

## Islamic Commercial Law

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There has always been a close historical connection between Islam and commerce. The Prophet came from the Arabian town of Makkah, or, as it is known today, Mecca. At the time of Muhammad, Makkah had already been a major Middle Eastern commercial centre for over a century. Makkah was home to the Quraysh tribe and during this period the Quraysh had grown quite prosperous, in their desert world, primarily as brokers of trade between the Eastern and Western worlds. The principle reason for their success was a geographical one: Makkah was strategically located on the main commercial artery running from Yemen in Southern Arabia, where goods from the East arrived, northwards to the Mediterranean, where European traders eagerly waited with their own goods or cash. Makkah was also at the centre of another major trading route between the Persian Gulf (another arrival point for Eastern commodities), and the Red Sea Port of Jiddah, where goods from Egypt and other points in Africa entered into the sphere of East-West commerce.<sup>35</sup> Commerce was thus the lifeblood of Makkah and Muhammad, who was of the Quraysh tribe, was himself a successful businessman who after his marriage to his first wife, Khadijah, undertook several trading ventures to various places in Arabia, including Yemen and Bahrain.

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<sup>35</sup>Ferrara, Peter J. and Saffuri, Khaled, "Islam and the free market", *Islamic Free Market Institute Foundation* ([www.islamicinstitute.org](http://www.islamicinstitute.org)).

Not surprisingly, then, the attitude of Islam towards commercial activities is a generally positive one and there are many verses in the Quran which actually encourage trade and commerce. Morally, the guiding principle here is that there should be no impediment to honest and legitimate trade and business, which enables people to earn a living, support their families and give charity to those less fortunate than themselves. But if Islam does not expect believers to give away all their possessions and live the life of ascetics, it nevertheless requires that all Muslims conduct their business activities in accordance with the requirements of their religion, namely to be fair, honest and just towards others. Nor should Muslims allow their business activities to dominate their lives to the extent that making money becomes a first priority and they neglect their religious duties — it is stipulated in the Quran that all trading must cease during the time of the Friday congregational prayer. And just as the Shari'ah regulates and influences every other sphere of life, so too with business and commercial activities, which are subject to a rigorous code of conduct so that they may conform with Islamic principles.

### 3.1 Islamic vs. Non-Islamic Commercial Transactions

Perhaps the most important single difference between Islamic commerce and conventional commercial transactions is the Islamic prohibition on paying or receiving interest (*riba*). But there are also other significant divergences, which also need to be taken into account. One of these is the notion that property is God-created and God-given. Clearly, the construction of property here differs radically from the common modern conception of property as a secular value, to be defined and redefined as needed to further utility, or else as the aggregate of whatever property claims the legal system chooses to respect. In Islamic law, by contrast, property is irreducible, sacrosanct

and virtually transcendent. The lawfulness of its acquisition and use is grounded in the Quran and the *Sunnah*, whose source lies above reason, and is a matter with which God is minutely concerned.

Ultimately, the aim of the Islamic economic system is to allow people to earn their living in a fair and profitable way, without exploiting others, so that the whole of society may benefit. In this last respect, Islam emphasises the welfare of the community over individual rights. This is in line with recent Western thinking which criticises open-market approaches to economic management because they emphasise economic growth at all cost without regard for quality of life and the widening gap between rich and poor in society.<sup>36</sup> Clearly, Islamic religious precepts are fundamentally opposed to the doctrines of unbridled capitalism, which are seen by Islamic countries as posing a threat to society by undermining Shari'ah values.

### 3.2 Principal Requirements of the Shari'ah in Relation to Commercial Activities

As we have seen, the most striking difference between Islamic commercial activities and conventional business activities is that Islam expressly forbids the giving or receiving of interest, which in the eyes of the Quran is tantamount to usury (*riba*).

The prohibition of interest in Islam should be seen in the context of the basic characteristics of an Islamic economic system, which may be enumerated as follows:

- (i) All persons should have at least the minimum economic resources needed for subsistence.

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<sup>36</sup>Baydoun, N. and P. Blunt, "Notes on Islam, culture and organisational behaviour", 1997, p. 2. Unpublished Paper, Northern Territory University.

- (ii) Undue concentration of wealth in a few hands should be prevented.
- (iii) Hoarding should be discouraged and the use of wealth for productive purposes should be encouraged.
- (iv) The economic system should function so that there is no room for idlers; reward should accrue solely as a result of the expending of effort, except in the case of the naturally handicapped and involuntarily unemployed.<sup>37</sup>

Apart from this prohibition regarding receiving and giving interest, there are two other activities prohibited by Shari'ah law that have had a significant impact on Islamic finance. They are a ban on gambling (*maysir*) and the prohibition of uncertainty or risk-taking (*gharar*). The prohibition on *maysir* is often used as grounds for the criticism of conventional financial practices such as speculation, conventional insurance and derivatives, while the prohibition of *gharar* can be applied to various types of uncertainty or contingency in a contract. In the latter instance, the prohibition on *gharar* is used as the basis for criticism of conventional financial practices such as short selling, speculation and derivatives. Obviously generalised prohibitions on increase and risk, if interpreted in the widest possible sense, run contrary to the very core of the concept of commercial gain,<sup>38</sup> but here the legitimacy of gain through trade — a vexed issue at the intersection of ethics, economics and contract law — is resolved in a strikingly liberal fashion.

For example, risk-taking, though normally prohibited by Shari'ah law, when related to a commercial enterprise can be

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<sup>37</sup>El-Badour, R.I., "The Islamic economic system: A theoretical and empirical analysis of money and banking in the Islamic economic framework", 1984, p. 135. Unpublished PhD dissertation, Utah State University, Logan, UT, USA.

<sup>38</sup>Vogel and Hayes, *Islamic Law and Finance: Religion, Risk and Return*, 1998, pp. 68–69.

a socially productive economic activity and is consequently entitled to a reward. Second, and a related point, the creation of loans that are intended to finance socially productive economic activities receive a similar endorsement. Third, financial risk is acceptable if the risk lies solely with the lenders and not with the managers and agents.

Hence, it can be seen that Islam offers a unique and ideal perspective of business ethics. It regards commercial activities as part of one's religious life, provided that they are conducted in accordance with the commands of Allah, and the moral code of conduct prescribed by Islam. In this context, fundamental Islamic principles such as truthfulness, honesty, trust, sincerity, brotherhood, science and knowledge, and justice, provide a moral and ethical background to the way in which business should be conducted.<sup>39</sup>

### 3.3 Islam: the Difference between Equity and Debt

The distinction between equity and debt in Islam is the same as in conventional economic systems except that the Shari'ah prohibits any return on a debt and does not consider lending to be a legitimate profitable activity. All wealth creation should result from a partnership between the investor and the user of capital in which rewards and risks are shared. Returns on invested capital should be earned rather than pre-determined.

Equity represents an investment exposed to all kinds of business risks and sharing in the profits of the business. It may be of a permanent nature, that is, redeemable only upon liquidation of the business — or earlier by mutual agreement — but not on demand. Debt on the other hand, is a contractual

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<sup>39</sup>Elati, Mas, "The ethical responsibility of business: Islamic principles and implications", *OIC Exchange* ([www.oicexchange.com](http://www.oicexchange.com)), 2 May 2002.

obligation to pay a specific value, whether in cash or kind, on an agreed date or on demand, for value consideration received, with the important proviso that value at both ends of the transaction must be equal in terms of whatever commodity or currency they are denominated in. Any discount or excess on account of a contractual obligation falls in the category of *riba* (interest or usury), which, of course, is expressly forbidden in the Quran.

### 3.4 Rationale of the Prohibition of Interest

The representation in the holy Quran of the practice of interest as an act of “war with Allah and his messenger” provides an insight into the philosophy behind the prohibition of interest in Islam. It is a clear pointer that the institution of interest is something which runs counter to the scheme of things which Islam stands for and which Allah wanted to see established on earth. That the words “Allah has blighted *riba* and made *sadaqat* [gift-giving] fruitful”, which occur in verse 276 of *Surah Al-Baqara*, also point towards the fact that the practice of interest militates against the objectives of an Islamic society, while *sadaqat* promotes these objectives. The main points of the rationale for the prohibition of interest in Muslim countries may be listed as follows:

- (i) Transactions based on interest violate the equity aspect of economic organisation. The borrower is obliged to pay a pre-determined rate of interest on the sum borrowed even though he may have incurred a loss. To insist on payment of a pre-determined rate of interest irrespective of the economic circumstances of the borrowers of money is against the Islamic norm of justice.
- (ii) An interest-based system discourages innovation, particularly on the part of small-scale enterprises. Large

industrial firms and big landholders can afford to experiment with new techniques of production as they have reserves of their own to fall back upon in case the adoption of new practices does not yield a good dividend. Small-scale enterprises hesitate to go in for new methods of production with the help of money borrowed from banks because the liability of the banks for the principal sum and interest has to be met, irrespective of what the results might be and the fact that small-scale enterprises usually have little reserves of their own.

- (iii) In an interest-based system, banks are only interested in recovering their capital along with interest. Their interest in the ventures they finance is therefore strictly limited to satisfying themselves about the viability and profitability of such ventures from the point of view of the safety of their capital and the ability of the venture to generate a cash flow which can meet the interest liability. Since the return the banks get on the capital sum lent by them is fixed and is not linked in any way to the actual profits of the ventures to whom they lend, there is no incentive for the banks to give priority to ventures with the highest profit potential.
- (iv) An interest-based system dampens investment activity because it adds to the costs of investment. If interest rates are raised to contain monetary demand in situations where excessive fiscal deficits are fuelling inflation, private investment receives a severe setback leading to "stagflation". This has actually been the experience of a number of developed countries in recent years.
- (v) The interest-based system is security oriented rather than growth oriented. Because of the commitment to pay a pre-determined rate of interest to depositors, banks, in their lending operations, are mostly concerned about the safe return of the principal loan along with the stipulated

interest. This leads them to confine their lending to the already well-established, big business houses or such parties as are in a position to pledge sufficient security. If they find that such avenues of lending are not sufficient to absorb all their investable resources, they prefer to invest in government securities with a guaranteed return. This exaggerated security orientation acts as a great impediment to growth because it does not allow a smooth flow of bank resources to a large number of potential entrepreneurs who could add to the gross national product by their productive endeavour, but do not possess sufficient security to pledge to the banks to satisfy their criteria of creditworthiness.

### 3.5 Conventional Banking and the Prohibition of *Riba* in Islam

In a capitalist market economy, the banks are profit-making institutions. They need to maximise their profit by advancing money at a higher rate than the rate at which they obtain it. The borrowing and lending of money takes place at a price called the interest rate, which is the pivotal point of all banking activity. In this last respect, the practices of the modern commercial banking system are directly in conflict with the principles of Islam, which strictly prohibit *riba* (interest or usury).

Seen from an Islamic perspective, the prevailing banking and finance system strikes at the very root of a fundamental principle of the Shari'ah in that it tends to promote a concentration of wealth in a few hands and thus breeds inequalities in society. Interest, which is the kingpin of the modern banking and financial system, serves as a powerful tool of exploitation of one sector of society by another. From the Islamic viewpoint, it has created "haves" and "have-nots", and acts as a barrier to the achievement of maximum welfare for the

maximum number of people. It is in this context that Islam forbids interest and it is with the aim of achieving the egalitarian objectives of Islam that the Muslim world is now embarked on the task of Islamising the financial system by unfettering it from interest;<sup>40</sup> it is to this process of transforming conventional financial arrangements into Shari'ah-approved (halah) alternatives that we now turn to.

### 3.6 Treatment of Deposits with Interest

As stated previously, the most striking difference between Islamic banking and Western-style banking is the Islamic view of interest. Because Shari'ah law prohibits interest, direct loans and other forms of lending such as guaranteed investment certificates, are interest-free. Consequently, Islamic financing must rely instead on a kind of joint venture, or mutual participation, between the customer and the Islamic bank, in order to generate profits. To this end, Islamic banking converts existing deposits into *Islamic* investment deposits, whereby the bank acts as agent or trustee (*mudarib*) instead of borrower. In order to persuade depositors to go along with this, it must be demonstrated that the performance of Islamic banks compares very favourably with that of conventional banks in terms of returns.

In the event of being left with depositors who are not willing to convert to Islamic investment deposits, a ruling is adopted under the Shari'ah necessity principle, which allows the continued payment of interest, as per the contract, till the maturation of the deposit, with the interest payments being sourced from borrowers of the same category.<sup>41</sup>

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<sup>40</sup>See Al-Harran, Saad, *Islamic Finance: Partnership Financing*, 1993, pp. 4–5.

<sup>41</sup>See Hassan, Hussein Hamed, "Conversion of National Bank of Sharjah into an Islamic bank: A Case Study", The International Islamic Finance Forum, International Institute of Research, Dubai, March 2002.

### 3.7 Profit and Loss Sharing

Commonly, business ventures start off with a loan. For Muslims, loans cannot be made or accepted according to traditional banking methods because this invariably entails the payment and receipt of interest and therefore is not *halah*. Skipping past the laws of conventional finance and banking, Islamic banking allows prospective clients to borrow money while still adhering to Shari'ah law through a profit- and loss-sharing scheme of financing. Profit-and-loss-sharing (PLS) financing is a form of partnership where partners share profits and losses on the basis of their capital share and effort. Unlike interest-based financing, there is no guaranteed rate of return. Islam supports the view that Muslims do not act as nominal creditors in any investment, but are actual partners in the business. This is an equity-based system of financing, where the justification for the PLS-financier's share in profit rests on their effort and the risk that they carry. In other words, they deserve to be rewarded since this profit would have been impossible without their investment and, furthermore, if the investment were to make a loss, then their money would also be lost.<sup>42</sup>

### 3.8 Profit-Sharing Enterprises

Islamic law recognises two principal forms of profit-sharing enterprises (PSE) based on PLS partnerships:<sup>43</sup>

- (i) *Shirkah al-'inan* or limited partnership. In this kind of partnership, partners contribute capital, property and/or

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<sup>42</sup>Al Tamimi & Company, "Islamic finance: A UAE legal perspective", The International Islamic Finance Forum, International Institute of Research, Dubai, March 2002, p. 2.

<sup>43</sup>Doi, Abdur Rahman I., *Shari'ah: The Islamic Law*, pp. 365–367.

labour. Profits and losses are shared in an agreed manner. The difference between this and other forms of partnership is that each partner is only the agent and not a surety for his co-partners, which means that a partner is not liable for a debt contracted by his co-partners and is only able to sue someone with whom he himself has contracted.<sup>44</sup>

- (ii) *Mudarabah* or dormant partnership (also called *qirad*). This is a contract whereby one person (the dormant partner) gives funds or property to another on the basis that the lender will share in the active partner's profits in a *proportion* agreed in advance. They may not agree on a fixed return since this would amount to *riba*. Equally, if there is a loss, they also share this loss proportionally, but the liability of the person who has provided the capital is limited to the amount of that capital. The dormant partner remains the owner of the capital, but takes no active part in the enterprise. The trader is responsible only for negligence or breach of contract. Legitimate expenses of the venture such as employees' wages and travelling expenses are deductible from the capital. The contract can be drawn by either party as long as notice is given to the other.<sup>45</sup>

### 3.9 Islamic Contract Law

Contracts are drawn to ensure the existence of clearly recognised guidelines for all parties involved. They state the standings of all those involved and the condition(s) of the transaction(s) that are to take place. This occurs in both conventional and Islamic banking. The general principle of the Islamic

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<sup>44</sup>Saleh, Nabil, *Unlawful Gain and Legitimate Profit in Islamic Law*, 1986, p. 93.

<sup>45</sup>Hussain, Jamila, *Islamic Law and Society*, 1999, pp. 166–167.

law of contract is contained in the Quranic verse: “O you who believe, fulfil all obligations”.<sup>46</sup> The definition of contract (*al-'aqd*) in Shari'ah law is similar to that in English common law, but is wider in that it includes dispositions which are gratuitous as well as endowments and trusts.

A contract in Islamic law consists of an agreement made between two or more parties and the basic elements are quite similar to those of English common law:

- (i) Offer and acceptance — a contract requires an offer (*ijab*) and acceptance (*qabul*). The contract can be oral or in writing, made by signs or gestures, by conduct or through an agent. If the offer is made in writing it remains in force until received by the other party who must then reply promptly.
- (ii) Consideration — as in English common law, consideration may consist of money, goods or services. It must be something which is capable of being given, or, in the case of a service, capable of being performed, and it must not involve materials or acts which are prohibited according to Islamic law.
- (iii) Capacity — the parties entering into a contract must be legally competent. A minor, a person of unsound mind, an insolvent person, a person legally declared a prodigal, an intoxicated person or a person suffering from an illness which leads to his or her death (*mard al-marwt*) cannot enter into a binding contract.
- (iv) Legality — the purpose of the contract must be legal in terms of the Shari'ah. A contract to grow grapes for wine-making, for example, would be illegal, as would a contract to sell firearms to criminals or to make a loan with interest.

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<sup>46</sup>Quran, 5:1.

- (v) Absence of duress — the parties must enter into the contract of their own free will. A contract concluded under duress is null and void.

### 3.10 Types of Contract in Shari'ah

There are seven types of contract recognised by Shari'ah law and they are as follows:

- (i) *Al-Tamlikat* (acquiring of ownership)

This kind of contract relates to the acquisition of ownership of properties, or the rights to the benefits of properties. The kinds of contract which fall into this category can be further divided into two subgroups, namely:

- (a) *Uqud al-Muawadhat* (contracts of exchange)

In this instance, the acquisition of ownership involves some kind of exchange between two parties involving a sale, hire, money changing, compromise, partition, sale by order and the like.

- (b) *Uqud al-Tabarruat* (contracts of charity)

This kind of contract relates to situations where the ownership of a property is acquired without involving an exchange, for example as a gift, alms, endowment, benevolent loan (*al-qard al-hasan*) or the assignment of debt. Sometimes a contract may be initiated as a contract of charity, but then later the receiving party is required to give an exchange. Examples of such a contract are guarantees requested by the debtor and gifts with the condition of an exchange. Contracts such as these commence as contracts of charity at the beginning, ending as contracts of exchange.

- (ii) *Al-Isqatat* (releases)

These contracts relate to the dropping of rights against others with or without exchange. If the release is without

compensation from the other party, then the release is an absolute release and includes repudiation, remission of the penalty of talion, release from debt and withdrawal from the right to pre-emption. If the release is with compensation from the other party, then it is a release with exchange.

(iii) *Al-Itlaqat* (permissions)

This kind of contract includes giving total responsibility to individuals, firms or agencies in the appointment of governors and judges; giving a person who is dispossessed of the power of administration, permission to administer his property, or giving permission to a minor to carry on trade; and the appointment of a nominee to take care of one's children after death.

(iv) *Al-Taqqidat* (restrictions)

Contracts in this group prevent or terminate the performance of certain functions. They include the dismissal of governors, judges and supervisors; the termination of endowments; the termination of the appointment of nominees and agents; and dispossession of the administration of property because of insanity, mental disorder, prodigality or infancy.

(v) *Al-Ta'athiqat* (securities)

This kind of contract is meant to secure debts for their owners and guarantee creditors of debts owing to them. They include guarantees and the assignment of debt and mortgages.

(vi) *Al-Ishtirak* (partnerships)

These contracts relate to sharing in projects and profits. They include *al-mudarabah*, where a person gives an amount of money to another to trade or invest with the condition that they share in the profit while the loss is borne by the owner of the capital. They also include

partnerships involving the cultivation of land and taking care of trees.<sup>47</sup>

(vii) *Al-Hifz* (safe custody)

Contracts in this group relate to keeping property safe for its owner and include some of the functions of agency.

### 3.11 Islamic Financing in a Contemporary Setting

Before the modern era, *mudarabah* partnerships, in which some of the partners contribute only capital and the other partners only labour, worked perfectly well, especially in traditional settings which typically involved simple commercial, agricultural or manufacturing ventures, where the number of investors was usually limited and the size of capital invested relatively small. Today, however, contemporary economic circumstances require a much more flexible institutional framework, whereby a PLS company arrangement is able to accommodate itself to a huge number of investors, enormous financial resources and ever-expanding technological frontiers. The problem here has been one of adapting what are essentially mediaeval financial practices to the modern world of banking and investment. This is a challenge that has been met by modifying present-day financial institutions to the extent that they can embody the principle implicit in the former, whilst still remaining compatible with contemporary practices.

### 3.12 The Problem of Uncertainty (*gharar*)

Risk-taking and uncertainty are a fact of life in the conventional world of business, even though most people will naturally

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<sup>47</sup>Some financing principles of Islam stem from ancient practices in agricultural which allowed parties to deal in crop-sharing for cultivable land and fruit orchards in accordance with Shari'ah law.

seek to minimise the chances of something going wrong due to unforeseen circumstances. However, as we have seen, under Islamic law, risk-taking or uncertainty (*gharar*) is expressly forbidden. In legal and business terms, *gharar* means to enter into a commercial venture blindly, without sufficient knowledge, or else to undertake an excessively risky transaction, and it can apply in a number of different circumstances. They include:

- Transactions where the seller is not in a position to hand over the goods to the buyer.
- Transactions where the item or commodity for sale cannot be immediately acquired — for example the sale of fruit which has not yet ripened, or fish or birds not yet caught.
- Speculative investments such as trading in futures or on the stock market.
- Transactions where the purchaser is not given the opportunity of inspecting goods before purchasing item.

However, minor uncertainties may be permitted in situations, provided certain necessary conditions are fulfilled, namely:

- The goods or service of the transaction be in existence.
- The characteristics of the goods or service are known.
- The parties to the contract should have such control over the subject as to be able to ensure that exchange will take place.
- If the transaction or exchange is to take place in future, then the date when it is to take place should be certain.

In Islamic law, the principle underlying most illegal contracts is to prevent benefiting from others for nothing and unfairly. A zero-sum exchange encapsulates precisely what is to be avoided: it is an exchange in which one party gains at the expense of another leading to a win-lose outcome. Naturally, no one of sound mind would enter into a game where losing was an absolute certainty; it is only when the outcome

is uncertain that such game is played; uncertainty or risk is what tempts rational agents to engage in exchanges where they know in advance that only one party will gain, whilst the other must surely lose. It is this temptation which is best described by the term *gharar* and it follows that a *gharar* contract is characterised as a zero-sum game with uncertain payoffs.<sup>48</sup>

### 3.13 Summary

It can thus be seen that there has always been a close historical connection between Islam and commerce. The attitude of Islam towards commercial activities is generally seen as a positive one. Hence, the principles and guidelines regarding Islamic finance, in essence, can be simply summarised as follows:

- (i) Any predetermined payment over and above the actual amount of principal is prohibited. Islam allows only one kind of loan and that is *qard-el-hassan* (literally a “good loan”) whereby the lender does not charge any interest or additional amount over the money lent. Traditional Muslim jurists have construed this principle so strictly that, according to one commentator, “this prohibition applies to any advantage or benefits that the lender might secure out of the *qard* (loan) such as riding the borrower’s mule, eating at his table, or even taking advantage of the shade of his wall.” The principle derived from the quotation emphasises that associated or indirect benefits are also prohibited.
- (ii) Lenders must share in the profits or losses arising out of the enterprise for which the money was lent.

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<sup>48</sup>Al-Suwailem, Sami, “Towards an objective measure of Ghararin exchange”, *Islamic Economic Studies*, Vol. 7, Nos. 1 & 2, 2000.

Islam encourages Muslims to invest their money and to become partners in order to share profits and risks in the business instead of becoming creditors. As defined in the Shari'ah, or Islamic law, Islamic finance is based on the belief that the provider of capital and the user of capital should equally share the risk of business ventures, whether those are industries, farms, service companies or simple trade deals. Translated into banking terms, the depositor, the bank and the borrower should all share the risks and the rewards of financing business ventures. This is unlike the interest-based commercial banking system, where all the pressure is on the borrower: he must pay back his loan, with the agreed interest, regardless of the success or failure of his venture.

The principle which emerges here is that Islam encourages investment in order that the community as a whole may benefit. It is not willing to allow a loophole for those who do not wish to invest and take risks, but rather are content with hoarding their money or else depositing it in a bank in order to receive an increase on their capital for no risk (other than the bank becoming insolvent). Within Islam, either people invest with risk, or else suffer loss through devaluation by inflation by keeping their money idle. Islam encourages the notion of higher risks and higher returns and promotes it by leaving no other avenue available to investors. The objective is that high-risk investments will act as a stimulus to the economy and encourage entrepreneurs to maximise their efforts.

- (iii) Making money from money is not Islamically acceptable. From an Islamic point of view money is only a medium of exchange, a way of defining the value of a thing; it has no value in itself, and therefore should not be allowed to give rise to more money simply by being put in a bank or lent to someone else at a fixed interest rate. The human effort,

initiative and risk involved in a productive venture are more important than the money used to finance it. Muslim jurists consider money as potential capital rather than capital, meaning that money becomes capital only when it is invested in business. Accordingly, money advanced to a business as a loan is regarded as a debt of the business and not capital and, as such, it is not entitled to any return (i.e. interest). Muslims are encouraged to purchase and are discouraged from keeping money idle so that, for instance, hoarding money is regarded as being unacceptable. In Islam, money represents purchasing power which is considered to be the only proper use of money. This purchasing power (money) cannot be used to make more purchasing power (money) without undergoing the intermediate step of it being used for the purchase of goods and services.

- (iv) *Gharar* (uncertainty, risk or speculation) is also prohibited. Under this prohibition, any transaction entered into should be free from uncertainty, risk and speculation. Contracting parties should have perfect knowledge of the counter values intended to be exchanged as a result of their transactions. At the same time, though, parties cannot pre-determine a guaranteed profit. This is based on the principle of “uncertain gains” which, on a strict interpretation, does not even allow an undertaking from the customer to repay the borrowed principal plus an amount to take into account inflation. The rationale behind the prohibition is the wish to protect the weak from exploitation. Therefore, options and futures are considered as un-Islamic and so are forward foreign exchange transactions because rates are determined by interest differentials.

A number of Islamic scholars disapprove the indexation of indebtedness to inflation and explain this prohibition

within the framework of *qard-el-hassan*. According to those scholars, the creditor advances the loan to win the blessings of Allah and expects to obtain the reward from Allah alone. A number of transactions are treated as exceptions to the principle of *gharar*: sales with advanced payment (*bai' bithaman ajil*); contract to manufacture (*istisna*); and hire contract (*ijara*). However, there are legal requirements for the conclusion of these contracts to be organised in a way which minimises risk.

- (v) Investments should only support practices or products that are not forbidden — or even discouraged — by Islam. Trade in alcohol, for example would not be financed by an Islamic bank; a real-estate loan could not be made for the construction of a casino; and the bank could not lend money to other banks at interest.<sup>49</sup>

Thus in conclusion, it can be seen that ultimately the aim of the Islamic financial system is to allow individuals to earn a living in a fair and profitable manner, without exploitation of others, so that all society benefits.

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<sup>49</sup>“Principles of Islamic banking”, *Nida’ul Islam Magazine* (www.islam.org.au), November–December 1995.