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Unlawful Gain and Legitimate Profit in Islamic Law: *Riba*,  
*Gharar* and Islamic Banking,  
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We begin by giving a summary of the main points. The book is chiefly concerned with prohibitory rules unanimously acknowledged in principle by all Muslims i.e. *riba* (unlawful advantage by way of excess or deferment) and *gharar* (uncertainty, risk and speculation). It is also concerned with interest-free banking and *mudarabah* (commenda partnership). The subject of the book is law not economics.

The prohibition of *riba*- applies principally to the two precious metals and the four commodities mentioned in the Prophet's Tradition as also, by analogy, to all species which are jointly governed by the same ratio legis (*'illa*) or belong jointly to any one of the genera to which the six articles named in the Tradition are subordinated. A *dhimmi* or a *musta'man* cannot enter a *ribawi* transaction in Dar al-Islam, whether with a Muslim or a non-Muslim, but a Muslim, according to Hanafi opinion can charge interest from non-Muslim in *Dar al-Harb*, reports the author. Hanbalis, Malikis, Shafi'is and 'Ibadis reject the opinion. The author thinks that the traditional Hanafi view on this particular point has been upheld by Pakistan (pp. 31-32)<sup>(\*)</sup>.

A loan should not, in principle, provide the lender with any advantage. This applies only if the advantage is agreed concurrently with the contract of loan. A term giving time for repayment is not binding in a contract of loan (except for Malikis) (pp. 41, 42, 43, 44). A gift stipulated in the contract of loan is also unlawful (p. 1). Similarly, granting a rebate is legalized by some Shafi'is, Hanbalis and 'Ibadis but disapproved by Malikis (pp. 41-42).

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\* All page numbers within parentheses refer to the book under review. As noted below, the author is mistaken on this point.

The question of effect of a special clause or condition involving *riba* on the validity of the loan agreement depends on its purpose and the effect of the condition and is differently decided by different schools of law.

In theory *riba* has a much wider field of application than loan. *Riba* may pervert any transaction which involves the exchange of two or more countervalues. Barter and money exchange are among the transactions that are vulnerable to *riba* (pp. 47- 48).

Practically speaking, popular belief is not far from reality and the censure of *riba* in practice amounts simply to the forbidding of payment and receipt of interest on money loans. Qur'anic verses in relation to *riba* speak of loan agreements. Barter was accounted among the transactions susceptible to *riba* by the Prophets Tradition (p. 48).

Unlike *riba* the field of application of *gharar* greatly widened over time. Concern for protecting human beings from extravagance is an important feature of the Holy Quran, and it consequently proscribed games of hazard. The idea of protecting the weak against exploitation by the strong led to the elaboration of a rule of general application, commending that all transactions should be devoid of uncertainty and speculation, and this could only be ensured by the contracting parties having perfect knowledge of the countervalues intended to be exchanged. *Gharar* pervades a number of contemporary operations which were not contemplated or at any rate not common during the Prophet's time. Most cases of *gharar* brought to the attention of early Muslim jurists were drawn from sale contracts. The few definitions we have are generally incomplete. Ibn Qayyim al-Jawziyya described *gharar* as being the subject-matter that the vendor is not in a position to hand over to the buyer, whether this subject-matter is in existence or not. Another author equated *gharar* with an uncontrolled subject-matter, such as a bird in the air or fish in the water. But here again the definition was an answer to those who had confused *gharar* with the unknown (*majhul*) (pp. 49-50).

The author also reproduces the (definitions of *gharar* as proposed by Ibn Juzay, Ibn Rushd and Sanhuri. In the end he concludes that averting *gharar* in any transaction would require the observance of the following three rules:

- (a) No want of knowledge (*Jahl*) regarding the existence of the exchanged countervalues.
- (b) No want of knowledge (*jahl*) regarding the characteristics of the exchanged countervalues.
- (c) Control of the parties over the exchanged countervalues should be effective (p. 52).

The motive behind the prohibition is not the existence or non-existence but, as in the *Sunnah*, sale producing uncertainty and that is what the vendor is not in a position to deliver, whether or not it exists (p. 53).

It would be wrong to assume that *gharar* corrupts nothing but bilateral contracts for exchange or countervalues; in fact, *gharar* can also impair gratuitous contracts and unilateral transactions like donation, wills and powers of attorney (p. 56).

Nearly all Muslim scholars are in agreement that the sale of fruits or agricultural products which have not yet ripened is unlawful with the exception of only the Malikis and perhaps a very few of the Hanafis. All Muslim scholars are in agreement about the lawfulness of the sale of fruits and agricultural products after they have been collected from trees or picked up from the field. Disagreement occurs, over the sale of fruits or agricultural products which have already ripened but have not yet been collected (p.59).

Generally speaking, schools of law concur in considering that the sale of fruits or agricultural products cannot be lawful except when the signs of readiness are shown, but they disagree on interpretation of "signs of readiness". As to the agricultural produce growing beneath the surface of the soil only the Malikis and 'Ibadis, validate their sale (p. 60). Similarly *istisna'* or manufacturing a commodity on order is approved on the ground of usage during the time of the Prophet himself who justified it on the ground of necessity. The exact nature of the contract of manufacture is disputed (p. 61).

Islamic *fiqh* has persistently emphasized that the exchanged countervalues in a bilateral transaction should be in existence at the time such a transaction is concluded. In other words, no material want of knowledge (*jahl*) should subsist with regard to the exchanged countervalues, otherwise *riba* or *gharar*, or both, have a greater chance to infiltrate the transaction. The safest way to avoid *riba* and *gharar* would be to have the exchanged countervalues in hand (p. 63).

In a fairly advanced merchant society during the Prophet's time and especially during the later Arab empire, people continued to exchange what they did not have in hand, what they did not see and even what they did not own. Business contingencies and legal requirements were about to clash. Islamic jurisprudence yielded to the pressure which led to exempt *bay gha'ib* (p. 64) *bay' salam* and (*bay' juzaf*) from the fold of illegal transactions, under specific conditions (pp. 64-65).

*Bay' salam* was bound by special rules intended to minimize the danger of *gharar* and, rather theoretically, the danger of *riba*.

*Bay' juzaf* was tolerated as a matter of necessity (*darura*). The Holy Qur'an and the *Hadith* pointedly refer to the sources of prohibition of *riba*. The Holy Qur'an (II:219 and V:93) prohibits games of hazard (*maysir*) and the Prophet, according to widely postulated traditions, has forbidden the sale of an escaped slave or animal, the sale of a bird in the air or a fish in the water, the sale of young still unborn when the mother is not part of the sale, the sale of milk in the udders, the sale of the stallion's sperm and many other forms of sale that were practiced locally.

Apart from theory the temptation to disregard Islamic teaching on the prohibition of *riba* and *gharar*, was, and still is, enticing. This is due to the financial system which prevails up to now, at least within a capitalist society which relies heavily on "interest", while speculative transactions like the insurance contract are very attractive to businessmen (p. 86).

The author asserts that although a significant number of Muslims refuse to deal with *riba* and *gharar*, it is unfair and unrealistic to expect Muslims to refrain collectively and permanently from being involved in them as long as these form the basic foundation of the ruling economic order. The necessary first step to do away with these two elements was considered by Muslim economists to be the re-organization of the banking system on the basis of Islamic ethics (pp. 86-87).

The oldest commercial interest-free bank, the Dubai Islamic Bank was founded some ten years ago. Pakistan was the first state to initiate the Islamization of its economic and banking system, in 1979 followed by the Sudan in 1982 (pp. 87-88).

The techniques of the newly emerged interest-free institutions consist of: *musharaka* (partnership), *murabaha* (cost-plus-profit contract), *ijara* (lease contract), *ijarawa-iqtina'* (hire-purchase contract), *qard hasan* (interest-free loan), *takaful* (mutual guarantee) and *mudaraba* (commenda partnership) (p. 89).

The *musharaka* of the Islamic financial institution is obviously participation financing. Under Islamic law no security can be taken from the partner.

In *murabaha* (cost-plus-profit contract) there are two aspects which are settled in different fashions by the various schools of laws: (a) Expenses a *murabaha* vendor be allowed to add to the *murabaha* price, (b) Options open to *murabaha* purchaser if *murabaha* price was unduly inflated.

The concept of *ijara* (lease contract) was examined in great detail by *fiqh*. Muslim scholars had lengthy discussions on whether *ijara* is a revocable or irrevocable contract.

*Ijara wa-iqtina'* is the hire purchase concept, called by the Islamic financial institutions "lease-purchase financing".

*Qard hasan* means an interest-free loan, but no advantage whatsoever should be derived by the lender from the loan. Of course each school of law has its own interpretation of what constitutes "advantage". One may wonder how lending could be a business proposition once interest is abolished.

*Takaful* literally means "mutual guarantee". In the context it is the Islamic answer to the modern concept of insurance.

In order to perform its function, under *mudaraba* an interest-free bank will enter into a *mudarabah* partnership with the depositor and into a separate one with the entrepreneur. There may be general *mudarabah* or specific *mudarabah* for a limited period. Negotiable certificate may be issued as a token of investment made towards the fund. The liability of the investor is limited. *Mudarabah*, according to Malikis and Shafi'is, is limited to trading but does not involve manufacturing. Hanafis differ on the point. Hanbalis, apparently, allow the investor and the agent-manager to enter into two separate contracts, one of manufacture and one of *mudarabah*, provided that one is not a condition for the other (pp. 101-104). The limited liability of the investor is ensured by restricting the power of the agent to commit the commenda partnership to any sum

greater than the capital in hand without the investor's specific authorization. As a matter of principle, the liability of the partners in a *shirka* contract is unlimited. The position is not the same when it comes to *mudarabah* (p.106). *Mudarabah* is a loose contractual relationship in which trading authority is bestowed upon the agent who is expected to generate maximum profit by deciding precisely when to buy and when to sell. This right of the agent has been subjected to the condition of profitability of the transaction otherwise the investor may intervene (pp. 111- 112).

### Comments

The book summarized above is among the few that reflect sound scholarship, full grasp of classical sources of Islamic law and command over reproducing legal theories and opinions.

The author's discussion of the jurists' interpretation on the lender's entitlement to derive any advantage from the *qard* is good. Despite its proliferation of divergent opinions of different schools of law, Appendix 2 on the sources of prohibition of *gharar* (p. 85) is the pith and marrow of the entire discussion on the subject and could form the practical basis of avoiding transactions containing this element. The book reflects the author's perfect understanding of the *shari'ah* law on *muamalat* as enunciated in primary sources referred to in the footnotes and bibliography.

In spite of the above merits, the book is not an easy reading for an average scholar like the reviewer.

Giving full treatment to five schools of law on each and every subject and microscopic differentiation between their respective views has reduced the book to perplexity and overshadowed the message it aims to convey. Common and reconciling normative judgments should have followed the apparently discordant views of the different schools. For example, no school would object to determining the cost and the price of a *mudarabah* object according to the prevalent custom and convention of the traders. This is what the Hanafi jurists lay down and could be concluded by the author. Moreover there was a ground for difference in the absence of a universal cost and accounting concept. These are now negligible in view of agreed formulae to settle the issue.

In *salam* the jurists agree that the goods should be so defined as not to leave any possibility of dispute. Some emphasize describing the merchandise so as to provide sufficient means of identifying it while others would achieve this objective by inspection. Viewed in context of contemporary practices of standardization of most of the traded commodities the possibility of dispute has been minimized and no school of Islamic law would disapprove of these practices.

After giving an explanation of the Qur'anic doctrine on *riba* (interest) the book tries to define the basic legal terms that are frequently used in explaining the *Hadith* teachings on the two well-known categories of interest. This is followed by traditional views on *riba* as expressed by the four Sunni schools of law as also that of Ibadis. The lengthy discussion on differences in determining the *ratio legis* of prohibition of *riba al-fadl* could have been avoided.

In the discussion on the legal position of credit sale with inflated sale price, the book devotes a large part to the opinions of the jurists of different schools about validity of sale on credit. Here also emphasis on highlighting controversies in place of presenting an agreeable conclusion seems to be unwarranted. Similarly under the heading *Qard* with a *riba* stipulation: valid or not" the discussion begins by posing a question: "What is the effect of a special clause of condition involving *riba* on the validity of the whole *Qard*" (p. 44)? This means the single point to discuss was the legal position of contract of loan stipulating the condition of paying interest. Does the condition nullify the contract or the condition alone becomes ineffective? The discussion on this simple and direct question could be disposed of without unnecessarily discussing the legal position of all conditional contracts as such in all the schools of law. The context of discussion on conditional contract is different from the position of a contract stipulating a void condition. The discussion on traditional views on *riba* is a perfect nonplus and baffling. It would have been better to state the essence of agreed concepts in a few sentences and to report the minor disagreements into a couple of footnotes (as was done by Chapra in his *Towards a Just Monetary System*). The same can be said about discussion on the *illa* and genus of the interest-susceptible items as outlined in the *Hadith*.

Vexing details are found on controversies on sale of goods that are out of sight (*bay' gha'ib*). The author fails to appreciate that the early '*Ulama*' suffered the constraint of items and institution of trade that obtained in the primitive society in which a merchandise not visible could involve the element of *jahl*. The spirit of *Ulama*'s approach needs now to be applied to *bay' gha'ib* of the items known by their manufactures or by internationally known standardizations and classifications. Will any school object to the *bay' gha'ib* of National T.V. or A.C., Phillips refrigerator, Mercedes car or Singer Sewing machine of specified models? The case of internationally traded agricultural commodities also is not much different. Viewed in this perspective the difference of opinions of different schools becomes negligible and applicable to those items only which have not been standardized by traders or are still traded in primitive fashion. There is too much emphasis on reporting controversies. Even the agreed sense in the definitions of *ijara* has become clouded as the author makes a comparative study on the basis of the minor conditions of the contract. The book ignores the point that such differences are generally explanatory, not contradictory. Similarly the entire discussion on whether the contract of *ijara* is revocable (*ghayr lazim*) or irrevocable (*lazim*) leads the reader to nowhere.

On *mudarabah* the claim that Maliki and Shafi'i jurists confine *mudarabah* contract to trade while Hanafis extend it to manufacturing too, needs to be reinterpreted. The Hanafis too confine it to trade. The reason of their extending it to examples of processing the trade goods or what can loosely be termed as manufacturing is that, according to them, such processing is customarily included in the definition of trading. Jurists like Sarakhsi also include farming under *mudarabah* because according to them, the holy Prophet (metaphorically) termed it as *tijara*.

We feel that the book, while emphasizing the controversial points ignores the temporal and spatial factors which are ever changing and necessitate a new legal approach.

The author is not convinced of the rationale of *qard hasan* being advanced by some interest-free institutions, as a business proposition. He is partly correct in his impression but he will not deny that the institution of *qard hasan* carries great economic significance in the financial system of Islam.

The author's interpretation of the Pakistani practice of retaining interest on foreign loans, ... etc. with reference to the permissibility of practicing interest with *dhimmis*, quoted on the authority of David Suratgar, is incorrect. The fact of the matter is that the practice in Pakistan is not based on legal reasoning but on practical constraints. The Council of Islamic Ideology in Pakistan while dealing with this question has already declared interest on foreign loans unlawful but allowed to practice it until alternative arrangement conforming with *shari'ah* are evolved in regard to the foreign transaction of the banks (Report, 1980, p. 52) of PICIC (p. 56) of NDFC (p. 58) and of the central bank (p. 82). As to the government borrowings from external sources the Report observes as follows:

"The Government of Pakistan has been borrowing substantial amounts from foreign governments and international financial institutions to finance economic development on which interest payments have to be made regularly. The Council feels that efforts should be made to reduce dependence on foreign aid in general and interest-bearing foreign assistance in particular. In addition, efforts should be made to foster greater economic cooperation among Muslim countries so as to promote movement of capital on the basis of profit/loss sharing or other non-interest basis. With such increased economic cooperation among Muslim countries it is not unlikely that, with the passage of time, non-Muslim aid giving countries and international financial institutions may also begin to deal with Muslim countries on a basis compatible with *shari'ah*. For the time being, external borrowings will have to be continued on the basis of interest."

The definition of *gharar* as want of knowledge regarding existence of price or object is not acceptable in as far as it includes non existence of price at the time of contract. *Gharar* exists in respect of the object of contract, not price.

As to the condition about price the book claims:

"In the same way as they should have control over subject matter, the contracting parties should also have an effective control over the price. The buyer may satisfy the seller through a third party by way of *hawala dayn* or transfer of debt to a third party" (pp. 80-81).

It is not clear how and why the buyer in a contract of sale should have effective control over price in the face of the legality of credit sale which means that the buyer may be empty-handed. The jurists do not even press upon the transferee of debt to prove his control on the amount of price; he may be equally empty-handed solvent. It can be pointed out that everything that corrupts a business transaction cannot be termed as *jahl* or *gharar*. There may be some other factors too that may make a contract defective or void viz., compulsion, harm (*darar*) and defective conditions (*shurut mu'fida*).

Citing the practice of purchase by townsman (intermediary) from the village supplier before the latter reaches the market place (*talaqqi al-rukban*) as example of transaction containing *gharar* is not appealing. *Talaqqi al-rukban* is disapproved and this has significant policy implications in respect of market mechanism. But this disapproval cannot be attributed to ban on *gharar* under any definition of the term.

Over-emphasizing differences on the concept of *gharar* without trying to reconcile the different but not divergent interpretations is not supportable. At places the discussion reflects a confusion in clearly distinguishing between *jahl* and *gharar*. *Gharar* is found in the nature (*asl*) of contract itself, in *jahl* it is not the nature but the condition or *wasf* of the contract that is defective. Another difference between *jahl* and *gharar* lies in nature of defect in both the contracts. A contract based on *jahl* is voidable or defective (*fasid*) but a contract based on *gharar* is null and void (*batil*). *Gharar* generally affects both the parties to the contract; *jahl* may affect one party only. The jurists do not disagree on the legal position of *gharar*; it is the application of *gharar* in context of different customs at different places which is controversial.

As regards the conditions that in order to be free from *gharar* the subject matter must be in existence, it should be noted that existence is one thing but ability to deliver the thing is different. A bird in the air or a fish in water exists but it cannot surely be delivered. The moon exists but the sites in the moon cannot, at the present, be delivered nor can these be possessed by anyone; thus the sale and purchase of sites in the moon imply *gharar*. Thus of the so many definitions of *gharar* that the book contains, Ibn Qayyim's definition seems to be most convincing and to the point.

An important point on the subject of *gharar* that has been lost sight of in the book is the *fuqahas'* approval of *gharar yasir* (negligible *gharar*) because, as they claim, the same does not lead to a dispute between the parties. This means that, according to them, the crucial factor in prohibition of *gharar* is probability of causing a dispute. The point is to determine the *shari'ah* position on *gharar fahish* which, due to contemporary legal and official protection, fails to cause a dispute which otherwise would have arisen. The anomaly is bound to persist as long as the cause or wisdom (*sabab* or *hikma*) is replaced by *ratio legis* (*'illa*) as the standard of prohibition.

Before closing our comments on *gharar* it can be observed that the discussion could have been conducted without overemphasizing differences of opinion among the five different schools of law. The book is so much engrossed in highlighting controversial opinions that it does not give a simple and agreed opinion on minor and supportive points like *hawala* and the impact of *gharar* on gratuitous contracts.

The opinion on *bay' salam* also needs revision. According to this opinion "Abu Hanifia and Malik, according to Ibn Qudama, are satisfied with the amount of description of the subject matter which constitutes, in their view, sufficient means for identification of the *salam* object, whereas Ibn Hanbal and Shafi'i require other defining characteristics, namely color, country of origin and any other features which have an effect on price or on the use" (p. 71). The fact of the matter is that according to Ibn Qudama (1367 A.H., p.4280) the three (basic) conditions are laid down by Maliki, Shafi'i and Hanafi. As regards the other subsidiary conditions added by Hanbali none of the three differs. What Hanafis emphasize is the point that all the subsidiary conditions are automatically implied in the three basic conditions.



Glossary of the *fiqh* terms given at the end of the book is a useful idea and reflects the author's grasp over *shari'ah* and modern law. The fact is that there are a number of *shari'ah* terms that hardly have parallels in modern legal terminology. There are also certain terms which need further elaboration. The glossary is also not free from these constraints for example the English substitutes of the terms *darura* (as compared with *haja*), *ghayr lazim*, *'inan*, *ja'iz*, *lazim*, *mashru'*, *mu'amalat*, *thamaniyya* and *ujrat al-mithl* have to be reviewed. Similarly attributing *mufawada* partnership to any other school of law than the two Hanafis, as explained in the glossary, is not convincing.

Despite its vexatious repetition and confounding discussion the conclusion which the author has derived about the *modus operandi* of the Islamic financial institutions is the quintessence of the situation that exists and requires serious consideration by the pioneers and founders of interest-free financial institutions. His final observations can be summarized here:

- Most schools of law teach that in secular (*sic*) matters (*mu'amalat*) permissibility is the rule unless there is prohibition; but when this principle is put into practice, these schools have shown a reluctance to allow the contracting parties to a given contract to change the pattern of that contract as defined by *shari'ah* by way of adopting supplemental stipulations which alter its effects. Permissibility is in any case tempered by a set of requisites. Chief among these requisites is the rule that any given transaction should be devoid of *riba* and *gharar* ... These requisites are intended to accompany the inception of secular transactions and to regulate them once in operation, to make sure that neither of the contracting parties suffer wrongs at the time the agreement is reached and during the implementation of the agreement. Actually it is a main concern of the *shari'ah* law of contract.

- It is not unusual to see new ideas - or, as one must say in the present circumstances, ideas revived after being kept in abeyance for a long time being met by a challenge as soon as they go beyond an abstract stage and begin to be put into practice. The reorganization of the banking system on the basis of Islamic ethics is no exception. The challenge that the reformed institutions confront is not only external from the conventional banking and financial systems, but also from within their own ranks. This internal challenge takes the form of some interest-free banks and investment companies resorting, more or less openly, to the use of legal stratagems (*hiyal*) in order to overturn the prohibitions of *riba* and *gharar*. With such means they are in a position to compete, rather unfairly, with other interest-free establishments which confine their activities within more orthodox boundaries.

The consequence, which is not always freely conceded, is that different operational techniques are current. On the one hand are the bankers and financiers who believe that lawful means can achieve objectives which are not necessarily lawful. On the other hand are those who maintain that an Islamic banking system has no *raison d'etre* and no prospect for success unless it safeguards the much heralded legitimacy of its means and objectives; otherwise the whole system will be perverted and its adherents betrayed. For, under a strict interpretation of those two prohibitions, the range of valid transactions is rather limited and the temptation to bend the rules in order to exceed that range is very strong.

- It is hard to say, for the moment, whether the two operational techniques will grow up concurrently or whether one technique will eventually prevail over the other. What is certain is that the growing rift in the process of splitting the newly established interest-free banking system will do nothing to enhance that system's credibility, and ways must be found to mend the rift.