of 20th March, 1986, the total private Sector deposits continued to increase and touched the figure of Rials 6.705 Millions. The gradual increase in deposits of private sector shows the confidence of the people of Iran in new banking system, introduced by the revolutionary government, which had full support of the masses to change their entire economic system according to the tenets of Islam. The success of the new system in Iran will not only provide the required social justice to its own people but will also be an example for others to follow the suit in future. This has also proved that the links with the banking system being practised in other Eastern as well as Western countries will also not be affected adversely if the Islamic system is adopted by them.

LENDING AND OTHER MODES OF FINANCING

The banks use to provide facilities in the form of loans, overdrafts in current accounts and by discounting bills under the traditional system of banking based on usury. The new law, however, seeks to provide and promote the concept of Qard-Al-Hasanah as an instrument of realization of the aims of the article 43 of the Iranian Constitution and banks are required to allocate a part of their resources for providing Qard-Al-Hasanah loans. Other modes of financing based on profit sharing are also permitted but only on the condition that respective transactions take place on Islamic principles and are free of interest. The mode of transactions as practised in Iran and their nature and their scopes are given in the following section of this chapter :

INSTALMENT SALES: Banks are allowed to provide financial facilities to their customers in industry, mining, agriculture and services sector by purchasing raw materials, parts, working tools, machinery and other equipment for sale to them on instalment basis. There are three parties to this sort of transaction. The seller, the bank and the buyer. For assessing the requirement of the production unit, the quantity of raw material sufficient for one production period is taken into consideration. Also the period of payment of instalments is not to exceed one production cycle or the listed (exempted) useful life of the machinery or equipment. New houses and dwelling units can also be sold on the basis of deferred payment in instalments.

The trading activities are not allowed to be financed under instalment scheme under the regulation in this regard. The rationale behind this decision is to channelize funds under this facility for productive purposes. It is, however, considered that by further progress in the use of other modes of financing, gradually the percentage of the volume of instalments financing would be smaller than the present level.

MUDAREBEH: It is the second most important mode of financing under the Islamic system of banking. Mudarebeh is confined to trading business i.e. purchasing or selling of goods. It does not comprise of any project financing as practised in some Islamic banks or financial institutions in other countries. Almost all main branches of commercial banks in Iran, traders, co-operatives and commercial companies are in a position to apply for the facility. It is permissible for the banks, as per law, that they can

provide cash capital to Agents (Modarib) who can be a real or a legal person) under a Mozarebeh arrangement. The preference is given to the legally established co-operatives. In import it is, however, limited to public sector but in export and domestic trade both public and private companies or individuals can avail themselves of this facility.

In a contract of Mudarabah the Modarib (the agent) expressly undertakes to use the capital solely on account of purchase price of goods and insurance, warehousing, transport, bank charges and packing expenses. He undertakes to bear other administrative expenses, wages, salaries etc. from his own resources. The Mudarib (the agent) further agrees to compromise with the bank all such sundry expenses incurred by him against the amount paid by the bank under Aqd Solh. The Agent undertakes to indemnify the bank for any damage or loss caused to the principal capital of the bank due to carelessness or negligence. The Agent also foregoes the right of cancellation of the Agreement upto the end of the agreed period until complete finalization of the respective accounts. By now the banks in Iran have gained useful experiences in practising of Mozarebeh transactions.

CIVIL PARTNERSHIP: The most important modes of financing introduced in the banking system in Iran under law was the CIVIL PARTNERSHIP under which the banks were allowed to provide part of the business capital. In most cases the facility-taker was required to pay minimum 20% share to the bank. This partnership is, of course, different to that of legal partnership. In legal partnership the banks acquire a share in the capital of a joint stock company already established or a new one to be established. But in the case of civil partnership the banks are also permitted to make direct investment of capital in productive and development projects. Upon accomplishment of the agreed operation or business the civil partnership is dissolved and accounts are settled. The facility can be availed of by all customers irrespective of whether they are engaged in productive, commercial or service activities without any restriction on the type of transaction.

The experience gained in the dealing of the type of financing has proved quite successful and the necessity of expanding it is being felt to provide more encouragement towards this end. It was, therefore, under consideration to obtain authority from the Legislature that the provisions of the Article 15 of the usury-free Banking Law must also be applicable to documents relating to civil partnership. The article reads as under :

"All agreements conducted in pursuance of Articles (9), (11), (12), (13) and (14) of the present law shall, under contract to be signed between the parties concerned, be considered binding documents and shall be subject to the rules governing legal documents."

Partnership was permitted under Article (7) of the law and like Joaalah, which was allowed under Article (16) was not included in the above-noted Article. The necessity of registering respective Agreements with the public notaries was, therefore, needed to avoid this procedure whereas according to the present law other contracts or documents signed with customer are considered binding papers and banks do not need to go to courts to prove them. Agreements made between banks and customers can be executed with least formality. As a matter of fact in the said Article the law has provided a very good protection for the newly introduced banking system based on Islamic principles.

QARD-AL-HASANAH LOANS: For the following purposes Qard-Al-Hasanah loans are provided:

(i) To provide equipments, tools and other means of work for gainful employment.

(ii) To boost up production, with particular emphasis on agriculture, livestock and industrial products.

(iii) To meet necessary personal needs of individuals requiring financial assistance for house repairs, marriages and medical treatments etc.

The expenses incurred by banks in providing Qard-Al-Hasanah loans are recovered from the borrowers on the basis of actual expenses as determined by the Central Bank as per the guidelines issued by them.

PURCHASING OF CLAIMS: It is permissible to purchase the claims by the banks on the basis of mark-down with the condition that these claims relate to real transactions. Before the introduction of present regulations it was permitted upto Rials 50 million in respect of one real person and upto Rials 1 billion for a legal person but the changed regulation restricted the purchasing of claims to Rials 5 millions and 50 millions for real and legal persons respectively. An amendment in respect of this type of financing is

required to improve it further. The credit line for buying claims should be related to debtor rather than the Endorser or the Assignor of the claims. This would involve important changes. Bank's financing risk in this field, would involve greater numbers of customers. It is also possible that innovation may lead to a mode of business whereby holder of claims (Bills of Exchange, Promissory Notes etc.) will be in a position to dispose of them, when convenient, to their discharge. It is also possible that this type of bill purchasing would be tantamount to creating a financial instrument for small businessman, who has a limited credit line with a bank and lacks other means to buy his small but numerous requirements from various suppliers. To encourage this mode of financing further studies for evolution of new permissible technique are, however, required.

JOAALAH: Joaalah means an undertaking whereby one party (the Joal, bank or employer) undertakes to pay a specified amount of money to another party in return for rendering a specified service in accordance with the term of contract. The party rendering the service is called "Amel" - the Agent or the contractor. Joaalah is also used for financing imports under letter of credit or financing the projects. Most of the bank services, like remittances against fees, come under this title. The banks are, therefore, allowed to engage in Joaalah in order to facilitate the expansion of production, commercial and service activities required by the community in the society. In the financial year 1986 the share of Joaalah in the total financing amounted to Rials over 24 thousand million i.e. less than 1.50 per cent.

HIRE PURCHASE: Article 12 of the Usury-free Banking Law provides the purchase of moveable and immovable properties by the banks at the request of their clients against their undertaking to hire-purchase the same for own use, and place them at the disposal of the clients as per hire-purchase arrangements. The purpose of introducing this mode of financing is to help services, agriculture, industry and mining sectors to avail themselves of hiring or leasing facilities where they are not able to have other forms of financing. The share of this sort of financing at the initial stage was Rials 16,200 million which comes to little over one per cent of the total financing of the commercial banks. But by introducing some improvement in tax regulation, avoiding double taxation, the financing under hire-purchase is improving and the results are quite encouraging.

FORWARD DEALS: Besides banks equity share in the capital of the units they also require the working capital for productive purposes. The

banks are, therefore, allowed to purchase, on forward basis, their products at a fixed price. The terms of the deal such as specification of the product, time of delivery, price etc. have to be settled in advance. Banks are forbidden to sell the products so purchased before the date of its delivery except when the product is delivered to the banks before agreed date. The substantial increase in the forward deal transaction is planned in the future which in 1986 was Riyals 24,000 million i.e. about 3-1/2 per cent of the total banks financing.

SHORT TERM RUNNING FINANCES: Occasionally the additional funds are required for the short period, even sometime for few days only, by the small as well as large traders and companies but they do not want to share their profit with the bank for the whole period under Mudaraba or partnership. Sometime the business conditions are such that bank customers come under great hardship and face business insolvency in the absence of bank's financial assistance. Qard-Al-Hasanah is one answer to such occasional requirements but it is not always advisable or possible to grant financial assistance to such customers. A solution is, therefore, had to be found out. Efforts were made to evolve a permissible procedure or mode of financing for such requirements. A formula was, therefore, considered for the solution of such situation and another mode of financing was put into practice within the framework of Musharika (Civil Partnership) to satisfy many genuine temporary financial needs.

Under this mode of financing a trader or company, in addition to the cash capital allocation, the borrower enters into a contract with the bank for a particular business with the condition that the cash capital of the customer will be constantly used in the proposed business but bank's capital will be used when needed. It is further agreed that Musharika between the customer and the bank becomes effective upon the first use of bank funds. Used amounts are calculated on the basis of daily product without charging the interest. At the end of the agreement the amount is charged on the basis of actually earned profit according to the share in the profit as agreed upon. If the customers incurred losses they will even be entitled to receive refund of the some percentage as that of profit, whereas under interest bearing overdraft system the borrowers had to pay to the bank a fixed rate of interest p.a. irrespective of the fact that they had incurred losses or gained profit. Naturally banks as in the case of Mudaraba and other transactions, take every precaution to deal in businesses expected to produce profits or also take necessary undertakings or collateral to ensure that no losses are caused

due to fraud or negligence. It is, of course, understood that at the end of agreed period partnership dissolves and accounts are to be settled or the arrangement may be renewed for a further period after settlement of the previous account. It is also clear that such facilities can be granted only to the selected creditworthy customers whose reputation, accounting systems or books would warrant a fair control of their business activities. With the experience gained by practising this mode of financing, in course of time, it is expected that new techniques of profit control and customer-bank relation would further be developed.

STATUTORY LEGAL RESERVES AND SUNDRIES: The banks in Iran are required to maintain legal reserves in respect of the bank deposits with the Central Bank of Islamic Republic of Iran at the following ratio :

(i) Investment, Term Deposits and Saving.....25%

(ii) Qard-Al-Hasanah, Current Accounts, Sight deposits etc.....27%

MOZAREBEH and MOSAQAT are two other forms of permissible financing in respect of farming and orchard or garden plantation activities. The transaction under these modes of financing are little in volume as under these titles farmers mostly receive financial help as Qard-Al-Hasanah or under other forms of financing.

TREATMENT OF PREVIOUS FACILITIES UNDER INTEREST BASED SYSTEM IN INITIAL PERIOD:

The banks in Iran began financing under the new law from 21st March, 1984. On the 20th March, 1984 the total balance of various facilities availed by the private sector amounted to Rials 4,114,907 million. After two years, on 20th March, 1986 the position of balance under old and new system were: Rials 4,837,330 million with the following break-up :

(i) Remainder of the old facilities.....Rials 3,207,510 million

(ii) Balance facilities granted on Islamic principles as per Usury-Free Banking Law.....Rials 1,63,320 million

It was originally intended that the old balances would be settled or restructured according to Islamic banking within a maximum period of two years. However, practically extensions have been granted to make it possible for the bank clients to settle conveniently or make new agreements. A quite good number of customers who had received loans to finance purchasing of housing units on 15 or 20 years instalments were allowed to continue under previous agreements. Industrial, commercial and other productive or service units adopted their banking operations quickly on the new regulations and needed time to settle the old ones. At the end of first year, assets on Islamic transactions accounted for about 15.50 per cent, at the end of second year it rose to about 34 per cent. Since no longer the traditional facilities were granted the financing under new regulation increased whereas the outstanding balances under old system reduced to a considerable extent and now a little percentage remain under old system which in due course of time, is expected, would be finally settled.

Conventional techniques are known in Islamic banking. However, still the experiments in the new system need careful consideration. The new system now operating within equity financing or trade-related framework need new techniques, proper supporting institutions and different auditing methods. Though the interest-free banking system has been brought in practice by Iran it is still a must for all concerned and interested countries to continue evolution of new techniques, employ more resources and carry out research work until it becomes perfectly efficient in all respects to compete with the most developed western interest-based system.

Following is the translation of Interest-Free Banking Act of Iran, passed by the Islamic Consultative Assembly (Parliament) on Tuesday, 28th August, 1983, from Persian to English by Dr. Ali Raza Naqvi of Islamic Research Institute of Pakistan, Islamabad, for the benefit of the readers to understand, in a better way, the legislative changes introduced by Iran in its Constitution.

In the name of Allah, the Merciful, the Compassionate

INTEREST (RIBA) - FREE BANKING ACT 1983

CHAPTER ONE

Objectives and Functions of the Banking System in the Islamic Republic of Iran

ARTICLE 1

The objectives of the banking system are:

(1) Establishment of a monetary and credit system on the basis of justice and equity (according to the Islamic laws and regulations) in order to regulate circulation of money and credit on a sound footing in the direction of a healthy growth of the country's economy.

(2) Endeavouring to the attainment of the economic goals, policies and plans of the Government of the Islamic Republic through the monetary and credit mechanisms.

(3) Creation of facilities necessary for the extension of public cooperation and *Qard al-Hasanah* through the attraction and absorption of surplus funds, deposits, savings and reserves for the purpose of providing conditions and opportunities for employment and investment in the realization of the provisions contained in Clauses 2 and 9 of Article 43 of the Constitution.

(4) Maintenance of the value of the currency, creation of equilibrium in the balance of payments and facilitating the commercial exchanges.

(5) Facilitating (monetary) payments, receipts, exchanges, transactions and other services to be performed by the Banks according to the law.

ARTICLE 2

Functions of the banking system are:

(1) Issuance of the currency notes and coins as legal tender in the country in accordance with the Law and regulations.

(2) Regulation, control and guidance of circulation of the money and credit in accordance with the Law and regulations.

(3) Performance of all banking transactions in foreign exchange and Iranian currency (Rial), and undertaking or guaranteeing foreign exchange payments of the Government in accordance with the Law and regulations.

(4) Supervision and control of transactions in gold and foreign exchange and the inflow or outflow of Iranian currency and foreign exchange, and formulation of regulations governing them in accordance with the Law and regulations.

(5) Performance of transactions relating to valuable papers and documents (or negotiable instruments) according to the Law and regulations.

(6) Implementation of the monetary and credit policies according to the Law and regulations.

(7) (Performance of) banking transactions relating to such sections of the approved economic plans as are to be conducted through the monetary and credit system.

(8) Opening of various *Qard-al-Hasanah* (current and saving) accounts, (accepting) term investment deposits, and issuance of relevant certificates in accordance with the Law and regulations.

(9) Extending interest-free loans and credits in accordance with the Law and regulations.

(10) Extending loans and credits and provision of other banking services to the legally established cooperatives in realization of the provisions contained in Clause 2 of Article 43 of the Constitution.

(11) Performance of transactions in gold and silver, and holding and management of foreign exchange and gold reserves with due observation of the relevant Laws and regulations.

(12) Holding the Iranian currency (Rial) balances of international monetary and financial institutions, or similar organizations and/or their affiliated agencies, in accordance with the Law and regulations.

(13) Conclusion of agreements for payments in implementation of the monetary, commercial and transit treaties signed between the Government and other countries, in accordance with the Law and regulations.

(14) Accepting from real or legal persons and holding in trust of gold, silver, valuable articles, negotiable instruments and official documents and leasing of lockers.

(15) Issuance, endorsement and acceptance of foreign exchange and Iranian currency (Rial) guarantees for customers.

(16) Performance of services of an attorney (or agent) or a guardian (or an executor of wills, *wasi*) in accordance with the Law and regulations.

CHAPTER TWO

Mobilization of Monetary Resources

ARTICLE 3

Banks may accept deposits under each of the following heads:

A- A- QARD-AL-HASANAH DEPOSITS
1. Current
2. Saving

B- TERM INVESTMENT DEPOSITS

NOTE:- Term Investment Deposits, for the utilisation of which the Bank enjoys the power of attorney, shall be utilised in joint enterprises, Mudarabah, hire-purchase, instalment transactions, Muzara'ah, Musaqat, direct investment, forward bargains and Ju'alah.

ARTICLE 4

Banks shall have to repay the principal sums of *Qard Al-Hasanah* (saving and current) deposits, and may guarantee and/or insure the principal sums of Term Investment Deposits.

ARTICLE 5

Profits accrued from transactions mentioned in the Note under Section 3 of this Act shall be apportioned on the basis of the agreement signed, in proportion to the terms and amounts of Investment Deposits and in observation of the share of the Bank resources in proportion to the term and amount of the aggregate sums utilised in such transactions.

ARTICLE 6

In order to attract and mobilize deposits, the Banks may, through adopting measures for encouragement (of depositors), award them the following concessions :

A- Award of non-fixed bonuses in cash or in kind to *Qard-Al-Hasanah* deposits.

B- Granting exemption from, or discount on, the payment of commissions and/or Bank fees.

C- According preference to depositors in the enjoyment of Banking facilities in cases specified in the (forthcoming) Chapter Three.

CHAPTER THREE

Banking Facilities

ARTICLE 7

In order to provide the necessary conditions for the promotion of the activities of various productive, commercial and services sectors, the Banks may, on the basis of partnership, provide a part of the capital and/or resources required by these sectors.

ARTICLE 8

The Banks may invest directly in the productive and development projects and activities. Plans for such investments must be incorporated in the State Annual Budget Bill and approved by the Islamic Consultative Assembly (Parliament), and the evaluation of the project must be indicative of no loss.

NOTE: The Banks are, by no means, entitled to invest in the production of luxury and non-essential consumer goods.

ARTICLE 9

In order to provide facilities for the promotion of commercial activities, the Banks may, within the framework of the commercial policies of the Government, place the necessary financial resources at the disposal of the customers on the basis of Mudarabah agreements, according priority to the legally established cooperative (societies or organizations).

NOTE: The Bank shall not enter into Mudarabah with the private sector for transactions relating to imports.

ARTICLE 10

In order to provide necessary facilities for the promotion of housing facilities, the Banks may, in coordination with the Ministry of Housing and Town Planning, construct low-cost residential units for sale on instalments or hire-purchase basis.

NOTE: There shall be no objection if the Banks acquire urban land for the construction of the residential units provided in Section 10 above.

ARTICLE 11

In order to provide necessary facilities for the promotion of activities in the fields of industry, mines, agriculture and services, the Banks may purchase movable property at the request of the client and his undertaking for the purchase, consumption and/or direct use of the property or properties requested, and sell them to the client on instalments basis after obtaining necessary security from him.

ARTICLE 12

In order to create necessary facilities for the promotion of services, agricultural, industrial and mining activities, the Banks may purchase movable and immovable property at the request of a client and his undertaking that he would hire-purchase the same for his own use, and place it at the disposal of the client on a hire-purchase basis.

ARTICLE 13

In order to create necessary facilities for the provisions of the circulating capital for productive units, the Banks may adopt any of the following measures :

A- Purchase raw material and spare parts required for the productive units at the request of the productive units and their undertaking for the purchase and consumption of the raw material and spare parts so requested, and sell them to the said units on credit.

B- Forward purchase at the request of these units such products of the units as are easy to sell.

ARTICLE 14

In order to realise the objectives contained in Clauses 2 and 9 of Article 43 of the Constitution, the Banks shall earmark a section of their resources for extension to the applicants as *Qard-Al-Hasanah*. The Rules for the enforcement of this Section shall be framed by the Central Bank and approved by the Council of Ministers.

ARTICLE 15

All agreements concluded in pursuance of the provisions contained in Articles 9, 11, 12, 13 and 14 of this Act, shall, as per agreement signed between both the parties, be treated as binding documents and shall be governed by the provisions of the Rules for the enforcement of the Official Documents (Act).

ARTICLE 16

In order to create facilities necessary for the promotion of the productive, commercial and services activities, the Banks may perform transactions by way of *Ju'alah*.

ARTICLE 17

The Banks may lend the agricultural lands and/or orchards at their disposal or in their possession on *Muzara'ah* or *Musaqat* basis.

CHAPTER FOUR

Central Bank of Iran and Monetary Policy

ARTICLE 18

The Central Bank of Iran, which shall henceforth be called Central Bank of the Islamic Republic of Iran, with respect to the state corporations the shares of which are not cent per cent owned by the Government, perform only such transactions as are sanctioned by this Act.

ARTICLE 19

The policy for credit and short-term (one-year) facilities shall be adopted on the recommendation of the general body meeting of the Central Bank and approval of the Council of Ministers, while the policy for credit and five-years and long-term facilities shall be incorporated in the Bills for five-year and long-term development plans of the country and submitted to the Islamic Consultative Assembly (Parliament) for approval.

ARTICLE 20

For the proper functioning of the monetary and credit system, the Central Bank of the Islamic Republic of Iran may, by using the following instruments and in accordance with the Rules for enforcement (of the Act) to be approved by the Council of Ministers, intervene in, and control the monetary and banking affairs on the basis of the provisions contained in Article 19 above :

1. Fixation of the minimum and/or maximum ratio of profits for the Banks in their joint enterprises and Mudarabah ventures; these ratios may vary for each of the different fields of activity.

2. Determination of various fields for investment and joint enterprises within the framework of the approved economic policies, and fixation of the minimum prospective rate of profit in case of selection of the various investment and joint enterprise projects; the minimum prospective rate of profit may vary for each of the different fields of activity.

3. Fixation of the minimum and maximum ratio of the Bank profit in transactions on instalment and hire-purchase basis in proportion to cost price of the goods transacted; such prices may vary in different cases.

4. Determination of the types and the minimum and maximum amounts of commissions for Banking services (provided they do not exceed the expenses of the service rendered) and the fees charged for putting to use the Investment Deposits received by the Banks.

5. Determination of the types, amounts, minimum and maximum bonuses provided in Article 6 above, and specifications of the rules for publicity by the Banks in such cases.

6. Fixation of the minimum and maximum limits for joint enterprises, *Mudarabah*, investment, hire-purchase, instalment, credit and forward transactions, *Muzara'ah*, *Musaqat*, *Ju'alah* and *Qard-Al-Hasanah* for Banks or any of them in any of the cases and in different fields of activity; as also fixation of the maximum amount of facilities that can be granted to each client.

CHAPTER FIVE

Miscellaneous Provisions

ARTICLE 21

The Central Bank is not allowed to perform Banking transactions involving usury with any of the Banks, nor are the Banks allowed to deal with one another in such manner.

ARTICLE 22

With the permission of the Central Bank of the Islamic Republic of Iran, the Banks may perform legal Banking transactions with the government or government-affiliated organizations and public corporations.

ARTICLE 23

The funds received as commissions and fees shall constitute the income of the Banks and cannot be divided among the depositors.

ARTICLE 24

Exemptions from Commercial tariff or tax exemptions granted by law to factories and productive enterprises shall also apply to the Banks acting in a position similar to the factories and productive enterprises in matters of imports or ownership.

ARTICLE 25

The units in which the Banks have a share or have made investments shall be governed by the Trade Act, unless they are subject to another law.

ARTICLE 26

Consequent to the enactment of this Act, all laws and regulations repugnant to this Act shall be null and void, and all the (powers and) duties provided in the Monetary and Banking Act and the Bill for Administration of the Banking Affairs and its Supplement which under the present Act have been delegated to some other competent authorities shall be withdrawn from the previous authorities.

ARTICLE 27

The Ministry of Finance and Economic Affairs shall frame the Rules for Enforcement of this Act on the recommendation of the Central Bank of the Islamic Republic of Iran and put it into effect following its approval by the Council of Ministers. The period between the drafting and approval of the Rules for Enforcement of this Act shall not exceed four months.

This Act, containing twenty seven Articles and four Notes, was passed by the Islamic Consultative Assembly (Parliament) in its session held on Tuesday the Eight Shahrivar, in the year one thousand three hundred and sixty two (28 August, 1983) and approved by the Council of Guardians (of the Constitution) on 10-6-1362 (30-8-1983).

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(—)

GLOSSARY

QARD-AL-HASANAH

A loan by individuals or societies generally as an act of piety, where the payee may repay it as and when it is convenient to him, but he is not obliged to pay any interest on it, nor is he obliged to repay it at all, should his circumstance not allow him to do so. In Islamic banking, however, it means an interest-free loan extended by a Bank to a real or legal person for a definite period of time within which the payee is obliged to repay the principal sum to the Bank (without interest).

MUDARABAH (or Metayage)

A contract in which the Bank (or any individual or body) called Mudarib, undertakes to provide capital to the other party, called 'Amil (or an Agent), and the other party undertakes to use the capital for commercial purposes, and the profit so accrued is divided between the two parties at the end of the term of the contract, or one or more transactions, in a ratio specified in the contract.

MUZARA'AH (or share-cropping)

A contract in which the Bank (or any other individual or body), called Muzari', hands over a specified plot of land for a specified period of time to another party, called 'Amil (or Agent), for the purpose of cultivating the land, and the harvest produced is divided between the two parties in a ratio specified in the contract.

MUSAQAT

A contract between the owner of an orchard or garden and another party, called 'Amil (or Agent), according to which the owner of the orchard or garden undertakes to place the orchard or garden at the disposal of the other party, and the other party undertakes to water and take care of the orchard or garden and gather its fruits or harvest; and the fruits or harvest so gathered are divided between the two parties in a ratio specified in the contract. The harvest may be fruits, leaves, flowers, etc. of the plants in the orchard or garden.

JU'ALAH

An undertaking by a Bank, (employer or any other person), called Ja'il, to pay a specified amount of money to another in return for rendering a specified service in accordance with specified terms. The party rendering the service is called 'Amil (or Agent). The difference between a Ju'alah and a contract of Hire is that while in the former an Agent may opt not to perform the service, and as long as he does not render the service the employer shall not be obliged to pay him the specified wages, while in the latter immediately after the conclusion of the contract, the employee becomes obliged to render the service and the employer becomes obliged to pay the employee the wages specified in the contract.

(SOURCES: Muhaqqiq al-Hilli's Sharayi' al-Islam. Ayatullah Ruhullah Khumayni's Tawdih al-Masa'il, etc.)

INTEREST-FREE BANKING SYSTEMS IN PAKISTAN

The purpose of creation of Pakistan was to provide territorial boundaries where the majority of inhabitants was Muslim and where they can live in peace by following their Islamic faith. It was the logic behind the declaration of the father of the nation, Quaid-e-Azam Muhammad Ali Jinnah, at the time of inauguration of the Central Office of the State Bank of Pakistan in 1948 when he said: ..... "The adoption of western economic theory and practice will not help in achieving our goal of creating a happy and contented people."....

It was, therefore, just before the end of 14th century of Hijrah (12th Rabi-ul-Awal 1399 -H/9th February, 1979) that the unique event in modern economic history took place when Pakistan announced the elimination of usury, phase-wise from its financial and banking system spread over a few years period. This historic initiative was immediately followed by Islamic Republic of Iran, where the revolution based on Islamic fundamentalism, was in its infancy stage.

In the first phase effective from 1st July, 1979 the Investment Corporation of Pakistan (ICP) eliminated interest from the operation of managing its Mutual Funds. At the same time National Investment Trust Limited (NIT) bade farewell to interest based system and adopted interest-free operations. In August, 1979, House Building Finance Corporation (HBFC) introduced interest-free scheme. Small Business Finance Corporation (SBFC) and Investment Corporation of Pakistan (ICP) converted their operations into Profit & Loss sharing with effect from 1st July, 1980 and 1st October, 1981, respectively.

DEPOSITS :

After the introduction of interest-free system in Financial Institutions the Nationalised Commercial Banks in Pakistan were asked to accept the Profit & Loss Sharing deposits with effect from 1st January, 1981. From 1st July, 1985, no bank in Pakistan, Nationalised or Foreign, was permitted to accept interest bearing deposits. All returns bearing deposits with the bank were required to be placed on Profit and Loss Sharing basis. The deposits in current accounts and other demand deposits were allowed to be accepted

by the banks as in the past. No return on interest was, however, payable thereon.

Deposits in Foreign Currency Accounts maintained in Pakistan and Foreign Currency loans were continued to be based on interest-bearing system, as previously, according to the terms and conditions as agreed upon by the concerned parties. The branches of Pakistani banks in foreign countries continued their operation on the interest-bearing system without any change and were allowed to follow the rules and regulation of the country they were operating in.

After the scheduled date the commercial banks were, however, asked to maintain separate accounts in their books for interest-bearing and non-interest bearing operations and were not allowed to mix up the transactions carried on non-interest basis. The banks were also asked to invest the deposits accepted on Profit and Loss sharing system in the restricted operations such as (i) Commodity operation of Federal and Provincial Governments and their agencies on mark-up basis. (ii) Export Bills drawn under Export Letter of Credit - negotiated without reserve. In such transaction the exchange difference of buying and selling of the currencies was allowed. (iii) Profit and Loss sharing (PLS) based transaction of the Investment Corporation of Pakistan (ICP), Bankers Equity Limited (BEL), investment in shares, National Investment Unit (NIT), Participation Term Certificate (PTC), on the basis of sharing profit in the shape of dividends received in their assets. (iv) Investing Funds with House Building Finance Corporation (HBFC) sharing profit and loss of the corporation during the relevant period.

MODES OF FINANCING UNDER INTEREST-FREE BANKING SYSTEM :

In January, 1981 when the commercial banks were asked to accept PLS deposits they were also required to invest the funds in the assets as mentioned above. The State Bank of Pakistan advised the commercial banks in March, 1981 to invest the funds in the following assets also, in addition to the assets as stated above, on mark-up basis :

(i) Inland Bills (Documentary) drawn under Inland Letter of Credits.

(ii) Import Bills (Documentary) drawn under Import Letter of Credits.

(iii) The credit facilities for trading operation to Rice Export Corporation of Pakistan, Trading Corporation of Pakistan and Cotton Export Corporation.

The financing by the Nationalised Commercial Banks, on consortium system, for fixed investment of trade and industry in the private sector under the lead of Investment Corporation of Pakistan (ICP) and Bankers Equity Limited was also made on mark-up effective from 1st July, 1981. The individual banks were, however, allowed to continue the financing of Participation Term Certificate (PTC) on the interest-bearing system.

The financing by the Nationalised Commercial Banks for House Building/ Purchasing to the individuals exceeding Rupees one hundred fifty thousand (Rs. 150,000/- but not exceeding Rupees three hundred thousand (Rs. 300,000/-) was also brought under the net of mark-up system and the mandatory targets were given to the banks by the State Bank of Pakistan.

Having introduced the non-interest system on experimental basis for 5 years Government of Pakistan with effect from 1st July, 1984 further allowed the commercial banks to provide the finance in any out of 12 modes of financing, as we shall narrate in the following paragraphs. It was, however, left to the discretion of the bank to settle the arrangements with its customers as they deem fit. The commercial banks were also allowed to continue the traditional financing on interest based system upto 31st December, 1984. As a further step towards non-interest basis system effective from 1st January, 1985, the financing to the Federal Government, Provincial Governments and their agencies, Public Sector Enterprises and Public and Private Joint Stock Companies was to be made only on non-interest basis. The renewal of old, interest based advances, was also to be converted into interest-free basis of the above-mentioned types of customers from the above date. From 1st April, 1985 all types of credit facilities provided by the Banks to other types of customer including individuals was made on interest-free basis.

To regularise the change over from the traditional modes of financing based on interest to the newly adopted interest-free based system the following 12 modes of financing were advised by the State Bank of Pakistan. In the subsequent paragraphs we shall talk about these 12 modes of system briefly :

(A)FINANCING BY LENDING

(1) INTEREST-FREE DEMAND FINANCE :

There might be two types of persons who may need financial assistance to meet their short term personal requirement due to having their limited means and therefore no savings being possible. Rather some time it becomes difficult for them to make both ends meet. But at the same time being the constituent of the society they have certain obligations to meet. They are, therefore, left with no alternative but to seek assistance from the agencies who are in a position to help them in their genuine requirements. The banks who have got capital and mobilize the small savings are in a position to provide such assistance to the individuals. But for the proper growth of the capital and to mobilize the small savings they are required to maintain big establishments, the management of which is not possible without incurring the administrative expenses. Besides the administrative cost there is an obvious element of cost of funds which is to be borne by these institutions. For a society where social justice and living with humane dignity is the object we may ignore the cost of funds but the administrative cost is to be borne by those who want to take advantage of the others' efforts.

Therefore, under this mode of financing the banks are not permitted to charge any interest on loans but are permitted to recover the service charges. The maximum rate which banks may recover as service charges during an accounting year is arrived at by dividing the total of its expenses by its total assets at the beginning and the end of year and rounding off the result to the nearest decimal of a percentage point. But while calculating the total of its expenses, the cost of funds, the amount of Bad Debts debited to expenditure account and provision thereof and the Income Tax paid and provided for the related year is to be excluded.

(2) QARD-E-HASANAH :

The people of small means need money to meet their urgent personal requirement as they do not have saving to meet such eventualities. This type of loan is, therefore, for these people which is based mainly on humane considerations.

Qard-e-Hasanah given by the banks on compassionate grounds is free of any interest or service charges. This loan is repayable as and when the borrower is in a position to repay.

(B) TRADE-RELATED MODES OF FINANCING :

(3) PURCHASE OF GOODS BY BANKS AND THEIR SALE TO CUSTOMERS AT MARK-UP PRICE ON DEFERRED PAYMENT BASIS :

In the interest-free system as adopted by Pakistan this mode of financing is applied mainly in financing of agricultural farm inputs as well as for the sale of movable or immovable property by the customer to the bank on 'Buy-Back' arrangement. In financing the agricultural inputs the method followed is direct. When a farmer approaches the bank for his financial requirements to meet seasonal demands the bank sanction him a limit considering the land being cultivated and the other conditions as prescribed by the State Bank of Pakistan from time to time in this regard. Having completed the necessary documentation the bank release the payment for the cost price of the inputs direct to the supplier from whom the farmer wishes to purchase the items. The bank at this stage debits the customer — i.e. farmer's account with the marked-up price i.e. cost paid to the input supplier plus bank's mark-up at the rate fixed by the State Bank of Pakistan which is advised to the banks from time to time. The amount of mark-up is credited to the mark-up recoverable account which is maintained separately in the books of the bank. The mark-up is not calculated on the daily product basis but is a preparation of bank purchase price of inputs provided to the farmer, irrespective of the actual period for which the finance remains outstanding. The State Bank of Pakistan has laid down three prices (a) the cost of the input to the bank i.e. the cost price of the inputs which is paid by the bank, (b) the credit price which is the price payable by the farmer to the bank, (c) prompt payment price which is the price payable by the farmer if he pays the purchase price within the pre-determined period i.e. on or before the date of final adjustment of the finance taken by the farmer. If the repayment is delayed by the farmer he will have to pay the full credit price. The final date on which the finance availed by the farmer is fixed at two months after harvesting of the crop.

(4) PURCHASE OF TRADE BILLS :

The purchase of trade bill may be classified in two categories : (a) Foreign trade related bills, (b) Inland trade bills. The system being practised in Pakistan is described as follows :

(a) Import bill drawn under the import letters of credit. Opening of an import letter of credit is dealt with in the same way as under the interest-based system. A customer who requests the bank to open a letter of credit, in favour of a foreign exporter, on his behalf is fully responsible for the goods imported. When the documents, as stipulated in the letter of credit, are received by the opening bank in Pakistan the transaction is treated on interest-free banking system. The import documents are sold by the customer to the bank and at the same time purchased by him from the bank on deferred payment basis. The sale price is calculated by the bank taking into account the amount of the bill and other charges, if any, claimed by the negotiating bank in the foreign country. No entry, at this stage, is passed by the bank for the buy-back price.

On receipt of the documents an advice letter is sent to the customer which contains the buy-back price which is sale price paid by the bank to the customer plus the mark-up thereon at the prevailing rate for 210 days. The letter of intimation also indicates the date of payment of the buy-back amount by which the customer is required to pay the amount. At the time of payment by the customer the amount of mark-up is calculated, at the rate applicable on this transaction, for the period from the date of negotiation by the foreign correspondent to the date of payment by the customer. If the customer fails to retire the documents by the due date the goods are cleared by the bank from the port authorities and stored in bank's godown. In such a case the bank, in addition to the "buy-back" price of the documents, charge the expenses incurred by the bank on clearance and storage of the goods. Besides the above-mentioned charges the bank is also entitled to claim liquidated damages @ 20% on such charges from the customer.

On receipt of the intimation for the arrival of the documents from the bank if a customer is not in a position to arrange money by due date for retirement of the documents he requests the bank for the

arrangement for the clearance and storage of the goods duly insured in the name of the bank and sign the necessary document. With the pre-arrangement the bank sanction a limit either for single transaction or a regular limit as the case may be. This financing is called 'Finance against Imported Merchandise" (FIM). In the case of FIM the goods covered by the import documents are sold to the bank by the customer and simultaneously bought back on deferred payment basis. The FIM account of the customer is debited with the amount of the bill plus the negotiating bank's charges, if any, converted into Pakistani Rupees at the rate applicable plus the mark-up from the date of negotiation of the bill to the date "Finance against the Imported Merchandise" (FIM) is allowed. Besides these items all other payment made by the bank on clearance, storage, cartage etc. of the goods covered by the import documents in question are also taken as remaining part of the sale price. The recovery of these additional expenses is already stipulated in the documents signed by the customer. The buy-back price for the customer is calculated on the basis of daily products of debit balances appearing in his FIM Account.

In the case of Export Bills drawn and negotiated under a letter of credit the bank will act as intermediary between the exporter and the importer. For the services rendered by the banks they are entitled to charge commission and the exchange differential of the selling and buying the currency. In such type of transaction no financing is apparently involved.

Besides performing intermediary service between the exporters and the importer the banks also act as intermediary between State Bank of Pakistan and the exporter. Bank disburses the money according to the prescribed procedure by the State Bank of Pakistan and then claim the amount from the Central Bank. The finance is provided by the State Bank of Pakistan at concessionary rate which is shared by the bank and the State Bank of Pakistan. At present this rate is 8% p.a. out of which 3% is retained by the Bank as service charges and 5% paid to State Bank of Pakistan.

There are two types of finances under these arrangements one is called Export Re-Financing Scheme - Part I and the other one is named as Export Re-Financing Scheme - Part II. Under Part I the

transaction is limited to the period of Export Letter of Credit whereas under Part - II the previous year exports of the customer are taken into account and the finance upto 30% of the last year's total export is provided by the bank. The condition for availing facilities under Part - II is that the exporter will export the goods during the current year not less than the last year. In case the export are less than the exporter will have to pay the penalty to State Bank of Pakistan upto 20% on the shortfall of the amount.

(b) As in the case of foreign trade carried on through Import Letter of Credit or Export Letter of Credit the same pattern is followed in the internal trade where a customer of the bank wants to purchase goods from a party who wants to ensure the prompt payment from the purchaser for the goods sold, for which he insists for an inland letter of credit issued by the purchaser's bank in his favour.

The seller of the goods presents the document, as stipulated in the inland letter of credit, to the letter of credit advising bank in his own town which are negotiated by the L/C advising bank and the amount is paid to the beneficiary (seller of the goods). In other words the documents are purchased by the negotiating bank from the beneficiary and would sell to the L/C opening bank for the amount paid plus their charges. On receipt of the documents the L/C opening bank would sell the same to his customer i.e. the opener of the letter of credit, at marked-up price. Apparently there seems no "buy-back" arrangement involved in the transaction but as a matter of fact the goods are first sold to the opener bank by the beneficiary of the L/C and then they are bought by the customer from the opening bank. This brings us to the logic that unless the goods are purchased by the opening bank they can not be sold to the opener. Moreover, the goods are supplied on the basis of the letter of credit opened by the opening bank and the documents are drawn according to the condition as laid down therein, which are, as a matter of fact, agreed upon by the opener and the beneficiary, but the liability of the payment lies with the opening bank. Therefore, strictly speaking, the goods are not the property of the opening bank but to channelise the transaction within the Islamic framework the transaction is given the treatment of "buy-back" arrangement.

(5) FINANCING ON "BUY-BACK" ARRANGEMENT OR OTHERWISE :

If a customer of a bank has got or accept to own some movable or immovable assets and needs money for fulfilling the immediate requirement he approaches the bank and sells the asset to the bank the possession of which may be given to the bank immediately or on some future date. He enters into an agreement with the bank which stipulates the sale of the assets to the bank by the customer and at the same time provide for the "buy-back" of the assets by the customer at a later date. To make the arrangement effective the bank is required to pay the agreed sale price to the customer immediately and the customer will "buy-back" the assets and will pay agreed amount to the bank and will have to deliver the possession of the assets to the customer. In case the ownership of the assets is not transferred by the bank to the customer he will have the option to refuse to pay the buy-back price.

To explain further, this mode of financing, if an agriculturist offers to sell to the bank a certain quantity and quality of cotton at an agreed price, the bank will pay the price immediately to the agriculturist. After harvesting the crop the agriculturist will either deliver the cotton or will buy-back the sold cotton and will pay the agreed amount. The criterion of such type of transaction is known as Bai-Salam in *Shari'a*.

The above example was based on agriculture produce but there might be the customers who are not agriculturists but need the money to meet the urgent requirements. He may have a business the shares of which he may like to sell to the bank. The bank will pay the agreed amount of the shares to the customer and the customer enters into an agreement with the bank to buy-back the shares after a pre-determined period and at price settled in advance or to be negotiated at the time of buy-back of the shares. The customer will have the option to rescind the buy-back arrangement before reaching the end of the agreement. He will, however, lose the right on the expiry of the agreement or we may say the completion of the transaction. Such type of financing may take place in a different method also where both the sale and the buy-back transaction may take place at the same time. In this case the agreement made between the customer and the bank may stipulate that while the sale price of the shares is paid by the bank to the customer immediately, the customer may pay the buy-back price to the bank after a mutually agreed period either in a lump sum or in instalments.

This buy-back technique is being used in Pakistan to avoid any dispute regarding quality, quantity, the various dimensional risks involved in owning the assets by the banks and the risk of liquidated damages for casualties. The chances of loss to the banks are minimum if the purchase of the assets from the customer and its buy-back at a future date with agreed price is finalised simultaneously on deferred payment basis. This method, however, will not be appropriate in case of agricultural farms inputs and bills purchased under inland letters of credit because in these two types of transactions the assets purchased by the bank, at first instance belong to a third party. Except in these two cases assets/documents first have been acquired by the customer and then sold to the bank with the arrangement to buy-back the same from the bank on mark-up basis.

(6) LEASING :

In this mode of finance the property/machinery/equipment is acquired by the client by entering into leasing agreement according to which he is to pay the value by instalments and also the residual amount, as agreed to at the time of entering into leasing arrangement, before he becomes the owner of the assets.

(7) HIRE PURCHASE :

Under the hire-purchase arrangements a customer of the bank may acquire the assets. The bank may provide the finance partially or fully for the acquisition of the assets by the customer. The ownership of the assets may remain in the joint name of the customer and the bank or may be held by the bank fully as agreed upon. Bank will, however, prefer to hold the ownership fully to protect its investment which is made from the funds of its own or the customers money and where the role of the bank is of an intermediary.

In addition to the ownership of the assets i.e. machinery, equipment or vehicles supplied to the hirer (customer), the bank may require some additional security also to ensure timely payments of the hire-purchase instalments and the implementation of other stipulation of the hire-purchase agreement. Besides the additional security the bank at its discretion may also ask for a certain percentage of the value of the assets as cash margin at the initial stage of the transaction.

For each transaction under hire-purchase the bank will open a separate "Hire-Purchase Account" in the name of the customer. The amount of cash margin if retained will be credited in this account. The value of the assets acquired or to be acquired under the hire-purchase plus the total amount of profit for the entire period as provided in the agreement is to be debited to the hire-purchase account of the client. The net debit balance in this account, will, therefore, show the value of the item and the total amount of the profit minus the cash margin payable by the customer for the hire-purchase period.

The most important factor in this type of financing is monitoring the end-use. The payment of the machinery, equipment, vehicles and or building is, therefore, made by the bank to the supplier directly. The payment of the supplier directly will also ensure that the money invested by the bank is properly utilised and the chances of misuse of the funds are minimised.

As already mentioned above the bank debits the amount of total profit for the hire-purchase transaction thus a proper accounting is to be maintained by the bank. The portion of the total profit payable by the customer is, therefore, credited in a separate account. At the end of every quarter the amount of profit for the quarter will be debited to that account and credited to the banks income account.

The amount of instalments paid by the customer will have two components, the acquisition value and the profit. The instalment may be fixed monthly or as agreed upon. The entire amount of the instalment is, therefore, credited to the Hire-Purchase Account. At the end of the hire-purchase period this account will stand fully adjusted. After the adjustment of this account the ownership of the assets will be transferred to the customer.

(8) FINANCING OF PROPERTY FOR DEVELOPMENT ON THE BASIS OF DEVELOPMENT CHARGES :

Under this mode of financing a customer approaches the bank for finance for the purpose of development of property and submits the estimate of expenditure to be incurred on the development of the property in details and the date by which he would adjust the amount fully. The feasibility of the project and the details submitted by the client are scrutinised and if found sound the limit is sanctioned to the customer with the mode of

repayment and the date of final adjustment. The procedure adopted in this mode of finance is that first the customer sell the property to the bank and then purchase the same property from the bank on the development charges basis. The sale price includes the amount of the expenditure which is to be incurred on the development of the project. The purchase price by the customer consists of the sale price of the property by the customer to the bank plus development charges. The development charges would be applied at appropriate rate from the first date of debit to the date of final adjustment of the amount plus six months. If the amount is paid on or before the date of final adjustment a rebate or bonus for prompt payment would be given. Keeping the nature of the project the repayment of the amount may be in instalments or lump sum as mutually agreed by the bank and the customer.

(C) INVESTMENT TYPE MODES OF FINANCING :

(9) *MUSHARIKA* INVESTMENT ON THE BASIS OF SHARING PROFIT AND LOSS :

This mode of financing may be applied for short term (running account), medium term or long term financing of a project/venture. The difference under the interest based system or non-interest basis is that instead of a predetermined rate of interest profit would be charged to the account periodically at a provisional rate subject to adjustment on the basis of actual profit of the customer's business/industry at the time of final adjustment or at the time of renewal of the agreement. In the interest based system the date of commencement of the transaction and the expiry date of the contract (limit) are important whereas in "*Musharika*" the period of the agreement is important as the financing is made available to the customer on the basis of sharing profit and loss, for the mutually agreed period. The commencement of "*Musharika*" starts from the date the funds are deployed in the business of the customer and terminates after the agreed period if not renewed for a further period. The period of "*Musharika*" may be for a year or a longer period as the requirement of the business demands. However, on expiry of the period it is renewable at the option of the bank and the share of profit and loss will continue until the "*Musharika*" is terminated at the end of the period.

The deployment of fund in "*Musharika*" business on profit sharing basis would include (1) share holders investment in business. This may be

determined by averaging the share holders share of pre-tax profit for the last three years and multiplying it by 5 is that 20 percent pre-tax return on the equity is normally considered reasonable. This method is applied in the cases where the figure as shown in the balance sheet are ignored. But if the above basis is not taken into account by the bank or the client the figures as shown in the balance sheet in respect of paid-up capital may be accepted. Even in the case where both the above methods are not agreed the bank and the customer may determine a figure in accordance with the recognised accounting standard with mutual consent at the time of signing the *"Musharika Agreement"*.

(10) EQUITY PARTICIPATION AND PURCHASE OF SHARES :

Under the old system based on interest commercial bank used to provide finance to the companies in the shape of bridge loan which was payable by the company on floatation of their shares or the banks were to purchase the shares and thus participate in the equity. This method was common in the case of consortium financing. Besides purchasing the shares bank finance was also provided by taking up the debentures.

Under interest-free based system banks participate by purchasing shares as well as take up participation certificate of medium and long term (STPC and LTPC) in the case of consortium financing. Banks also provide finance in the shape of participation term certificate, Mudaraba certificates and by purchasing National Investment Trust (NIT) units as their investment.

(11) PARTICIPATION IN THE EQUITY BY PURCHASE OF SHARES ON LONG TERM/SHORT TERM IN THE FORM OF PARTICIPATION TERM CERTIFICATES (LTPC/STPC) AND MUDARABA CERTIFICATES:

Under the interest based system this method of financing business/industry was being done under the name of purchase of debentures and share of the companies. The procedure now followed is more or less the same as was being followed under the old system of interest but the nomenclature has been changed. Now instead of usury the name of debenture it is called Participation Certificates whether it is for long term or short term. The terms and conditions almost are the same.

This mode of finance is normally used when banks participate in the equity as well as when it takes up participation term certificate in case of consortium and also purchase of shares, participation term certificate, Mudaraba certificate and National Investment Units as their investment.

To safeguard the interest of the bank from the manipulation of the account by the customer the bank may provide in the agreement that it still has the right to convert into ordinary shares maximum 75% of the outstanding invested amount in the project at any time during the validity of the agreement. This provision has, however, restricted when the bank shall not exercise the right if the customer earns the profit at a rate not less than 2/3rd of the profit as shown in the projection.

If the bank opt to sell the acquired or to be acquired shares the existing share holders would have the first right to purchase the shares at a mutually agreed price.

(12) **RENT SHARING :**

This mode of financing is used by the commercial banks in providing finance for construction and purchase of houses and apartments on rent sharing basis. The amount of finance provided by the banks is minimum Rs. 1,50,000/- and maximum Rs. 3,00,000/- in individual cases. The share of the bank is calculated out of the net rental at the same ratio as between the investment of the bank plus 50% weightage thereon and the total cost of the unit as estimated at the time of acceptance of the proposal. The rentals are determined on the basis of cost of land and cost of construction per square foot prevailing locally after the enquiries and verification are made. The net rental to be shared between the bank and the customer is the ratio, as agreed upon, is arrived at after making following deductions from the gross rental :-

(a) Property tax payable to the Provincial government or local authorities.

(b) Maintenance allowance @ 1/12th of the gross rent.

As per existing law the rentals are required to be revised upward by 10% every 3 years. The bank share in the rental is to be refixed every year taking into account the banks reduced investment as a result of payments made during last year by the customer.

The banks are, however, not using this method because of the difficulties and the complications involved in the proper determination of total cost of a constructed house with the bank's money. They are using the mark-up mode for this purpose also.

CONCLUSION

We have now come to the stage of summing up various subjects discussed in the preceding chapters in the light of the modern banking philosophy and practice adopted by any party wishing to follow the prevailing system, be it a company in the private sector or a public enterprise or an entity combining both these sectors.

In the beginning we set the landmark and took into consideration the practical facts characterised by their practicability, notwithstanding the banks already in existence. It would not be necessary to eliminate the existing banks while the effectiveness of this new system is proving itself. What is needed is not to exhaust in any way the non-usury firms or companies with law, prohibiting, allowing or restricting certain things, the legislator has the power to frame such laws as would suit the purpose.

A non-usury system in its reality is a national development which governs the course for the convenience of capital and labour which will maintain the social equilibrium and help the state to solve the employment problem in a manner capable of satisfying the aspirations of the mass of the population and make them happy and proud. The non-usury system will also be confirming the personal independence of the nation by having recourse to the principles of dealing on the basis which is consistent with the Islamic *Shari'a*.

In general term, the banking business is no more than a means to satisfy needs and requirements consistent with circumstances and conditions. The activities which had been known before the creation of modern banks could, under Islamic culture, find a suitable atmosphere where they attained a level which, as we have explained in the relevant place, excelled many of the known cultures.

The present banking business has developed in its modern form under European culture based upon usury. The operations under usury-based system are only possible on the basis of charging interest on deposits and loans. As a result of this, banking services were transformed into an accessory business taking secondary place after the new form of financial operation. When the modern banking was introduced into Islamic societies the material and the cultural state of the Islamic people were not favourable for the adoption of this new system in such a manner as will serve

the desired objectives according to a system which is not in line with the fundamentals of the *Shari'a*. The result was that the confusion prevailed and people stood undecided in regard to this system, not knowing whether to join or keep away from it.

The non-appearance of the opinions by contemporary Islamic thoughts provided the ground to some thinkers to argue for excluding banking usury, and whatever is tantamount thereto, from the illegitimate frame-work of usury, though the people were not convinced that they did not have an alternative option. The absence in Islamic field of a system which is consistent with modern banking business provided the best opportunity for the usury-based system to develop and create hindrances in the way the various attempts made by some thinkers on the subject particularly during the last 30 years.

Usury is not that unknown matter which can neither be defined nor distinguished from the present days concept of interest. What is needed is a careful, conscious and comprehensive study of the stipulations and investigation of the opinion and the work of the various competent jurists on the subject with the aim to reconcile and select the nearest form which will help in satisfying the intention of the great *Shari'a*. The various aspect of usury which some jurists of ancient times were unable to comprehend the wisdom has now been unveiled by the *Sunnah* of the Prophet (PBUH) which has been admitted at the highest level of banking business. This is tantamount to an acknowledgement instrument bearing witness to the people of these days that what descended in holy book Quran and what was revealed by the *Sunnah* is the general eternal *Shari'a* until God so wishes.

Inspite of the fact that the present day banking business is completely overshadowed by usury, it has capabilities of clearing its image if it is desired to achieve the same objectives without the means which violate the commandments of God. What is needed to do so in the field of banking service is some modification which does not conflict with the intended business. These modifications or changes are possible with the regulation of operations capable of remedying the disease with which the contemporary societies are mostly suffering. Concentration on hired labour prevents those who possess the capabilities of work from becoming producers or employers.

Mudaraba, as a system, is a good basis to contain all types of banking operations and is capable of achieving the just meeting of money with labour which the present banking system failed to achieve. However, Mudaraba which can be suitable to the banking business, in term of efficiency and organization, should not be of that old form which was in use in the early stage of Islamic culture. It must be organised on the basis of common collective business suitably to the needs of the people of these days.

As far as the investment of resources is concerned, the flexibility achieved by the present banking system is not a monopoly of the method of dealing upon usury. There would be no hindrance in the creation of suitable form of organising and investment of money in such a way as would be similar to the banking system, provided the rules framed are followed in letter and spirit which will guarantee fair role of money as intended in the Islamic *Shari'a*. It may, therefore, be ensured that it can deliver the fruits of making efforts and work without monopoly of tyranny.

What provides us the confidence is that some of the countries which are inhabited by the people who believe in God, his Prophet and *Sunnah* have already broken the ice and have introduced the system based on Islamic *Shari'a* which, of course, is in infancy and need constant vigilance and monitoring to improve further by bringing the psychological as well as the legislative changes.

Lastly, before we end this work which contains the story of a struggle where hopes defeated the elements of despair and belief conquered the circumstances of surrender, we earnestly hope to that day when non-usury institutions will provide not only in Islamic world but in all those countries also who believe in humanity and social justice.

We put the fullstop with the prayer and thanks to God, the Lord of the Universe.

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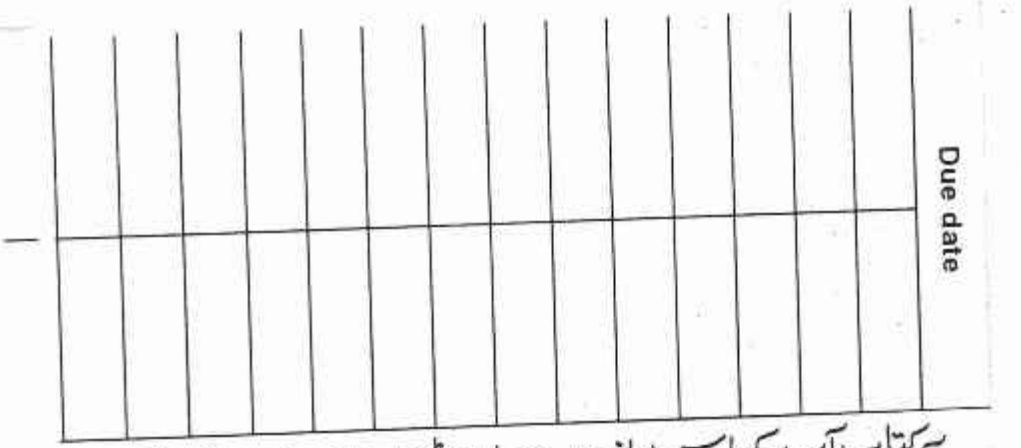
241. Ibn Qudama, *Op. Cit.*, Part-5, P-58.
242. Al-Futuhi, Division-1, P-464.
243. Ibn Qudama, *Op. Cit.*, Part-5, P-58.
244. Az-Zubaydi, It'haf al-Muttaqueen, Part-5, P-471.
245. Al-Kassani, *Op. Cit.*, Part-7, P-3546.
246. Al-Kassani, *Op. Cit.*, P-3540-1.
247. Ibn Qudama, Al-Mughni, *Op. Cit.*, Part-5, P-16.
248. Al-Kassani, *Op. Cit.*, Part-7, P-3541.
249. Al-Kassani, *Op. Cit.*, Part-7, P-3546.
250. Al-Bahr Az-Zakhar, *Op. Cit.*, Part-4, P-93.
251. Ar-Ramli, Nihayat Al-Muhtaj, Part-4, P-176.
252. Az-Zubaydi, Ithaf Al-Muttaqueen, *Op. Cit.*, Part-5, P-93.
253. Ibn Qudama, Al-Mughni, *Op. Cit.*, Part-5, P-63.
254. Ibn Rushd, Bidayat Al-Mujahed, *Op. Cit.*, Part-2, P-238.
255. Ibn Qudama, Al-Mughni, Part-5, P-223.
256. Al-Futuhi, Muntahal Iradat, Division-1, *Op. Cit.*, P-464-5.
257. Al-Bahuti, Kashaf Al-Qina, *Op. Cit.*, Part-3, P-432.
258. Ash-Shafa'i, Al-Ilm (the mother), Part-3, P-39.
259. Al-Kassani, Al-Badai, Part-8, P-3598.
260. Ibn Hazm, Al-Muhalla, *Op. Cit.*, P-248.
261. As-Samarqandi, Tuhfat Al-Fuqaha, *Op. Cit.*, Part-3, P-29.
262. (1) Ibn Al-Murtada, *Op. Cit.*, Part-4, P-88.
    (2) Muhammad Jawad Mughnia, *Op. Cit.*, Part-4, P-162.
263. Az-Zayla'i, Tabyeen Al Haqaiq, Part-5, P-70.
264. Ibn Jazzi, Al-Ahkam Ash-Sharia, *Op. Cit.*, P-310.
265. Sharh Al-Khurashi, *Op. Cit.*, Part-6, P-217.
266. Az-Zubaydi, It'haf Al-Muttaqeen Fi Sharh Ila Olum Ad-Deen, Part-5, P-471-2.
267. *Idem.*
268. Al-Bahutti, Kashf Al-Qina', Part-3, P-431.
269. *Idem.* Also, Ibn Qudama, *Op. Cit.*, Part-5, P-72.
270. Ibn Qudama, Al-Mughni, Part-5, P-47.



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