

# **The Concept of Agricultural Finance in Shariah An Analytical Study**

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Master Dissertation

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Lutfullah Saqib  
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Supervisor Professor Dr.Muhammad Tahir Mansuri

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**Faculty of Shaira and Law**



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**Acceptance by the Viva Voce Committee**

Title of Thesis: **The Concept of Agricultural Finance in Shariah – An Analytical study**

Name of student: **Lutfullah Saqib**  
Reg No : **7- FSL/LLM/ICL/07**

Accepted by the Faculty of Shari'ah & Law, Department of Shari'ah (Islamic Law), INTERNATIONAL ISLAMIC UNIVERSITY ISLAMABAD in partial fulfillment of the requirements of the MPhil in Islamic Commercial Law degree.

**Viva Voce Committee**



1. \_\_\_\_\_  
**Supervisor/Chairman Viva Voce committee**  
(Professor Dr. Muhammad Tahir Mansuri)

2. *Rejected*  
\_\_\_\_\_  
**External Examiner**  
(Prof. Imran Ahsan Khan Nyazee)

3.   
\_\_\_\_\_  
**Internal Examiner**  
(Dr. Abdullah Rizk) *ALmuzaini*

Dated \_\_\_\_\_

## Dedication

This humble work is dedicated to my grand fathers and well renowned religious scholars Mulavi Habib al Rasool (Fazili Dewband India) and Mulavi Abdul Qahhar (Fazil Dewband India), to my father Inayat ullah Haqani (Fazili Haqania Akora Khattak), to my respected teachers and well renowned scholars Dr. Muhammad Tahir Mansuri, Prof Dr. Mehmood Ahmad Gazi and Prof. Imran Ahsan khan Nyazee, to my fatherly figure Prof. Muhammad Ammanullah Khan (who always like a father directed me towards the right path through his esteemed knowledge and vast, immense and huge experience), to my late younger brother Abbas Ahmad Khan (who was martyred in his young age and his innocent smile was grabbed from us. His handsome face is always in my heart, his jokey statements are always in my minds, his melodious recitation of the Holy Quran is always in my ears and his smile compels me always to put down tears from my eyes.....), to my lovely brother Khog Jhan (Jalil Ahmad Khan; who helped me a lot throughout my scholastic life through his sincere love and affection .....I can't forget his severe, angry, rigorous, harsh, disputed nature and other diverse qualities that he mixed up with his deep affection, goodwill,love and fondness, and confused me mentally and emotionally to the extent that I became a PhD Scholar and a respected university teacher ..... ) and to my sister Nida Rasheed (who put a new life in my dead thoughts and directed me towards a real life through her great love and affection .....

## **Thesis Statement**

The flexibility of Islamic commercial law ensures the effective application of agricultural finance both for crop and non crop activities.

## Abstract

Economic stability of a country mostly depends upon its agricultural development. It has a great effect on the GDP. but unfortunately those people who are related to this sector, mostly belongs to the lower class of the society. They are always facing financial crisis and because of this financial instability they are unable to fulfil their basic agricultural requirements both for crop and non crop activities. These requirements are different for different sectors. in they very first priority these include basic agricultural requirements that can also be called basic agricultural inputs seeds ,fertilizers,herbicides,weedcides,insecticides,manual sprayers, basic agricultural equipments like rake,fork,hoe,hand fork wheel barrow,wateringcan ,transport facilities like motorcycle, cycle ,van and etc.besides this they also have the responsibility to feed their families. Such financial problems not only affect their own lives but also of those people who are not directly relayed to the agricultural sector. It also affects the GDP to an alarming extent and increases the unemployment ratio. If their agricultural problems are not solved, it will give birth to dire consequences which are mentioned above. Being an important contributor to the economy of a country. it is the duty of the concerned state to take some solid steps for the rapid development of such sector .one of the vital among these steps is the insertion of financing to this sector through the financial institutions i.e. banks. As for as the Islamic state is concerned, it has to apply the Islamic financial system in this regard through the inclusion of Islamic banks and other Islamic financial institutions

Islamic financial system can be effectively applied to the agricultural sector both for crop and non crop activities. Such system is so comprehensive that it fulfils all requirements of a farmer which starts from basic agricultural inputs and ends with heavy machionary.in this connection all modes of Islamic financial system can be utilized.i.e trade based modes of financing like Murabaha,Musawama,salm, istisna,rental based modes of financing like ijarah and participatory modes of financinglikeMusharakha,DiminishinMusharakha,Mudarabha,Musaqah,Muzarraha,and etc.The issue of agency is always involved in all these modes of financing. A pure Islamic financial system requires active participation from the Islamic financial institutions in all sort of commercial transactions particularly in trade based modes of financing. But because of some reasons, mostly such participation is not practicable and this situation gives birth to the concept of customer's agency which is allowed with certain condition but not desired .Besides this the physical inspection and possession of the agricultural commodity and goods is also a Shariah requirement which must be followed by the Islamic banks.

Islamic banks and other Islamic financial institutions demands according to their financing policy some securities or collaterals from a farmer .It is done for the purpose to protect their investment .These may be in the shape of movable property ,immovable property or any other asset or commodity that satisfies the bank in this regard. But mostly such securities are in the shape of charge on agricultural land through pass book system .on the similar way interaction of the bank with the farmer is also indispensable for the effective monitoring and recovery system. But such interaction will be of such nature that makes the recovery and monitoring system according to the principles of Islamic commercial law

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October 7, 2009

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# 1. Introduction

Food is one of the basic necessities that are imperative for the nourishment and survival of human life. Among other sources of food, agriculture is probably the most important source through which farmers grow food for themselves and others to meet the current and future demand. A considerable portion of the world's labour force is attached to this sector, and it contributes significantly to the world's economic development. In case of Pakistan, agriculture accounts for 23% of its GDP, and employs 42% of its labour force<sup>1</sup>.

The work force that is getting its bread and butter from this sector includes both poor and elite classes; however, poor class is more dominant in terms of numbers. Due to shortage of the financial resources, at times poor class is unable to get maximum benefit from their efforts. Most of the times, they require additional money to cater the financial needs arising at different times of harvesting cycles. e.g. at the start of cycle, money is required to buy basic agriculture inputs like seeds, fertilizers, herbicides, and plowing tools. Similarly during the mid of harvesting cycle, money is required to purchase pesticides, and different agricultural tools. Since money is required at all steps, and the majority of farmers have a shortage of it, therefore, they borrow it from various sources including individuals, organizations, banks, and government. In short words they fulfill their agricultural requirements through formal and informal institutions of credit.<sup>2</sup>

As agriculture is a mainstay of most of the country's economies, and it is the responsibility of the government to provide food to all population, therefore, almost all of countries try their best to accommodate the financial needs of the agriculture sector. These activities / steps include advancement of agricultural loans, giving of subsidies over the agricultural commodities, and levying off different kind of taxes. Private sector is also playing a vital role in this regard. However, the private sector is only extending the financial loans to the farmers.

It is a matter of fact that agriculture has an important role in the economic stability of a country. Such role may be direct or indirect. It can be determined by three ways; first and the most important that agriculture is a main and basic source that provides foods for the consumer. It also provides fibers at local and international level through livestock.<sup>3</sup> Secondly; it produces goods for international market and thus becomes a main source of foreign exchange. It means that agriculture enhances export activities of a country by the help of which its economic growth can be determined. Thirdly, it serves as a main market for industrial goods and commodities. In short it is a source of food, feed, fiber, animals, fertilizers, cut flowers, ornamental and nursery plants, animal hides, leather, industrial chemicals, fuels, drugs and etc. Besides all these it also provides employment opportunities and thus increase work force. In Pakistan it employs 47 percent of the national employed labour force.<sup>4</sup> Because of all these reasons experts of the

agriculture field have a view that if a country has rich agricultural activities then its developing process never stops.

It is a solid reality that those people who are related to the agricultural sector, majority of them belongs to the lower class of the society .It is said that small farmersdominate the agrarian structure of most developing countries.<sup>5</sup>They accept agricultural credit because of lack of capital for running their form activities.<sup>6</sup>For such people agricultural is not a business but a way of life. It is because of this reason that they are always in need of money in the beginning of a season to buy basic agricultural inputs and to feed their family till to the next harvest .According to the experts of agricultural finance if this situation is not properly dealt then it will impede the agricultural development of the concerned country. Because of the tense need, farmers resort to public and private financial institutions to get financial assistance in the shape of agricultural loan to fulfil their agricultural requirements both for crop and non crop activities. But both these sources provide agricultural loans based on interest .in short term it solves a farmer's problem but create more problems for him on long term basis because he repays the principal amount along with the interest.It is because that the cost of providing credit is independentof the amount of the individual loan.<sup>7</sup> However this system can be worked in a non Muslim state and can be used for solution of financial problems faced by a non Muslim farmer.

But as for as Muslim farmer is concerned, he is prohibited by Shariah to get interest based loan and at this particular stage the concept of Islamic financial system arises for the solution of his agricultural's problems through different modes of Islamic commercial law i.eQardi Hasan, Murabaha, Musharakha, Mudarabha,Salam,Istisna,Ijaraha,Musaqah,Muzaraha and etc.All these transactions can be effectively used to fulfil his different agricultural requirements both for crop and non crop activities.

It is pertinent to mention that agriculture finance is entirely a new concept. But it does not mean that the classical jurists did not pay any attention to the agricultural sector in their juristic work. All most all of the classical jurists discussed the concept of Muzaraha and Musaqaah in their books with minute details.<sup>8</sup> The example of Imam Malik can be cited in this regard. he thoroughly discussed this concepts in his well known book"Al –Mutha" in details. However, the relation between agricultural finance and other Islamic commercial transaction is not mentioned. The reason is that this concept did not exist at that particular time. But this fact can not be denied that they discussed the basic rules and regulation for all these commercial transactions in a broad sense

Keeping in view the above discussion, the objectives and aims of the present work can be easily described in the following way

Firstly; As stated earlier that majority of farmers belong to a lower class of the society and always in need of money in the beginning of a season to buy basic agricultural inputs .it is endeavoured in the

present work to point out their major problems and to find the solutions for the same in Islamic agriculture finance

Secondly; conventional agricultural financial system is entirely structured on interest based loans. its alternative has been presented in the very beginning of the present work in the shape of Qadi-Haasan. Different issues related to this concept are dealt in a very juristic manner according to the humble knowledge of the researcher.

Thirdly; the classical jurists described broad rules for all Islamic commercial transactions. The present work is related to those methodologies by the help of which such commercial transactions can be practically applied to the agricultural sector .in this discussion it is strived to find out basic requirements of different agricultural sector and then to employ different modes of Islamic financial system for their fulfilment.

Fourthly The Accounting and Auditing Organization for Islamic Financial Institutions presented a specific procedure for all modes of Islamic financial system. Some basic principles are also laid down in this regard .But such procedure is seemed very difficult to be applied to the agricultural sector. In the present work it is tried to suggest simple procedure as compared to that of Shariaha Standards. But it is done without any violation of the basic principles described by Shariaha for commercial transactions.

Fifthly ;There are various issues in the Islamic modes of financing .The most important among these are the issue of agency, physical possession and inspection of the agricultural commodity and machinery, direct payment to the supplier by the Islamic bank, Hamish Jeddy,down payment,securities,schedules for repayment, recovery procedure ,insurance of the agricultural commodity and etc.The object of the present work is to develop a realistic approach to all these issues from the agricultural perspective. A practical study of the agricultural sector is done for this purpose.

Fifthly; Islamic financial system has particular characteristics that it should be applied along with its spirit otherwise its desired objectives cannot be achieved. But unfortunately in the contemporary financial system such spirit has been damaged severely particularly on those occasions when there is no way to find an alternative. It is the main object of the present work to present Islamic agricultural finance with its real spirit

The present work differs from those written in English or Arabic on Islamic agricultural finance in many respects by contemporary scholars. first ,it attempts to compare the philosophy behind the conventional agricultural finance with that of Islamic agricultural finance and proves with solid arguments that the previous is based on commercialization while the latter is more cooperative and for the prosperity of the society.The advancement of loan is accepted by Shariah only for this purpose.<sup>9</sup> So the purpose of Islamic agricultural finance, in the first instance, to cooperate with the farmers rather than to earn more profit from him.second, it does deal with Islamic agricultural finance only from theoretical

angle as did by many contemporary writers but also deals with its practical utility. Because of this reason case study has been given at the end of each Islamic commercial transaction. All these cases are critically analyzed in the light of their corresponding theories given in the beginning of the chapters. Thirdly, the present work attempts to envisage and apply the concept of Qardi Hasan to Islamic agricultural finance to bring it in conformity with the philosophy of Islamic financial system. It is the very first time that an attempt is made for the application of Qardi Hasan to the agricultural sector. Some basic rules and regulation are framed in this regard in the light of Shariah. This idea is totally a new one and hence required many suggestions for its improvement which is expected to be done in a separate work. Fourthly, it attempts to describe all modes of Islamic commercial transactions with minute details from the perspective of Islamic agricultural finance. It is done through different ways i.e. a classical theory of different modes is given in the beginning of their corresponding chapters, followed by their implementations to the agricultural sector and ends with a case study. Fifthly, it attempts not to follow the existing rules and regulations of Islamic agricultural finance blindly. It is for this reason the view of classical and contemporary jurists are studied analytically and suggestions are given where it is deemed necessary. During this process it is strived to decrease the gape between theory and practice. New ideas are presented in the light of Islamic commercial law and put forward many issues for further research to the mind of a reader. Sixthly, the present work attempts to follow the traditional pattern as in the classical work. The reason is that students of Islamic law are familiar with such method and a new pattern may distract them. So first a definition is given of a particular mode, followed by its legal justification, its application to the agricultural sector and comes to an end with the presentation of its practical study.

As for as the structure of the present work is concerned, it is divided into five chapters. The first chapter deals with the conventional agricultural finance in details. However it also throws a light over the brief introduction of agricultural sector along with its brief history and classification. The sole purpose of this chapter is to pave a way for analytical study of Islamic and conventional agricultural finance. During research it is noticed that most of the Islamic banks and other Islamic financial institutions are using the same financial terminologies as used by the conventional financial institutions i.e. working capital, term financing, securities and collaterals, Memorandum of understanding and etc. It would not be wrong to say that the procedure which is followed by the Islamic banks is similar to that of conventional. But it is pertinent to mention that the latter is followed if it does not violate the basic principles of Islamic commercial law. In the second chapter highlights the concept of Qardi Hasan and its implementation to agricultural sector both for crop and non crop activities. Being a new concept it is endeavoured to present it in the most possible simple way without compromising on its comprehensive description. In this very chapter a very rare resort has been made to the work of classical jurist as compared to that of contemporary scholars. The reason is that such concept is a new borne concept in the Islamic financial

system. The third chapter is devoted to participatory modes of financing of Islamic financial system that includes Musharakha, Diminishing Musharakha, Musaqaat, Muzaraat and etc.all these concept are discussed there in a minute details. In the beginning of this chapter the basic rules and regulations of all these modes are discussed followed by their practical implementation to the agricultural sector. The procedure prescribed by Accounting and Auditing Organization for Islamic Financial Institution for such modes is critically discussed and some valuable suggestions are given in the light of Islamic commercial law to make it simple. it is tried to translate the basic Arabic terminologies for all these modes of financing into English lanuage.it is done specially for those people who are not conversant with the work of classical jurists that is almost given in Arabic language.Moreover all these modes of financing are explained through the citation of modern example to make the theory more understandable.

After a throughout discussion of participatory modes of financing in the third chapter, the fourth chapter is devoted to trade based modes of financing i.e. Murabaha,Musawamha,Salam,Istisna and etc.Like the pervious chapters, a theory of all these commercial transactions is given in the beginning of the chapter followed by their practical implementation to the agricultural sector. There are some important issues related to these modes of financing i.e. agency agreement between the Islamic bank and a farmer, status of promise from the perspective of shariah,physical inspection and possession of the required agricultural commodity, actual and constructive possession of the property,urboon and its legal status, payment to the original supplier, direct and indirect payment,colletrals and securities, and etc.All these issues are dealt critically and some suggestions are given in the existing concepts to make these more suitable for the agriculture sector. All these suggestions are put forward after a practical study of the concerned sector particularly that of rural area. The fifth chapter deals with rental based modes of financing. A special attention is given to such mode of financing being a mostly used mode of financing by the Islamic banks and other Islamic financial institutions. In this very chapter the concept of leasing in the conventional agricultural finance is compared with that of Islamic agricultural finance and proved with solid arguments that the latter is more comprehensive in nature and more beneficiary for the agricultural sector. Besides this those kinds of conventional leasing which are according to the basic rules of shariah, suggested to be inserted Islamic agricultural finance.

As for as the research methodology is concerned, the descriptive methodology has been followed in the present work as it is mostly followed in the legal research. It is known that there are different types of descriptive methodology i.e. continuous description, case study, genetic description, survey, and etc.all these types are followed in the present work. But it does not mean that most part such work is theoretical in nature although it is a matter of fact that an overwhelming character is given to it. In this regard the literature available on the given topic in the classic books is thoroughly discussed. It is tried to present such literature in the easiest form without detoriating its original spirit. The style followed by the classical

jurists in their work has been retained in the present work as far as possible. It is because of this reason a literal meaning of a commercial transaction is given, followed by its technical meaning and ended with the explanation of its basic principles, rules and regulations. It is intentionally done for those people who are accustomed with the methodology of the classical jurists. A resort is also made to the work of contemporary jurists who did a great work not only for the development of Islamic law in general but also for Islamic commercial law in particular. The work of a well renowned jurist Mufti Muhammad Taqi Usmani in this connection is very remarkable. During research a survey is conducted particularly in the rural areas for the purpose to understand the real and major problems faced by farmers of that area both in crop and non crop activities. Some suggestions are taken from them for the solution of such problems. It helped the researcher to critically analyse the existing agricultural finance and to make it more suitable for the agricultural sector. A case study is also conducted on the wishes of my respected teacher Dr Muhammad Tahir Mansori to give an indispensable strength to the present work. In order to fulfil it some practical commercial transactions i.e. Murabaha, Ijarah, Istisna, Salam, Diminishing Musharaka and etc conducted by some esteemed Islamic banks, are resorted to. It paved a way to study profoundly the existing procedure followed by such Islamic financial institutions in the agricultural finance. All these commercial transactions are studied and critically analysed in the perspective of Sharia. Most of the research materials particularly those related to the work of classical jurists are collected from library, while others related to the work of contemporary scholars are accumulated from web resources.

It is a matter of fact that agricultural finance is a newly developed subject of Islamic financial system and therefore, not discussed by the classical jurists in their work. However; it does not mean that these jurists were totally unaware of the said discipline. A thoroughful discussion of Muzaraha and Musaqah can be found in their books and both these are main concepts of Islamic agricultural finance. Some of the jurists Imam Kasani, Imam Shawkani, Imam Sharakhsi and ibni Qudama devote separate chapters to both these concepts. A well renowned jurist Imam Malik presents a full pledge discussion of Muzaraha and Musaqah in his classical book Muwatha. All issues related to both these concepts are dealt analytically and solved through examples along with solid arguments. All these jurists discussed the concept of Salam as a special mode of financing to be applied to the agricultural sector. The origin of this mode shows the same fact. It is therefore, can not be said that the classical jurists do not pay a required attention to the issues of agricultural sector.

But the question arises that why the classical jurists discussed the concept of Muzaraha, Musaqah and Salam in minute details while giving no space to the application of other modes of Islamic financial system like Murabaha, Musharakha, Ijarah, Istisna, Mudarabha and etc to the agricultural sector. The answer to this question can be easily understood if the environmental conditions of Arabian is studied. It is a solid fact that the people of such area were strongly involved in the business activities. They used to go

different parts of the world for trade. It shows that such business activities were not limited to the local trade but beyond that in the shape of international trade. Their tendency and inclination towards the trade was due to the lack of suitable environment for agricultural activities. It is because of this reason all modes of Islamic financial system were discussed with a special reference to trade and not agriculture.

In the modern age a dire need for the agricultural finance is felt by the scholars and hence they start research work for its development. This need is also felt at the state level and it is because of this reason some of the countries like Sudan, Iran, Pakistan and etc encourage the scholars to discuss different modes of Islamic financial system and their application with a special reference to the agricultural sector. A guideline is issued by the State Bank of Pakistan for the same purpose. Dr. Muhammad A. Gulaid also contributes his work in the shape of a research paper with the title of "Financing Agriculture Through Islamic Modes And Instruments Practical scenarios And Applicability". In his work he tries to examine the contemporary relevant Islamic modes from the agricultural perspective. Similarly another contemporary scholar Adam B. Elheraika also contributes his work in the shape of a book named "On The Experience Of Islamic Agricultural Finance In Sudan Challenges And Sustainability". It provides significant thoughts and information regarding challenges faced by the Islamic banks and other Islamic financial institutions in the agricultural finance. It is tried in the work to develop market for the agricultural finance. The book is particular in nature as it is related to agricultural finance in Sudan but its applicability may be generalized and can be effectively extended to other agricultural countries.

Some of the scholars restrict their research to the application of a particular mode of Islamic financial system to the agricultural sector with respect to a particular country. For example Adam B. Elheraika, the above mentioned writer, writes on the application credit to the agricultural sector in Sudan. Similarly Ahmad Kaleem and Rana Abdul Wajid write on the application of Salam to the agricultural sector in Pakistan.

## **2 Conventional Agricultural Finance**

### **2.1 Introduction**

Food is one of the basic necessities that are imperative for the nourishment and survival of human life. Among other sources of food, agriculture is probably the most important source through which farmers grow food for themselves and others to meet the current and future demand. A considerable portion of the world's labour force is attached to this sector, and it contributes significantly to the world's economic development. In case of Pakistan, agriculture accounts for 23% of its GDP, and employs 42% of its labour force<sup>10</sup>.

The work force that is getting its bread and butter from this sector includes both poor and elite classes; however, poor class is more dominant in terms of numbers. Due to shortage of the financial resources, at times poor class is unable to get maximum benefit from their efforts. Most of the times, they require additional money to cater the financial needs arising at different times of harvesting cycles. E.g. at the start of cycle, money is required to buy basic agriculture inputs like seeds, fertilizers, herbicides, and plowing tools. Similarly during the mid of harvesting cycle, money is required to purchase pesticides, and different agricultural tools. Since money is required at all steps, and the majority of farmers have a shortage of it, therefore, they borrow it from various sources including individuals, organizations, banks, and government.

As agriculture is a mainstay of most of the country's economies, and it is the responsibility of the government to provide food to all population, therefore, almost all of countries try their best to accommodate the financial needs of the agriculture sector. These activities / steps include advancement of agricultural loans, giving of subsidies over the agricultural commodities, and levying off different kind of taxes. Private sector is also playing a vital role in this regard. However, the private sector is only extending the financial loans to the farmers. The most important among these considerations is the advancement of loan to the agricultural sector. Such facility is generally called agricultural finance.

In the coming pages different issues of agricultural finance will come under a profound study. In the very beginning a brief history of agricultural sector will be given, followed by its narrow classification into different sectors i.e. livestock, poultry farming, local farming, fish farming, horticulture and etc. All these sectors will be discussed with a minute details in the same chapter. After this the most important issue that how All these different agricultural sector can be financed, will be discussed. The procedure followed by the conventional banks and other conventional commercial institutions will be critically analyzed, and some suggestions will also be given in this regard. Different types of securities required by the bank from a farmer for the advancement of agricultural loan will also be a vital part of our study. It is

a fact that loan facilities are given for different tenures which totally depends upon the nature of the loan and the purpose for which they are secured .Such tenures will be discussed under the topic of repayment schedule. Most of the Governments now in these days advance government agricultural loans that are also called public loans.It is observed that usually a farmers have more tendency to get such loans as compared to private loans .There are different reasons for such tendency which will be a part of our study and research.

## **2.2 Definition of Agricultural Finance**

Agricultural finance can be defined as “it is the advancement of loan and other financial facility by the financial institutions for the development of agricultural sector both for crop and non crop activities”

## **2.3 History of agricultural finance**

The importance of agriculture in the economic stability of a country cannot be ignored. It does not only play an important role in the GDP of a country but also minimizes the rate of unemployment for the same. It acts as a base sector for major industries like textile, sugar and etc. It not only fulfills the demand of local people for food but also a major source for earning foreign exchange. It also plays an important role in poverty alleviation and provides maximum opportunity for work. Keeping in view its importance, the political thinkers have the view that economic and political stability are directly related to each other. But unfortunately this sector is ignored instead of its undeniable importance, particularly in the sub-continent. It is because of this reason that many countries of the same region are in the state of infancy for the development of this sector. Although this fact cannot be ignored that substantial progress has been made but still there is a long journey towards the destination. There is still a lot of room available and waiting for further improvement.

The rapid growth in population also increased demand for food and consequently a tense need for the increase of production rate. Such a situation compelled the nations particularly that of sub-continent to give a due attention to this sector. They stated to finance this sector but to a very low level. There was no concept of subsidies for the basic agricultural requirements and was no relaxation in taxation over the agriculture income. Such arrangements were not in position to clear a way for the smooth development of the sector. But the question arises that why the conventional banks particularly that of the state were so reluctant from financing such sector. The reason was very logical and that was, that the agriculture was prone to many natural risks. For example incidence of drought, floods, hail storms, earthquakes, mud slides and a multitude of other mishaps often needed to be taken in the decision making process.<sup>11</sup> All these factors were beyond the control of farmers for which they could not be made responsible. Because

of these reason the conventional banks and other financial institutions were discouraged (by these natural mishaps) from investing in this sector and most of the credit funds were shifted to other sectors in which these risks were not common. But instead of this fact the agriculture sector was not ignored totally regarding their financial requirements both for crop and non-crop activities. But with the passage of time expansion came in the size of agriculture sector and consequently its financial needs also increased when the modern farming technologies were introduced to the agriculture sector, it brought two changes in it. First it reduced risks of mishaps in the agriculture sector and secondly and most importantly it increased the rate of production. After this dramatically change in the agriculture sector and its expansion to international market compelled the financiers to realize the viable nature of this sector. They not only started to finance this sector but also made rules and regulation for it. They introduced guidelines for the farmer to make them aware that how they could increase their production. Some of the banks envisaged the idea of agricultural departments, which would work only for the development of agriculture sector. Some of the governments recognized expansion of the agricultural sector and introduced a separate set of banks for its development e.g Zarie Tarqiyati Bank, Agricultural Development Bank, and etc. Some of the countries particularly the western countries started the study of agriculture as a separate discipline and introduced agricultural departments at universities level. When the agriculture sector was divided into further sub sectors like poultry farming, livestock farming, fish farming, horticulture and etc, some of the governments upgraded the already existing agricultural departments to universities e.g. Agricultural University New York, Agricultural University Peshawar and etc. While concluding the above description it can be said that expansion of agricultural sector and an introduction of modern technologies to it, are responsible factors due to which financiers started to fiancé this sector.

Most of the financial institution mostly provides loan facility to its customers with a stipulated excess over the principal amount. They do not want to participate actively with its customers in a business activity. This is the safest way for them to get profit in the shape of interest. Because of this reason the whole philosophy of conventional financial system revolves around few concepts such as eligibility of borrowers, types of financing, loans limit, time for repayment, stipulated excess or markup over the principal amount, securities, collaterals and insurance, recovery system, loan monitoring, compliance with prudential regulations issued by the central bank and etc. After a profound study of different banks that how they finance different sector of agriculture, it can be easily said that they are financing these entire sectors i.e poultry farming, livestock farming, fish farming, horticulture and etc, mostly by similar types of financing e.g. working capital financing, term financing, and etc. But in most of the cases they show content only on working capital financing and term financing. After studing different guidelines issued by the State Bank of Pakistan such as guide line for Horticulture Finance, guide line for Fishery Financing, guide line for Poultry Farming, guide line for Livestock Financing, financing scheme for small farmers,

frequently asked question (FAQs) on agricultural financing and etc it is revealed that all most all these guidelines are describing the same methodology which is the application of working capital financing and term financing to the agriculture sector.

## **2.4 Baisc needs of the agricultural sector**

Before the discussion regarding needs of the agricultural sector it is appropriate to mention that agricultural sector can be divided into different sectors i.e local farming, live stock, fish farming, poultry farming,dairy farming and etc.All these sectors have different needs.The following description will highlight this fact with a minute details.

### **2.4.1 Needs of local farming**

. It is the most important sector of agriculture and a majority of farmers are related to it directly or indirectly.They are always in need of basic agricultural requirements such as seeds, fertilizers, insecticides, pesticides, herbicides, weedicides, manual sprayers and etc.Their needs also include trailers, thrashers, power filter, power and boom sprayers, plough, cultivators, riggers or drills, rotavators, cotton picker machine, saw machine for crate making, press machines for wheat straw and dry fodder, cheisel ploughs, potato planters, sugar cane planters, rice trance planters self propelled reaper for harvesting wheat and rice crops.<sup>12</sup>

### **2.4.2 Needs of livestock**

Livestock is the term used to refer as a singular or plural to a domestic animal intentionally reared in an agricultural setting to produce things such as food or fiber or for its labour.<sup>13</sup> It is the largest sub-sector of the agriculture sector accounting for 46.8 percent of value added of the sector and constitutes about 10.8 percent to the GDP.<sup>14</sup> Such sector has different agricultural requirements such as purchasing of mature milk yielding buffaloes or cows, replacement of existing buffaloes and cows, purchase of young buffaloes, cows, sheep and goats for rearing for meat production, milk storage chilling tanks, refrigeration plants and milk carrying containers, refrigerated net storages and refrigerated containers, distribution vehicles such as motorcycles, pickups, refrigerated vans and etc.<sup>15</sup>

### **2.4.3 Needs of the dairy farming**

Dairy farming is an important source for yogurt, cheese, butter, ice- cream, Kefir, Kumis and etc.such sector has different needs i.e milk storage chilling tanks, refrigeration plants and milk carrying containers, refrigerated net storages and refrigerated containers, distribution vehicles such as motorcycles, pickups, refrigerated vans and etc.All these needs can be fulfilled effectively through medium and long term loans provided by the conventional financial institutions.

#### **2.4.4 Needs of fish farming**

Like other sub sectors, fisheries is an important sub sector of agriculture sector and play an important role in the economic stability of the concerned country. It is stated earlier that there is a great pressure of demand for beef, mutton and poultry which is reduced to a great extent by modern fisheries. But unfortunately a due attention is not given to this sector, particularly in the subcontinent which has a great potential for this sector, given to them by nature. It has different needs that can be fulfilled through the advancement of loan i.e For example such loans can be used for the purchase of motorboats, fishing trawlers, purchase of marine engines, replacement of engines and spare parts, construction of cold storage by fisherman with the use of insulation materials or sheets for walls or roof, purchase of other deck equipments like winch, wire rope, gallows, net handlers, navigational lights, communication equipments, radars, life jackets, life boats, anchors, direction finders (compasses), echo sounded (fish finders), life buoys, insulation materials, purchase of nets trawlers, purchase of chilling or freezing plants, fish storage center, fish or shrimp hatcheries, purchase of mobile insulated, pickups, Vehicles and etc.<sup>16</sup>

#### **2.4.5 Needs of poultry farming**

Poultry farming are established for the purpose to produce meat and eggs. It has different classes i.e. breeder farming, layer farming and broiler farming. An individual of middle class can establish poultry farming because it does not require huge investment as compared to other sub-sectors of poultry industry. The development of such sector is possible when its basic needs are fulfilled. These needs include construction of broiler, layers, breeder and hatchery farms, feed mills, control sheds, automatic drinkers or tube feeders, generators, ventilators, tables or breeders eggs storage refrigeration plants, purchase of machinery or equipments for poultry farming, hatchery and feed mill, transport vans, eggs and poultry carrying vans, distribution vehicles such as motorcycles, pickups, deep freezers, slaughtering, and defeathering machines and etc.

#### **2.4.6 Needs of horticulture**

Horticulture is an industry and science related to plant cultivations. It is a vast field of agriculture sector which includes plant propagation and cultivation, crop production, plant breeding and genetic engineering, plant biochemistry and plant physiology. The needs of such sector are related to the production of fruits, berries, nuts, vegetables, flowers, trees, shrubs, turf and etc

## 2.5 Classification of agricultural finance into capital and term financing

Conventional banks advance two kinds of loan for the development of agricultural sector. Both these loans are given for different purposes and accordingly their amount varies from each other. They can be easily applied to the crop sector (which includes fruit crops and non-fruit crops) and non-crop sector (which includes livestock, poultry farming, fish farming, horticulture and etc.) in the coming paragraphs some details regarding the application of both these type of financing to the agriculture sector will be given. After a profound study of financing agriculture sector by the conventional banks, it is revealed that such institutions are dividing their financing into three classes' i-e long term financing, medium term financing and short term financing. This division has been made on the basis of period for which the agricultural credit is given. All these three forms of agricultural credit are given for different purpose. The following discussion will show the required details.

## 2.6 Classification of agricultural finance w.r.t. time

### 2.6.1 Short term financing

Short term agricultural credit is given usually to small farmers who are mostly living in the rural areas. These meet the basic agricultural requirements of a farmer on immediate basis. Such loans are used by a farmer to purchase seeds, fertilizers, insecticides, pesticides, herbicides, weedicides, manual sprayers, to meet labor charges and other their day-to-day requirements. These kinds of loans are given for period less than fifteen months and are expected to be repaid immediately after the first harvest. As it is known that most of the farmers belong to the lower class and mostly they have no money in the beginning of a season to buy seeds and other necessary agriculture requirements. Short term financing plays an important role to overcome such problems of a farmer.

Zarai Taraqiati Bank limited which plays an important role in the agricultural development of Pakistan, provides short term loans for twelve months which are to be recovered in lump sum after the first harvest. The amount of such loans varies for different crops.<sup>17</sup> Sometime the amount of such loans also depends upon the crop for which they are given. For this purpose Zarai Taraqiati Banks divided all crops into three classes i-e major crops, minor crops and fruit crops. Details are given below.

<b>Major crops</b>	<b>Fruit crops</b>
Wheat	Pear
Paddy	Loquat
Sugarcane	Plumb
Cotton	Apple
<b>Minor crops</b>	Papaya

Potato	Almonds
Tobacco	Peach
Maize (Hybrid)	Citrus
Maize (local)	Dates
Mash	Strawberry
Lentil	Guava
Groundnut	Olive oil
Sunflower	Coconut
Soya been	Coconut
Canola	Lichi
Rape seed	Cheery
Mustard mung	Mango
Bajra	Apricot
Jawar	Banana
Gram	Walnut
Guara	Pompygranate
Caster oil	Palm
Barley	Persimen
Berceme	Zizi
Janter	Watermelon
Garlic	Muskmelon
Turmelic	
Ginger	

The above division clearly shows that how the conventional banks take interest in the agricultural sector, keeping in their view the profit potential of such sectors.

### 2.6.2 Medium term finance

These are funds provided by the conventional banks to the farmers for the purpose to raise the standard of their tillage and to bring about an improvement in yields. The farmer use such loans mostly for the purchase of different equipments and agricultural machinery e.g. trailer, threshers, power tillers, power and boom sprayers, plough, cultivators, rigors or drills, driggers, cotton picker, saw machine for crate making, press machine for wheat and dry fodder, chisels ploughs, potato planter, sugarcane planter, rice trance planter, self propelled reaper for harvesting wheat and rice crops and etc.<sup>18</sup> They can also be used for sinking of wells, purchase of bullocks, pumping plants and etc. These loans are given for longer period than short-term loans. A farmer has to repay it within the duration specified in the contract. Normally the period of repayment starts from minimum level, which is fifteen months and reaches to its maximum level, which is five years. But this mode of financing is not beneficiary for small farmer but for middle class of farmers. The reason is that a farmer of a lower class is unable to have money for his basic agricultural needs, then how he can buy such heavy machinery.

### **2.6.3 Long term finance**

Long term finance is provided to a farmer for different purposes i.e. purchase of land, construction of factory building, permanent improvements on land, to pay the old debts of short term and medium term finance, purchasing heavy machinery. These loans are usually larger than the previous two types of financing. Such loans are not helpful for small farmers, as said earlier but very useful for middle and upper class of farmers.

The above discussion shows that most of the conventional financial institutions are not helping out the poor farmers but they are always talking about the livestock, fish farming, poultry farming and etc which are mostly not related to a small farmer .Because of this drawback the state bank of Pakistan issued a guideline with the name of “Financing Scheme For Small Farmers”. As it is known that agricultural production of a country depends upon millions of small farmers of that country. It is actually the intensity of their effort and efficiency of their techniques that helps in raising the rate of production per acre, and hence brings economic stability in the country. But unfortunately the lack of adequate financial resources and the absence of timely credit facility at reasonable rates (rate of interest), many of these small farmers, even though otherwise willing, are unable to go in for the improved seeds and manures. They are also unable, because of lack of proper loan facility, to introduce better methods or techniques for the increase of production. Works of minor irrigation like well owned by the cultivator either gets into disuse or are not fully utilized for want of capital.

The major object of the agricultural credit should be for the development of agricultural sector particularly that of rural areas and to help out only the small farmers. These loans should be used for the development of local resources of seeds, manures , irrigation and other accessories of production. For the purpose to utilize manpower and cattle resources more fully than is done at present, some improvement must be made in the modern financial system. Its inclination towards the upper and middle class of farmers must be reduced and should be directed towards the lower class of farmers particularly those of rural areas. In other words it can be said that major portion of the agricultural credit should be given in the shape of short term financing.

### **2.7 Application of long, medium and short term financing to agricultural sector**

In the coming pages application of different types of financing to different agricultural sector will come under discussion. Some suggestions will also be put forward for further improvement in the existing financial system.

## **2.8 Application of short term financing to different agricultural sector**

Short term financing is a small loan facility provided by the conventional banks. It is actually working capital financing which is given to a farmer particularly that of rural areas to meet short term or day to day requirements of a farmer. It can be used by farmer for the fulfillment of crop and non-crops activities. So, it can be easily applied to all sectors of agriculture i.e. local farming, poultry farming, dairy farming, fish farming, livestock and etc. But it is more suitable for local farming which has been ignored by the financial institutions because of many reasons (for example local farmers are mostly poor people and the possibility is that they may default the payment of loan). The following are the details of its application to different agricultural sector.

### **a) Local farming**

As mentioned earlier that the most suitable sector of agriculture for the applicability of short term financing is the local farming. A local farmer can fulfill his basic input for crop production by these small loans. He can purchase by such loans seeds, fertilizers, insecticides, pesticides, herbicides, weedicides, manual sprays and etc. He can also purchase by it different small tools which are indispensable for local farmers e.g. rake, hoe, hand fork, trowel, shovel, spade, wheel borrow, watering cane, and etc. It can also be used for the payment of different facilities bills such as electricity, water, labor, gas and etc.

### **b) Dairy farming**

Short term financing can also be used for the purpose to purchase the cheaper commodities for dairy farming. These commodities include animal fodder and feeds, feed grinders tokas, feed mixing machines, feed or milk containers, vaccinators, vitamins and other medications for animals, utensils for animals feeding, calf feeders, bangles, rope or iron chains and etc.<sup>19</sup> If the amount of short term financing is a reasonable amount then it can also be used for the purchase of different animals which are necessary for dairy farming.

### **c) Fish farming**

Short term financing is very effective to be used for the development of fish farming. It can be used for the purchase of fuels, ration and ice, packing and processing, cleaning items required for export of fish, consumable items for curing and drying, procurement of insulated boxes, purchase of plastic fish crates, plastic basket and etc. It can also be used for some other major purposes i.e. maintenance of farm, machinery, implements and other working capital needs in term of labor charges, water charges, gas charges, utility charges and etc.<sup>20</sup>

### **d) Poultry farming**

Poultry farming plays an important role in the economic stability of a country. However, it has some necessary requirements which can be easily fulfilled by the way short term financing. Such limited facility can be used effectively for its development. It can be used for the purchase of feed, birds, day old

chickens, feed raw material, vaccination, vitamins and other medications for poultry birds, saw dust, wood, coal, water filter cartages, utensils for poultry birds feed, etc.<sup>21</sup>

## **2.9 Application of medium term and long term financing to the agriculture sector**

Under this title, the application of long term and medium term financing to the agricultural sector will be discussed .it is worthy to note that long term and medium term financing serve the same purposes of the agricultural sector. Both are collectively called term financing, which is used for the purpose to meet different financial requirements of farmer for both crop and non-crop activities.

It is to be noted that the main purpose of medium and long term financing are to purchase fixed assets i.e. purchase of machinery, equipments, tractors, vans. They can also be used for construction purpose i.e. construction of sheds, farms, hatcheries, and other investments on farm land by farmers.

The applications of the medium and the long term financing has wide range which required details .such details are given below separately for each and every sector of agriculture.

### **2.9.1 Application of medium and long term financing to local farming**

The medium and long term credits can be effectively applied for the development of local farming. It can be used by a farmer (mostly the middle class farmer and upper class farmer) for the purchase of different agriculture implements and equipments. For example it can be used for the purchase of trailers, thrashers, power filter, power and boom sprayers, plough, cultivators, riggers or drills, rotavators, cotton picker machine, saw machine for crate making, press machines for wheat straw and dry fodder, cheisel ploughs, potato planters, sugar cane planters, rice trance planters self propelled reaper for harvesting wheat and rice crops.<sup>22</sup>The medium and long term credits can also be used for transport financing so; it can be used for the purchase of tractors, refrigeration vans, farm cooling tanks, motorcycle for milkman, small pickups, mini trucks and chiller carries and etc.

The above description shows that medium and long-term credit not only helps a farmer in the production of produce but also help him to take it to the markets.

### **2.9.2 Application of long term and medium term financing to poultry farming**

The importance of poultry farming has been discussed in the previous discussion. The development of this sector is very necessary for the economic stability of country. The medium and long-term loan can play a vital role in the development of this sector. After getting such loans from the conventional banks, a farmer can use them for the fulfillment of different poultry farming requirement i.e. construction of broiler, layers, breeder and hatchery farms ,feed mills, control sheds, automatic drinkers or tube feeders, generators, ventilators, tables or breeders eggs storage refrigeration plants, purchase of

machinery or equipments for poultry farming, hatchery and feed mill, transport vans, eggs and poultry carrying vans, distribution vehicles such as motorcycles, pickups, deep freezers, slaughtering, and defeathering machines and etc.<sup>23</sup>

### **2.9.3 Application of medium and long-term loan to the fish farming**

Medium and long-term loan can be effectively applied for the development of fish farming by the different ways. For example such loans can be used for the purchase of motorboats, fishing trawlers, purchase of marine engines, replacement of engines and spare parts, construction of cold storage by fisherman with the use of insulation materials or sheets for walls or roof, purchase of other deck equipments like winch, wire rope, gallows, net handlers, navigational lights, communication equipments, radars, life jackets, life boats, anchors, direction finders (compasses), echo sounded (fish finders), life buoys, insulation materials, purchase of nets trawlers, purchase of chilling or freezing plants, fish storage center, fish or shrimp hatcheries, purchase of mobile insulated, pickups, Vehicles and etc.<sup>24</sup>

### **2.9.4 Application of medium and long-term loan to live stock**

Livestock is the largest sub sector of agriculture. Accounting for 46.8 percent of value added of the sector and constitutes about 10.8 percent to the GDP. An appreciable development has been made in it in the last five years. But unfortunately in the past this sector did not get its due share in the credit provided by the conventional financial institutions.

The medium and long term financing can play an important role in the development of this sector. These can be used for the purchase of mature milk yielding buffaloes or cows, replacement of existing buffaloes and cows, purchase of young buffaloes, cows, sheep and goats for rearing for meat production, milk storage chilling tanks, refrigeration plants and milk carrying containers, refrigerated net storages and refrigerated containers, distribution vehicles such as motorcycles, pickups, refrigerated vans and etc.<sup>25</sup> These can also be used for different construction purposes such as the construction or procurement of permanent sheds, water tanks, water pumps, tube wells and generators, fencing and enclosure, establishment of slaughter houses and etc.

The above discussion shows the application of medium and long-term loans to particular sector, but it is not comprehensive one and such loans can also be used for the fulfillment of different agricultural requirements such as irrigation purposes which includes installation of tube wells, turbines, lining of water courses, installation of sprinkles or drip irrigation system, water management and etc. These can also be used for the establishment of green houses, godowns and cold storage, for the development of dairy and live stock farms, construction and improvement of live stock laboratories, installation of fruit and vegetable machinery and etc.

While summarizing the whole discussion, it can be said that agricultural loans (short term, medium term and long term) are given for the following purposes

- Inputs for agricultural production.
- Purchase of agricultural land
- Purchase of tractors
- Purchase of tube wells
- Purchase of other live stock
- Purchase of different equipments for the fishing
- Medical expenses
- Marriage, death and other ceremonial expenses
- Purchase consumer durables
- Improving family dwelling
- To pay off old loans
- Purchase of different equipments for poultry farming
- Construction purposes

## **2.10 sources for conventional agricultural finance**

There are two sources for conventional agricultural finance i.e formal sources and informal sources. They are also called formal institutions and informal institutions respectively. They play a vital role for the development of agricultural sector both in crop and non crop sectors. The following description will highlight their importance for the development of Agricultural sector

### **2.10.1 Formal sources (formal institutions) for Agricultural Finance**

There are so many institutions, which are providing loans for agricultural sectors for the development of both crop and non-crop sectors. In Pakistan the following institutions are providing loan facilities to the agricultural sector. Commercial banks i.e. Askari Bank, Habib Bank, Al- Falah Bank and etc. Zarai Taraqaiti Bank which was formerly known as Agricultural Development Bank. It is specialized body for the development of agricultural sector. Women's Bank Non-government organization. House Finance Corporation Other cooperatives also play an important role in this regard. Zarai taraqaiti bank provides most of the loan to the farmers for their agricultural needs. It is need of the time to strengthen these institutions particularly those, which are specifically working for the improvement of agricultural sector to play their efficient role in agricultural sector.

### **2.10.2 Informal sources (informal institutions) for conventional agricultural finance**

It is discussed in the previous topic that agricultural sector is less viable for the financial institutions. According to the experts of agricultural finance it can be made viable if the non-institutional credit is encouraged. It will reduce burden form the financial institutions.

Although there is no available data, but there are some indications that a longer proportion of the agricultural finance (it is usually in the form of loan) in developing countries is provided by non-institutional source.<sup>26</sup> Such loans are free-interest and mostly given by relatives, friends and etc.<sup>27</sup> But it is usually small amount and cannot fulfill all the agricultural requirements of a farmer. It is pertinent to mention that in such loans the time frame work for repayment is not scheduled and some time not repaid at all, and consequently a line of demarcation between gift and loan is blurred.<sup>28</sup>

Besides the loan finance provided by the relatives and friends, the local traders, money lenders and landlords also provide the same facility to a local farmer. It resembles with the institutional credit in money respects e.g. the time framework is specified in the contract, it must be repaid, some amount must be given as an excess over the principal amount and etc. it is alleged that such local financiers (Local Traders, money lenders and landlords) make monopoly profits and use the debt relationship to exploit their clients, but there is lack of empirical evidence to support this thesis.<sup>29</sup>

### **2.11 Rate of interest on agricultural Finance**

As said earlier that majority of the farmers belong to the poor class, so the interest rate charged by the conventional banks from the farmer on agricultural loan must be a reasonable one. Usually the interest rate charged by the banks is not fixed one but it is floating between two levels. The amount of markup is determined between these two levels and such determining depends upon mostly on two things ,firstly, the purpose for which the loan is given and secondly, on the basis of agro climate of the region. In Pakistan the interest rate is floating between 10 to 20 percent and amazingly it was found higher in Barani Punjab to the extent of 20 percent, which was followed by Balochistan 17 percent. The results were consistent with Malik (1999).<sup>30</sup> But surprisingly the interest rate is very low in India as compered to Pakistan. In the Budget for the Years of 2006-2007, it was announced that the farmers will receive loan upto the principle amount of 3.00 laks at 7% rate of interest. Some other reliefs were also provided in the same budget. The government has provided a sum of 1700.00 crores for the practicle implementation of their policy to the agricultural sector in the union budget for the years of 2006-2007. According to the Financing Scheme for Small Farmers, a guideline presented by the Agricultural Credit Development of State Bank of Pakistan, the conventional banks have to follow two rules while deciding the markup e.g.

- Bank shall determine markup on the basis of KIBOR and their cost of funds in the line with their credit policy.<sup>31</sup>
- Banks shall not charge on penalty an early repayment or adjustment of loan.<sup>32</sup>

It is to be noted that first rule reveals the philosophy that the state bank of Pakistan gives discretion to the banks to make their own credit policy, while the second rule describes the fact that flexibility should be given to the farmer.

In a normal credit if the debtor pays the debt early, then a penalty is imposed on him and consequently an extra amount is charged from him but as far as the agricultural credit is concerned, a farmer is immuned from such rules.

As a general rule, the interest rates prescribed by many countries, particularly in developing countries for agriculture loans are low in comparison to those in other sectors of the economy. Controlled agricultural rates are also low in relation to the economic value of capital and the costs of providing credit. Often they are even lower than the inflation rate, or negative in real terms.<sup>33</sup> Experts of the fields are describing numerous grounds and reason for low interest rates. Some of them are given below.

- The first notion is that investments by the conventional banks in agriculture sector do not produce a high rate of production and because of this reason this sector is in need of cheap credit to encourage innovation.
- Study reveals that most of the farmers belong to the poor class and because of this reason they are unable to afford high interest rates.
- Agricultural sector plays an important role in the economic development of a country and it is for this reason that special rates (usually low interest rate) are prescribed for the development of agricultural sector.
- Some of the people believe that low interest policy is traceable to the political influence of the rural elite, who profit from cheap loans. International capital aid is said to support this policy intentionally or unintentionally when it provide funds on concessional terms.<sup>34</sup>

But after research it is found that it is one side of the picture and the claim that low interest rates are charged from a farmer on agricultural credit is merely a theory and not more than that. It is pertinent to mention that the interest rate charged by the banks over the agricultural credit is only a small part of the cost of borrowing. When a small farmer gets official credit from a bank then the transactional cost are usually far higher than the interest charged. This transactional cost along with lower interest increases the total costs of the farmer to the extent that the difference between high and low interest rate becomes a nominal difference. The following example will clarify the reader's mind.

From fertilizing small farmers commonly expect an average increase in revenues. From higher crop yield, that is twice as large as the cost of fertilizing

(i.e. a 100 percent return). In these calculations the difference between interest rate of 8 percent or 16 percent for a fertilizer loan is hardly material.<sup>35</sup>

Some of the people, particularly those who are expert in the field of agricultural financing have the view that interest subsidies often creates effect which are totally different or even opposite to those effects which are intended from such subsidies. This draw back is further clearer in the case of those subsidized loans, which are given to a small farmer for the development of his farming. A long experience of the experts shows that such subsidies are usually misused by the landlords who do not deserve to get subsidized loans.<sup>36</sup>

It shows that the landlords usually misuse subsidized loans and it is for this reason that some of the economists are against the cheap credit facility for the farmers. They have the view that small farmers clearly have better prospectus of getting credit when interest rates are high. High rates limit the big farmer's investment opportunities and restrict their demands for credit. Many small farmers are accustomed to paying moneylender rates that are far higher than the highest bank interest rates.<sup>37</sup>

It is to be noted that the transactional costs over the agricultural credit can be reduced by many ways. For example by the simplification of application procedure (the existing procedure is very complex in nature and requires a bulk of documentations) that is made to the conventional banks for agricultural credit by an illiterate farmer, by reducing queuing time and by providing credit at the required time .it is noticed that a farmer procedes an application in the beginning of a season and secures loan at its end. Group credit arrangement can also be suggested for reducing lending costs. Similar will be the case if the banks are opening their branches in the rural areas that are almostly ignored in the agricultural credit policies. If it is done then the phrase "Difference between the high interest rate and low interest rate" will have a meaning for a small farmer. Otherwise, it will remain a theory.

## **2.12 Loan security and determination of credit worthiness**

Credit worthiness of a farmer is based on the value of the security provided by him to bank. It is also called asset based lending strategies. Instead of the fact that this method is conservative in nature, according to the experts of the field, but this fact cannot be denied that it is very successful method applied by the banks to secure their debts given to the farmers. In a contrast to this theory, some of the financial institutions considers the expected income from the agricultural investment as a yardstick and they are not bothering securities or other collaterals. This progressive approach is known as cash flow lending. According to this approach the lender is in a better position to estimate more or less accurately two facts i.e first that how much profit can be obtained on agricultural investment and secondly how it

will increase its additional debt capacity through it. This requires experienced and trained personnel who are familiar with the agricultural sector and with agricultural investment analysis.

It is a customary fact that conventional financial institutions advance loans without any advice to the farmer that how to use such agricultural credit and this really puts their loan unsecured. It is the duty of agricultural finance specialists to counsel borrowers for the protection of loan quality by educating them that how they should use loans to achieve those purposes and objectives for which the loans were granted. In developing countries the provision of technical or extension advice with credit under a single program is known as "supervised credit"<sup>38</sup>

Inadequate collaterals or lack of it is the main cause that some deserved farmers to secure agricultural credit. It is because of this reason the farmers are asked at the time of agricultural financing by the financial institution about the collaterals used by them for the credit. The following types of collaterals can be used as a security for agricultural credits.

- Agricultural land
- Residential or commercial property
- Other ornaments, utensils and consumer durables
- Guarantee by employers
- Gold and silver and even some precious stones if its value is properly estimated and determined
- Guarantee by a relative, friend or even a neighbor having some property
- Defense saving certificate
- Special saving certificate having some property.

It is to be noted that the above list is not comprehensive in nature and a bank can accept any thing as a guarantee if it is suitable for the security of debt. It is also pertinent to mention that analysis reveals that about 77 percent farmers use agricultural land as collateral, and this is an acceptable security for all financial institutions.<sup>39</sup> But it does not mean that farmers do not use other collaterals as a security but these have a negligible share. The collaterals, other than agricultural land, are just like additional securities used by the banks to enhance the security of their debts. Generally the agricultural land under the pass book system urban or rural property, commercial property, defense saving certificate, special saving certificate, gold and silver ornaments, personal surety, hypothecation of livestock, and other assets e.g. motorboats, fishing trawlers and etc are generally accepted by banks as collaterals.

Zarai Taraqaiti Bank, which was formerly known as Agricultural Development Bank, has a very solid system of securities for agricultural credit. It divides securities into three classes as

- Immoveable property
- Moveable property

- Personal surety

This is a very comprehensive division and covers all types of securities. So, for a better understanding, it is necessary to discuss them thoroughly.

### **2.12.1 Immoveable properties as a security**

As said earlier in the previous pages that majority of the farmers, particularly those who belong to the rural areas, are using lands as collaterals for their debts. The study reveals that nearly 77 percent farmers use agricultural land as collaterals. The reason is that most of our farmers are having a piece of land and that is their whole property. Taking debt from the financial institutions by them reveals the same fact. All the financial institutions accept land as a security because it is easily and readily convertible into cash without a resort the court of law for the recovery of debt. Zarai Taraqaiti Bank uses the immoveable property under the pass book system in which charge is created on such a property. But it is not necessary that it should use always the passbook system and loans can also be given outside the passbook system. Such immoveable property includes agricultural land (under the passbook system and outside the passbook system), commercial or industrial land (under the passbook and outside the passbook system), urban residential or commercial plots in all localities (outside passbook system), residential or commercial buildings, lease hold rights of a leased land of CDA with 99 years of lease and etc. Some of the scholars of agricultural finance, keeping in their views the importance of immoveable property, rightly say that the lack of immoveable property as a security is the major obstacles in the agricultural credit for small farmers. It also shows the fact that most of them do not have their own property. This obstacle may also arise from the absence of registered land, titles or tenancy contractors.

### **2.12.2 Moveable property as a security**

Moveable property can also be used effectively as collateral for agricultural credit. These types of securities are wide in range as compared to immoveable properties. These include gold and silver, pledge of different agricultural products (particularly those for which loans are given), other ornaments, utensils and consumer durables, unconditional banks guarantee from scheduled banks, guarantee issued by central or provisional government securities, defense saving certificates, FEB certificate, special saving certificate, fixed term deposit receipts, NIT units, life insurance policies and etc.<sup>40</sup> In case of certificates and government securities, the debt is given by the Zarai Taraqaiti Bank to a specific proportion of the face value of the concerned certificate given by a farmer for agricultural credit.

### **2.12.3 Personal surety as a security**

Personal securities are actually intangible securities used by the financial institutions to secure their debts. It is the guarantee given by a third party for agricultural credit. Even when the estimated increase in income available for repayment is the most important criterion for credit worthiness. The creditor may still in such circumstances seek security to safeguard his position. Some financial institutions vary the limits of their loans according to the number of guarantors presented by a farmer. So, more loans will be given to that person who presents more guarantors. Zarai Taraqaiti Bank also accepts personal guarantees (surety). It gives a loan against a bond with two sureties under general credit and one surety in special schemes.<sup>41</sup> This shows that Zarai Taraqaiti Bank also varies the amount of loan according to the number of guarantors presented by the farmers.

### **2.13 Insurance as a security for Agricultural Finance**

Insurance may also be used effectively as a security for agricultural credit.<sup>42</sup> But unfortunately this instrument is not used by the developing countries as it is used by developed countries. One of the biggest agricultural banks in South America, the Caja Agraria in Colombia, includes a life insurance Policy in its loan contracts.<sup>43</sup> For a premium of one percent added to the interest rate, the insurer repays the loan balance if the borrower dies. On the same way the crop insurance and livestock insurance are also used to protect both creditor and debtor against damage and loss. It means that insurance policy can be applied to all sectors of agriculture both for crop and non-crop activities. But it is also a fact that premiums are usually very high and resultantly, it will increase the total cost for a poor farmer. So, it is necessary that the premium should be reduced to a great extent and if it is done then it will be very beneficial for the agricultural sector. It is the duty of the concerned government to subsidize such premiums for the purpose to make it attractive for the small farmers. The government of Kenya has attempted to promote large-scale maize and wheat production by a subsidized guarantee minimum return sufficient to repay operating capital loans for qualified growers of these crops.<sup>44</sup> If the government is unable to subsidize all agricultural credits (livestock credit, poultry credit, fishery credit and etc) then at least it has to subsidize those loans which are given for the development of local farming. In short words it can be said that combining Insurance with agricultural credit can assist agricultural development.

The importance of insurance in the agricultural sector has been recognized by the government and because of this reason the State Bank of Pakistan advises other banks to arrange insurance of the amount of loan disbursed for crop and non-crop activities (wherever available), and life insurance of the borrower

to safeguard the interest of the borrower and the bank, in case of losses due to natural calamity or event above the control of the borrower.<sup>45</sup>

## **2.14 Viability of credit institutions**

It is relatively risky and expensive for the financial institutions to provide loan facility to the agricultural sector. There are so many reasons because of which these institutions are reluctant to invest in this sector. The first and the most important reason is that natural risks e.g. incidence of drought, floods, hailstorm, earthquake, mud slides and etc. Before advancing an agricultural loan, a financial institution must have to consider all these natural mishaps in the decision making process. Ironically, these risks are not common in other sectors.<sup>46</sup>

Secondly, the low interest rate policy which is mostly backed by the concerned government also contributes to this lack of viability of agricultural sector for the financial institutions.<sup>47</sup> As a result of lack profit, the financial institution prefers to give agricultural loan to large enterprises or trading in agricultural equipments and products to overcome their financial problem.<sup>48</sup> Because of this inclination of financial institutions towards the large agricultural sectors, a local farming is totally ignored, which is the real and deserve sector to be financed.

Thirdly, the non-repayment of debt in the agricultural sector is very high as compared to other sectors and more than 20 percent of funds loaned and occasionally exceed 40 percent (this usually in the case of state credit agencies) are remain due.<sup>49</sup>

All the reasons which are discussed above severely undermine the viability of many agricultural credit institutions and if solid steps are not taken by the concerned government in this regard, it is much possible that these institutions will close their gates for agricultural sector forever. Such problems can be overcome if the government intervenes and provides liquidity out of public funds.

## **2.15 Why do farmers accept credit?**

As mentioned earlier that majority of farmers belong to the poor families and there is always absence of cash money in their pocket to purchase their basic agricultural requirements. In other words it can be said that cash money is a starting point for most of the farmers to decide whether they have to borrow or not. The second important factor, for the farmer to decide whether he has to borrow money or not, is the availability of assets possessed by him. So, if he possesses the basic agricultural equipments, then there is a little chance for his decision to borrow money.<sup>50</sup> Both these factors (cash money and possessing of assets) can be collective called capital possession. When there is lack of availability of these two factors or one of them, the farmers will decide to obtain outside Funds for their agricultural activities. In short words it can be said that farmers are borrowing money in the absence of basic sources.

But besides sources, there are some other factors which are responsible for the acceptance of credit by farmers. A credit is always exclusively acceptable when they experience a very difficult life situation.<sup>51</sup> In such a situation if they do not borrowing money from the financial institutions then they will be unable to produce yields because they will invest nothing. In other words it can be said that borrowing becomes the only chance for their survival. They are expecting that by borrowing money they will be at least in a position to generate money. Experts of agricultural finance have the view, after describing the above reason, that farmers do not really want to take credit except when there is lack of capital (which is used to mean 'cash money' or other assets that can be sold for financing farm activities) for running their farm activities. Farmers generally reject credit advanced by the financial institutions in circumstances where they have sufficient funds available for undertaking their farming activities. So, mostly they are accepting credit because no other choice is available to them.

It is revealed from a continuous survey that farmers have a negative attitude towards the credit provided by the financial institutions. This attitude is because of so many reasons. For example they have a perception that credit as being risking and liable to cause severe loses. It is possible that crop production may fail or price may be lower than what was expected. In such a situation they will not be in position to repay the debt. Besides these reasons a farmer who borrows money from the financial institutions face mental problem as he feels embarrassment being known by other community members having debt and this pressure continues until the debt is fully repaid and it is for this reason that he is always reluctant to take debt from the financial institutions.

It is a matter of fact that if farmers are in need of credit and choice among the credit sources are also available to them, then in such a situation they prefer government credit over private credit. The following are the various reasons for this tendency.

- (i) The government credit has a low cost of borrowing as compared to that of private credit.
- (ii) The government credit is very flexible in nature and there is a suitable time for repayment. This characteristic is missing in the private credit.
- (iii) The level of risk in government credit is very low as compared to that of private credit.
- (iv) The government usually charges low interest rate on its credit as compared to private credit. It is experienced that the rate of interest charged on private credit is mostly doubled as compared to that of government credit.<sup>52</sup>The reason is that the government does not earn too much profit from the agricultural credit. It just wants to develop it. While for private financial institutions advancing of agricultural credit is a business and consequently they want more profit form it.

- (v) In case of private credit the period for repayment is very short while on the other hand in case of government credit a borrower can repay the credit over a long period e.g. after crop harvest, and sometime extendable until the next harvest.
- (vi) If repayment is not made on time or a farmer fails to pay the debt, the penalty imposed by private lenders is more severe as compared to the penalty available in the government credit. For example when the government credit occurred, a borrower is required to pay the regular monthly interest for the overdue period in addition to the original period interest rate. While on the other hand a private lender can double the initial interest rate (which was already double that of government source) or take over the borrowers collateral if repayment is not made in time.
- (vii) According to the experts of agricultural finance credit application for securing government credit consumes less time as compare to that of private credit. The reason is that usually farmers have good relationship with the government credit officers due to which the procedure for credit application is handled quite easily. This relationship between a farmer and a government officer developed and established through family connections, being known and trusted, and also from a friendly communication style.

While summarizing the above description it can be easily said that low interest charges, favorable repayment schedule, low risk, easier procedure, good relationship between a farmer and government credit officer, and etc are the factors due to which a farmer prefers government credit over private credit and the previous is avoided as much as possible.

## **2.16 Repayment of agricultural loan**

Repayment of agricultural credit is the most important issue particularly in the agricultural sector. In most of the countries low interest rates are enforced by the concerned government over agricultural credit. Because of this low interest rate some of the people believe that those loans which are granted cheaply should be collected as soon as possible. It is a matter of fact that the profitability of the financial institutions is more related to the markup as compare to the period of repayment. The low interest rate and short period for repayment neither help the financial institutions nor the farmers.<sup>53</sup>

It is also noticed that if an agricultural loan is advanced for a long term then it will be more effective then the loan which is given for short span of time. Because of un-profitability of short term loans, the financial institutions are reluctant to advance loans.

The repayment period usually depends upon the type of loan advanced e.g. short term loan, medium term loans and long term loans. It is totally left to the financial institutions to schedule repayment

period for such loans. So, the period for repayment varies from bank to bank. For example Zarai Taraqati Bank Limited prescribes the following schedule for the repayment of loans.<sup>54</sup>

<b>Types of loans</b>	<b>Recovery period</b>
1. Short term loans	Crop production working capital loans recoverable in lump sum commencing after the harvest or marketing of respective crops and within maximum period of 12 months.
2. Medium term loans	They are given for dairy farming, livestock, poultry farming and etc. they are to be repaid yearly or in a half year or in monthly installments and within maximum period of five years.
3. Long term loans	They are advanced for the purchase of high machinery e.g. Tractor, agricultural machinery, poultry farming, god owns and orchard. They are usually repayable yearly or half yearly installments within a maximum period of eight years and above.

As said earlier the repayment issue is a very complex matter as for as the agricultural sector is concerned. This complexity cannot be removed because it is usually based on such causes which are not under the control of farmers e.g. incidence of drought, floods, hail storm, earthquake, mud slides, bad weather, non-availability of water and etc. All these natural mishaps are natural hurdles in the repayment of agricultural credits. If the financial institutions impose penalty for the non-repayment of debt under such circumstances, it will be against the philosophy of natural justice because all these factors are not under the control of a farmer. So, these factors may effete the repayment capacity of the borrower at least temporarily. It is therefore, allowed to grant relaxation period to one year in repayment schedule to the borrowers who have been adversely affected due to such factors. However, such relaxation will not be granted on individual basis rather it would be granted for all the borrowers in any specified area after obtaining prior approval from the Board of Directors of the concerned banks / DFIS. Where such relaxation has been granted by banks / DFIS, the relaxation period would be counted towards default period and non-payment in the relaxation period would not adversely effete the category of classification. However, the markup accrued during the relaxation period would not be credited to income account but kept in memorandum of account.<sup>55</sup>

In the above lines we discussed those factors which are responsible for the non-repayment of agricultural credit. In the coming pages those factor will be discussed due to which a farmer is ready to repay the agricultural credit.

Experts of agricultural finance have the view that there are three factors due to which a farmer is ready to repay the agricultural credit. All these reasons (factors) are interrelated or connected with each other. They are given below

- The first reason is the financial capability of a farmer. This reason is a natural one and cannot be denied even with solid arguments. This solid truth is that if a farmer has money in his pocket, he will never keep himself to be indebted. It seems hopeless to expect farmers to meet their obligation of debt when they are financially incapable for doing so.<sup>56</sup>
- The second reason for the repayment of agricultural credit is the good character of borrowers. It means that good character increases the repayment rate. But the question arises that what does good character mean? It is extremely a difficult job to give answer to such question. However, there are some standards by the help of which it can be easily determined. These standards include responsible nature of a farmer (which means to pay debt), awareness and etc

### **3. The concept of loan in Sharia and its implementation in the agriculture sector**

#### **3.0 Introduction**

Islam is a perfect code of life. It covers each and every aspect of life. Economic aspect is one of the most important aspects of life. As it is to give them something yourselves out of the means which Allah has given to you know that Allah (SWT) is the real owner of wealth as proved from many verses of the Holy Quran i.e. "Give them something yourselves out of the means which Allah has given to you".<sup>57</sup> Another verse reveals the same fact as "And spend out of what We Have provided for them"<sup>58</sup> This money has been given by Allah (SWT) to the man as His vicegerent and representative. He will use it according to the provision prescribed by shariah. According to Abdul Qadir Awdah that man has only the right to benefit from what is given in his possession.

Inequality in terms of wealth should be accepted as a natural fact of life and consequently to some people more money are given to some other less.<sup>59</sup> Islam produces a cooperative society in which all its members cooperate with each other at the time of need. For this purpose Islam put brings the concept of loan in which an individual of a society assists his brother at the time when he is in the tense need of money. So, the basic purpose of Islam from the recognition of loan is to create cooperation in the society.

#### **3.1 Literal and technical meaning of Qard**

The word "Qard" is the alternative of loan in Arabic language. The literal meaning of which is to cut off" while technically it means "a charitable contract in which one party gives a determined sum of money to another party, and the second party returns it without any excess to the principal amount when he is able to repay it" or "it is a specific transaction in which one party gives fungible property to another party for the purpose to receive from him the fungible property". This definition has been put forward by Hanafi school of thought.<sup>60</sup>

#### **3.2 Legitimacy of Qard**

The legitimacy of Qard has been proved from Sunnah and Ijma (Consensus of opinion). Narrated Abu Huraira The Prophet said, "Whoever takes the money of the people with the intention of repaying it, Allah will repay it on his behalf, and whoever takes it in order to spoil it, then Allah will spoil him."<sup>61</sup> It is also reported from the Holy Prophet (P.B.U.H) that charity will be changed by ten times while debt (Qard) will be changed by eighteen times"<sup>62</sup>. All the Muslim jurists unanimously held the contract of loan

is a valid and lawful contract.<sup>63</sup> In Shariah permissibility of loan transaction has been constricted on the basis of Itihisan.

According to some jurists, loan transaction generally comes under the preview of sale transaction because there is exchange of property for property.<sup>64</sup> Ibn-e-Qudama says that a group of the Muslim jurist declare that loan (Qard) is itself a sale transaction.<sup>65</sup> But if loan is considered as a sale transaction, then it will lead to a number of issues because in that case all rules and regulation of sale will be applicable to it.

### **3.3 Rules and regulation for loan**

Before embarking on the rules and regulation of loan, it must be determined that what is the basic and real philosophy of Islam behind the loan transaction. According to Sharia loans are meant for cooperative and charitable activities and not for commercial activities or transaction, except in a very limited range. A great contemporary jurist Mufti Muhammad Taqi Usmani has the same view.<sup>66</sup> According to Sharia a believer should extend money to other person only for the purpose to help him. His principal amount will be secured and guaranteed but he should not claim any additional amount over his principal. Because of this reason advancing of loan is prohibited if it is not for charitable purpose but for some other purpose like profit or taking benefit.

If the tradition of the Holy Prophet (P.B.U.H) regarding loan are profoundly studied, then it becomes clear that the purpose of loan is charitable and not commercial. So, a debt will be given by the creditor only for charitable purpose and his intention from advancing such loan will not be a commercial one, otherwise, it will deteriorate the whole philosophy behind loan in Islamic commercial law. The advancing of loan for charitable purpose is not only approved by the Holy Prophet (P.B.U.H) but also practiced that.<sup>67</sup>

According to the jurists Islamic law of options (Khayarat) is not applicable to the contract loan because it is not a binding contract and both the parties can terminate it at any time without consent of the party. As for as the time of repayment of loan is concerned, it should not be specified in the contract of loan and when the debtor takes the possession of debt, the creditor is entitled to ask him for its recovery at any time, and after such demand it becomes binding on the debtor to repay the same.

It is to be noted that it is not permitted to stipulate any excess over and above the principal sum of money in the contract of loan, otherwise, it will amount to Riba, and in this case the creditor is entitled only to the principal amount.<sup>68</sup> Similarly according to a hadith of the Holy Prophet (sm) a creditor is not allowed to accept any gift from the debtor.<sup>69</sup> Similarly, if the excess is not stipulated but according to the prevailing custom excess is given on loan, then advancing of such loan is prohibited in light of Sahriah. Similar is the case of gift by the lonee to the creditor.<sup>70</sup> But if it is not stipulated then according to Imam Al Kasani it will not amount to riba.<sup>71</sup> But in the researcher's point of view if this rule is applied then it

will open a gate for interest based loan transaction, however the Hanafi Jurists consider the repayment of a debt along with such excess (that is not stipulated in the contract of loan) is the best repayment.<sup>72</sup>

From the above discussion it can be easily concluded that if an excess is not stipulated nor it is practiced in the custom, then any addition to the principal amount is not prohibited by Shariah as it is not the outcome of contractual obligation, and such additional amount will be considered as a gift from the debtor to the creditor.

While summarizing the above discussion the following results can be drawn

- Loan should be given only for charitable and cooperative purpose
- The time of repayment should not be specified in the contract of loan for repayment.
- No excess should be stipulated in the contract of loan.
- There should be the absence of such custom that permits excess over the principal amount even if it is not stipulated in the contract.

### **3.4 Application of Qardi Hasan (Loan) to Agricultural Sector**

As said earlier that Qard is given only for charitable and co-operative purpose and not for commercial purposes, and the creditor cannot claim an excess over and above his principal amount .It means that Islamic financial system is based on free interest based transactions and in this case Qard Hasan is the most obvious and the best alternative to the transaction of loan.

It is a matter of fact that evolution of commercial banking and human obsessions with profit maximization leaves a little room for extending interest free loans to other. Unfortunately the Islamic banks and other Islamic financial institutions has also left this highly potential area as unexplored. Although the literature does mention it as a minor possibility and that too in the case of dire need. The fact is that Qard Hasan provides a concept which can be developed into useful dimensions of interest free banking and we only need to study it profoundly.<sup>73</sup>

If it is said that the concept of Qardi Hasan can be practically applied to the agricultural sector then a series of questions will come to the mind of a vigilant reader e.g. why it should be applied? How it should be applied? What would be the benefit of Islamic banks and other Islamic financial institutions? Because any profit over the Qard is prohibited, what would be the sources with the financial institutions for giving such debt? How it could be recovered? For what purpose the former would use such debt (in crops or non-crops activity) and etc. The following description will give a full pledge answer to the questions mentioned above. For better understanding the answers of all these questions will be given one by one.

The answer to this question is not a simple one but it will tried to convince a reader to some extant.

### **3.4.1 Why Qard Hasan should be applied to the Agricultural Finances?**

As it is known that majority of the world population are related to farming and the example of Pakistan can be cited in this regard in which seventy percent of its population are related to agricultural sector. Most of them belong to the lower class. It is a matter of fact that small formers constitute majority of the forming community. According to 1972 census agriculture, there were in all 3.8 millions private farms in the country of these 89 percent were of the size less then 25 acres, covering 63 percent of the total cultivated area. Moreover, a large numbers of forms were smaller in size then the subsistence holding. Farms of sizes below 12.5 acres constituted 68 percent of the total private farms and covered 34 percent of the total cultivated area.

The above figures are taken in 1972, nearly before 36 years which is a long duration. The recent data is not available on the record. But due to inheritance and land reform it can be easily presumed that the number of small forms must have increased to a great extant. It means that the majority of the farmers have small land, especially those formers who cultivate food grains.it is said that 84% of the country's farmer comprises of small farmers.<sup>74</sup>They don't have a marketable surplus, and in other words it can be said that agricultural is a way of life for them other then business. These farmers deserve to be financially assisted.

### **3.4.2 How Qard Hasan would be applied to the agricultural finance?**

From the previous discussion it can be easily concluded that the majority of our farmers are poor people and they have small lands. They are always in need only to borrow small amounts. As said earlier that loan should be given for charitable and cooperative purpose and not for commercial purposes. So, the idea behind the Qard-i-Hasan is cooperation and not profit.A pure jurisprudential approach support the idea that bank is a juristic personality and it has resemblance in many aspects with the real personality. Islam recognizes the concept of juristic personality. So, if a real personality is advised to help out the poor people, the same rules can be applied to a juristic personality. So, it is suitable for the Islamic banks and other financial institutions to advance small loans to these millions of poor formers to facilitate them to

earn money for their livelihood. Such loan facility will be given for a short time and can be called “Special Loan Facility”.

It is pertinent to mention that the financial institutions must have to advance loan only to the small farmers who are in tense need of money for their agricultural activities. It means that such facility should not be misused by providing it to the landlords who are not deserved to be assisted financially; otherwise, the whole philosophy of Islamic financial system regarding Qard-i-Hasan would be deteriorated as it said that loan should not be commercialized and should be given only for charitable purpose. So, such loan will not impose any sort of financial burden on a poor section of the population and it will help out the farmers to raise their living standards.

### **3.4.3 Will such loans be always in the shape of cash?**

A profound study of Islamic commercial law reveals a fact that it is not necessary that Qard will be always in the form of cash and it may be in the shape of any other thing which is consumable in nature. While applying the above rule, it can be said that an Islamic bank can give Qardi Hasan in any other shape e.g. seeds, fertilizers pesticides, insecticides, herbicides, mammal spray as and etc. when the Qard is in shape of cash then it will be called loan by the help of which an indigent farmer can buy all the above things for himself. A farmer who is doing poultry farming, the Islamic bank can purchase for him, feed raw materials for bird, vaccination, vitamin and other medications, wood, coal, utensils for poultry bird feed etc,<sup>75</sup> and will handover all these to the farmer on Qard-i-Hasan basis. While in the case of fish farming the Islamic bank can provide, under the same doctrine, fuel, ration, ice, consumable items for curing and drying, plastic fish crates, plastic baskets and etc.

The above idea may be useless in the eyes of some people, especially those who are conversant with the Islamic financial system, and they may argue that by the implementation of such idea, the financing will become more complex and resultantly impossible, because if the bank gives all these consumable things under the doctrine of Qard-i-Hasan, the farmer will return the same after the stipulated time and it will become a headache for the bank. The answer to such question must be sought. It is to be noted when a particular doctrine of sharia is applied to a particular area; then it must be applied with its full pledge philosophy. It is not allowed in shariah to apply a portion of a particular concept and to leave its substantive portion in Islamic commercial law the concept of Qard-i-Hasan is applicable to all consumable and fungible goods. For the purpose to remove complexity, the bank can appoint the farmer as its agent who will sell all these on its behalf. Similarly it would be also very beneficiary for the bank to have a separate department which deals with the commodities returned by a farmer as a Qardi Hasan or salam commodity. It will also deal with the commodities provided by a farmer to the bank as

collaterals. However this fact can not be denied that this idea will give birth to a substantive number of problems. But it is an innovative in nature and will provide a soil for new research.

#### **3.4.4 What would be the sources from which the bank can advance such Qardi Hasan?**

It is the most important question that comes to the mind of a reader that for advancing free interest loan, what sort of sources can be used by the Islamic banks and other Islamic financial institutions. The following discussion will give a full pledge answer to the question.

The most important source with the Islamic banks and other Islamic financial institutions, for advancing such free interest loan is charitable fund that holds nearly by each and every one of them. A great scholar of the contemporary world, Mufti Muhammad Taqi Usmani has put forward the same idea in the general context, he says

“For the purpose it was suggested that the client, when entering into a Murabha transaction, should undertake that in case of default of payment at the due date, he will pay a specified amount to a charitable fund maintained by the bank. It must be insured that no part of such amount shall form part of the income of the bank. However, the bank may establish a charitable fund for this purpose and all amounts credit therein shall be exclusively used for purely charitable purposes approved by the sharia board. The bank may also advance free interest loans to the needy persons from this charitable fund”<sup>76</sup>

The second source for advancing loan to the needy farmers is the capital of the Islamic bank. As said earlier that these loans are very small and resultantly it will never affect the capital of the bank to a great extent. Similarly these loans are not given for long term but for short terms. It means that the bank will get back its liquidity in a short span of time. The Islamic banks can also use money of their depositors for financing agricultural sector after taking explicit permission from the account holders in this regard. The most suitable deposits, which are available to the Islamic banks for such purpose, are current accounts. Because such accounts are kept with the Islamic banks under the concept of Ammana and they do not pay any surplus to the customer. The same can be done with saving and fixed deposit accounts but in this latter case the process will be more complex.

A vigilant reader may put an objection that the customers are depositing their money with the Islamic bank on the basis of Ammanaha in the shape of current account. According to shariha the Islamic bank cannot use such money. If it is so, then how the Islamic bank can handover such money of depositors to a farmer on a Qardi Hasana basis? This objection is jurisprudential in nature and its answer also must be given accordingly.

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Actually when a depositor deposits his money with the Islamic bank on the basis of Ammanaha then the latter cannot use it nor guarantee it. If the deposit has destroyed without banks negligence, misconduct or breach of the contract, then it will not be responsible. This is the first problem from the perspective of the depositor. On the other hand it is also not beneficiary for the Islamic bank not to use such amount and keep it in idle state. To avoid both these problems the Islamic bank uses such amount. After the use, the Islamic bank becomes liable for the safe return of such amount. Now the current account will be considered as Qard, and the relation between the Islamic bank and depositor is that of the creditor and debtor. It is because that according to the principle of Islamic law that Ammanah becomes a debt by its use.<sup>77</sup> It is also proved from the Hadith of the Holy Prophet (SM). Actually when a depositor deposits money in the bank then it is dealt as a Guaranteed Ammanaha which is nothing but Qard according to Islamic law. The question arises that why we are not calling it “Qard” from the very beginning? It is because that the Islamic bank is not a poor person and because of this reason the word “Ammanaha” is used and not “Qard”.some of the jurists have the view that the money deposited by a customer with the bank is a loan from the very beginning and if it is so then the bank can use it without permission of the customer.a contemporary scholar Mulana Ejaz Ahmad Samdani has the same view.<sup>78</sup>

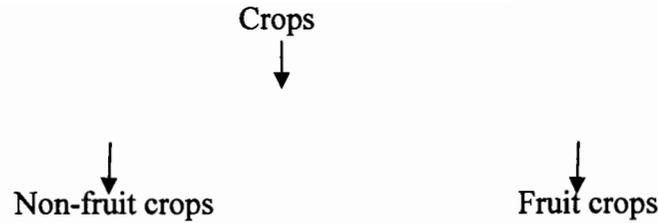
In short words it can be said that the money deposited by the depositor is not an Ammanah but “guaranteed amuna” which is another name for Qard, and if it is so then the bank has the choice to give it to the farmer or to anyone else.

It is the duty of Islamic state to establish specialized agencies such as agricultural banks, land banks and etc to help out effectively the agricultural sector. On the similar foot the government can provide sufficient funds to the Islamic banks and other Islamic financial institution to help these channels for financing agricultural sectors. The aim of such funds would be

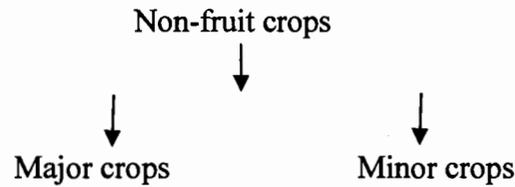
- a) To mobilize domestic savings in order to broader the resource base of agricultural credit.
- b) To assure reasonable price for agricultural produce.
- c) To assist the producers with the proper use of loans
- d) To improve the rate of loan recovery. It is better for the government to provide funds for agricultural sector especially to the banks that are operating in the rural areas<sup>79</sup>.

### **3.4.5 For what purposes the farmer can use Qard-i-Hasan?**

Before answering to the question that for what purposes the farmer can use Qard-i-Hasan, first it is necessary to determine and describe the basic needs of a farmer. Generally crops can be divided into two classes i.e. non-fruits crops and fruit crops as shown in the figure



The non-fruit crops are the most important from the perspective of farming. They can be further classified into two classes i.e. major crops and minor crops as shown in the figure



The major crops are those which are cultivated by almost majority of the farmers. They can be divided into four types i.e. Wheat, Paddy, Sugarcane, and Cotton. While minor crops, on the other hand, are more in numbers because they mostly depend upon on a particular environment i.e. Tobacco, Rape Seed, Maize (Hybrid), maize (Local), Mash, Canola, lentil, soybean, groundnuts, sunflower, and etc.

As for as the fruit crops are concerned, they are also more in numbers i.e. pear, dates, loquat, strawberry, plum, tea, apple, gnava, papaya, pomegranate, almond, palm, cocount, olive oil, lichi, walnut, cherry, persimmon, banana, water melon, peach, musk melon, citrus and etc.

All the above mentioned details show the basic needs of a farmer. Besides these he is also in need of agricultural equipments and implements i.e. rake, trowel, shovel, spade, fork, hoe, hand fork, wheelbarrow, watering can and etc. A former is also in need of a minor transport i.e. motorcycle, cycle and etc. The Islamic banks and other Islamic financial institutions can advance Qard-i-Hasan to a farmer to able him to fulfill all of his agricultural requirements whether they are related to crop or non-crop activities.

### 3.4.6 Limit of Qard-i-Hasan?

The most important question that comes to the mind of a reader that what would be the limit of such Qard-i-Hasan. In other words it can be said that how much amount will be given to a farmer by Islamic banks and other Islamic financial institutions?

The amount which is given by the Islamic banks to a farmer is different for different commodities. After a practical study of the agricultural sector, the following scale is drawn for the advancement of such loan. But such estimation is on the basis of per acre.

### MAJOR CROPS

Wheat	7500
Paddy	8300
Sugarcane	17600
Cotton	12200

### MINOR CROPS

Potato	14200	Bajra	3500
Tobacco	2000	Jawar	4000
Maize (Hybrid)	1000	Gram	3500
Maize (local)	4000	Guara	2500
Mash	200	Caster oil	5500
Lentil	5000	Barlay	8500
Groundnut	7000	Berceme	4000
Sunflower	7000	Janter	3500
Soyabean	5500	Garlae	23000
Canola	4000	Turmeric	23000
Rape seed	4000	Ginger	27000
Mustard Mung	3000	Tomato	1500

### FRUIT CROPS

Pear	1400	Coconut	18000
Loquat	18000	Lichi	23000
Plum	15000	Cherry	23000
Apple	30000	Mango	28000
Papaya	20000	Apricot	23000
Almond	18000	Banana	35000
Peach	23000	Walnut	22000
Citrus	3000	Pomegranate	23000
Dates	23000	Palm	13000
Strawberry	23000	Persimmon	12000
Tea	50000	Zizi	23000
Guava	13000	Melon	12000
Olive oil	12000	Water melon	10000
		Musk melon	10000

### 3.4.7 Advancing Qard Hasan benefits

Mostly, conventional banks are advancing loan for interest purpose, so they are not facing any problem in this regard. But as for as the Islamic banks are concerned, they avoid to advance loan because of the prohibition of any excess over and above the principal sum as mentioned earlier. But it is to be noted that excess over and above the principal sum is prohibited only when it is the outcome of constructional obligation or when it is a customary practice.<sup>80</sup> But when such excess is not the outcome of constructional obligation or when there is absence of any customary rule in this regard, the debtor can give by his own will an excess over and above the principal sum of money which will be considered as a Hiba from him to the creditor according to the rules of sharia. Similarly if the farmer gives any excess over and above the principal loan by his own free will, then it will not only help the Islamic banks to grow up but will also encourage it to advance more loans to the agricultural sector in the future. But it is the duty of the state and educated people to create such awareness in the illiterate farmers.

The second benefit to the Islamic banks from advancing such loans to the farmers that it will attract the peasant to do participate with the bank in other modes of financing just like trade based modes of financing, in which Islamic bank acts as a trader and supplies goods on demand of the customer after purchasing the required good either directly or through agent just like murabaha, Musawamah, Salam, Istisan, rental based modes of financing, in which bank purchase an asset and hand over it to the customer on rental basis just like Ijarah participatory modes of financing in which the bank and farmer participate in profit and loss just like Musharakha, Diminishing Musharakha, Mudarabha, Musaqah, Muzarah. This benefit is looking a remote one but if looked profoundly, then a conclusion can be drawn that it is the real benefit from the future perspective for which the bank advances loan.

The third benefit for the Islamic banks from advancement of such loans that it will get publicity in the agricultural sector, and consequently will attract a majority of the population to its business activities.

The fourth benefit, which may be the most important for the Islamic banks and other Islamic financial institutions, that they can get service charges on such loans. These service charges can be determined by the Islamic bank keeping in view the rate of interest charged by the conventional banks. This rule is not in contradiction with the rules of sharia. A contemporary scholar Mulana Muhammad Taqi Usmani has the same view when he says "No doubt the use of rate of interest for determining a Halal profit cannot be considered desirable. It certainly makes the transaction resemble an interest based financing. Keeping in view the severity of prohibition of interest, even this apparent resemblance should be avoided as far as possible".<sup>81</sup> But it must be noted that when all the sharia's requirements for Qard Hasan are fulfilled, then merely using the interest rate as a bench mark for determining service charges

does not render the transaction invalid, haram or prohibited because such commercial transaction itself does not contain any interest. Moulana Muhammad Taqi Usmani gives a very clever example in this regard. He says

A and B are two brothers. A trade in liquor which is totally prohibited in shariha. B, being a practicing Muslim dislikes the business of A and starts the business to earn as much profit as A earns through trading in liquor, therefore, he resolves that he will charge the same rate of profit from his customer as A charges over the sale of liquor. Thus he has tied up his rate of profit with the rate used by A in his prohibited business. One may question the propriety of his approach in determining the rate of his profit, but obviously no one can say that profit charged

by him in his Halal business is haram, because he has used the rate of profit of the business of liquor as a benchmark.<sup>82</sup>

The above description shows that the Islamic banks can take service charges on the advancement of loan according to the rate of interest charged by the conventional bank on loan.

Keeping in view all these benefits it is suitable for the Islamic banks and other Islamic financial institutions to advance free interest loans to the agricultural sector, which will not only help poor farmers but will also help these institutions to expand their business especially in the rural areas.

#### **3.4.8 How the recovery of Qard Hasan should be made**

The most important question in Qard Hasan financing is that how it can be recovered. Such recovery must be made in time to the Islamic bank; otherwise, it will face the liquidity problem. As for as the conventional banks are concerned, if the farmer delays the repayment of loan, it will not create any sort of problem for it but the loan will be rescheduled, but rescheduling of loan is prohibited by shariha and hence the Islamic banks cannot do that. So a very strict procedure should be followed for the recovery of loan. It is worth mentioning that the procedure for the recovery of debt prescribed by Accounting and Auditing organization for Islamic financial institution must be followed for the recovery of loan because loan comes under the preview of debt it is also a financial liability. A short description of the rules for the recovery of debt has been given below

Non-payment of loan by the borrower who is being capable of paying, is strictly prohibited by sharia, so, a farmer who is a real believer must have to keep this fact in his mind and to pay the loan in time. The Holy Prophet (P.B.U.H) said

“The best among you, who repays the debt in the best way”<sup>83</sup>

The Islamic bank can ask a farmer to pledge or mortgage his property which may be moveable or immovable respectively with it as a security so in case of default it can sell this property for the liquidation of debt. According to an established principle of Shariah it can also ask the farmer for guarantor. In this case the institution is entitled to demand payment from either the debtor or guarantor. The question arises that what will be the time for repayment of such loan. As said earlier that advancing loan is a short term financing. It is given mostly to the farmer for the purpose to buy pesticides, insecticides, seeds, fertilizers and etc. the repayment period will be between 6 to 15 months. In other words we can say that the farmer must have to repay the loan after harvest. The following table will clarify the whole description mentioned above.

Types of Loans	Recovery Period
Short Term Qardi Hasan	Crop production working capital Qardi Hasan recoverable in lump sum commencing after the harvest/marketing of respective crops and within maximum period of 12 months.
Medium Term Qardi Hasan	Dairy farming and livestock etc. In yearly/half yearly/monthly installments and within maximum period of 5 years.
Long Term Qardi Hasan	Tractor, agricultural machinery, poultry farming, godowns and orchard In yearly/half yearly installments within maximum period of 8 years and. above.

## **4. Participatory Modes of Financing and their applications to agricultural sector**

### **4.1 Introduction**

Islam is a religion of cooperation and it envisaged this idea from its very beginning. A practical shape is given to such idea by inculcating it in each every aspect of life for the purpose to make the society prosperous. Relation between Muhajereen and Ansar can be sited the best example in this regard. The Islamic commercial law also bears the same philosophy in all rules and regulations of Islamic commercial transactions. This description gives birth to some important transactions of Islamic financial system i.e. Musharakha, Diminishing Musharakha, Mudarabha, Musasqat, Muzaraat and etc. such transactions can be called participatory modes of financing in which the participants participate (cooperating) with each other by the way of capital and work from both side (which is called Musharakha) or capital from one side and work from other (which is called Mudarabha) and etc. The idea of cooperation presented by Islam is directly or indirectly reflecting form all these transactions. For example if a person has capital only and but has no skill, then he can not utilized his properly .On the other hand another individual has some skills while he has no money to start a business. Such problems of both these individuals are solved by Islamic commercial law effectively by the way of Mudarabha

In the participatory modes of financing both the parties are participating in profit and loss. Usually the profit is distributed according to the ratio mentioned in the contract while the loss is borne according to the capital. The Islamic banks and other Islamic financial institutions can use such modes for financing purposes by providing funds to the customer for different business activities and thus become entitled to share profit and share loss. But it is pertinent to mention that these financial institutions should not use these modes in such a way that resembles conventional financing. They are required to actively participate in the business activities. This will pave a way to wards pure Islamic financial system. In this very chapter definition of Musharakha along with its historical background, it's different types, the rules for it in the classical books, its contemporary issues discussed by some prominent scholars, its application to the modern financial system, its viability for the financial institutions and customer and etc will be thoroughly examined .At the end its practical implementation to the agricultural sector will be discussed which is the basic aim of the present work.

## 4.2 Definition of Musharakha

The word “Sharikat” has been taken from Arabic language and literally it signifies two meanings mixing or Ikhtilat and the contract of partnership. The literal meaning has been proved from the Holy Quran “Most of the partners are transgressing on each other.”<sup>84</sup> It is pertinent to mention that different technical meanings have been assigned to the word “Sharikat” by jurists but all these meanings are not go beyond the literal meaning because partnership arises either through a contract or through the mixing of wealth. Different jurists define Sharikat according to their own style. According to Hanbali school of thought “Musharakha is permission from each of the partners to the other for appropriation and disposition while retaining the right to transact personally”.<sup>85</sup> According to Hanafi school of thought “Sharikat is a contract between two or more persons for participation in capital and its profit”<sup>86</sup> The sharikha’ definition in other school of thought is the same as that in these two schools of thoughts with a minor difference and therefore, not required to be discussed separately.

If the above given definitions are profoundly studied then it can be easily concluded that the last definition put forward by the Hanafi school of thought is the most suitable one as it includes all necessary ingredients of a partnership e.g. agreement, capital investment from the parties, sharing of the profit, and etc.

## 4.3 Background of Sharikat

From the very beginning of the society, it is a matter of fact that the methods to meet day to day needs have been changing with the change of social, economic, scientific, cultural and political circumstances, especially habits, fashion and the standard of living. It is also a true fact the methods that regulate the commercial activities also vary from place to place and time to time.

At the time of rise of Islam the Arab society had a very simple financial system with simple financing methods and forms of business peculiar in nature to that society. It means that there was no complexity in the financing methods and other forms of business that were prevailed in that society. The advent of the Holy Prophet (SM) saw that the people of the time were practicing Musharakha. The Holy Prophet (SM) not only rectified it but also practiced it by himself.<sup>87</sup> After Hijra a brotherhood was started among the Muhajireen and Ansar by the order of the Holy Prophet (SM). After this historical revolution in the form of brotherhood, they joined as partners in the form of Musharakha. This partnership was also extended to Muzara and Musaqah which were nothing but kinds of Musahraka in the agricultural sector. Muzara was applied to the agricultural sector by the partners; Musaqah was in gardening and etc. Mudarabha was also applied to the trade being a kind of Musharakha according to some jurists.<sup>88</sup> A well renowned Hanafi jurist Imam Sarakhsi also considers Mudarabha as a kind of Musharakha and it is because of this reason he describes both these commercial transactions in a single chapter.<sup>89</sup> With the

passage of time such transaction got development and it became independent commercial transaction. After this development the jurist settled detailed rules for Musharakha and Mudarabha as separate transactions.

#### **4.4 Types of Musharakha or classification of Sharikat**

Different jurists classify Musharakha differently. But generally they divide it (partnership) into three classes

- (i) Sharikat-al-ibaha (Common sharing of things)
- (ii) Sharikat-al-Milk (Co-ownership)
- (iii) Sharikat-al-Aqd (Partnership through contract)

The above division has been mentioned by a well renowned scholar Prof. Imran Ahsan Khan Nyazee in his book "Outline of Islamic Jurisprudence" and this division can be preferred because it is comprehensive one covering all related areas of partnership in Islamic law. The same classification has been followed in Majallah al-Ahkam-al-Adliyah. This is actually the use of the term sharekat in a broad sense. But the classical jurist discusses only two kinds of Sharikat i.e. namely sharikat-ul-Milk and sharekat-ul-Aqd. The reason is that Sharikat-ul-Ibaha is merely a common right and such transaction comes to an end when the property is acquired by someone.<sup>90</sup>

Before a detailed discussion of Sharikat al Milk and Sharikat-ul-Aqd, it is better to define all the previous three kinds. The first among these is Sharekat-ul-Ibaha which can be defined as "it is the common right of the people in ownership by acquisition or gathering of things that are permissible and not originally owned by any one". It means that if the thing is not permissible in shariah or when it is acquired by someone else then such common right cannot be exercised. Most of the classical jurists like Imam sharakhsi and imam kasani and etc do not discuss the concept of Sharikat-ul-ibaha in their work. It is because of the reason which is mentioned earlier.

As for as the Sharikat-ul-milk is concerned, classical Hanfi jurist Imam Sharaksi defines it as "it is the partnership between two persons in a property"<sup>91</sup>. He further says that such partnership may be formed either through the act of the parties or without that. inheritance is the best example of the previous one while an accepted sale, gift, Sadaqa and etc can be quoted for latter one. A comprehensive definition of Sharikat-ul-Milk is given Ibn-Abidin. He says that "Sharikat Al-Milk is ownership by a number of persons of an any ascertained property or dayn (debt not ascertained by weight of measure or other means) arising through inheritance or through exchange (Bay) or through other means".<sup>92</sup> It is a comprehensive definition which discusses not only the nature of Sharikat-ul-Milk, but also describes its different kinds. In the light of above given definitions it can also be defined as "it is that type of

partnership where more person happens to get joint ownership of some asset without having entered into a formal partnership agreement”

The third kind of Sharikat is Sharikat-ul-Aqd. It can be defined as “it is a proper partnership in which two or more persons willingly enter into a contractual agreement for joint investment and the sharing of profit”.<sup>93</sup> It is defined by Majala-Al-Ahkham-al-Adliya as “it is a partnership, which comes into being as a result of agreement between two or more persons in order to share profit”.<sup>94</sup> These two definitions show that the basic purpose of Sharikat-ul-Aqd is profit. Both these definitions are not comprehensive in nature. The best definition in this regard is given by a contemporary scholar Prof Imran Ahsan khan nyazee. He defines Sharikat-ul-Aqd as “A contract between two or more people for participation in capital and its profits, or participation in transaction in someone else capital and its profit or participation in profit without participation in capital or transaction”.<sup>95</sup> This definition is very comprehensive in nature, because it covers all kinds of Sharikat-ul-Aqd.

#### **4.4.1 Classification of Sharikhatul –al-Milk (Non-contractual partnership)**

Sharikat-ul-Milk is a joint ownership of two or more persons in a particular property. It means that such contract implies co-ownership and comes into existence when two or more persons happens to get joint ownership of some asset without having entered into a formal partnership agreement. This form of Sharikat may come into existence in two different ways. Sometime it comes into operation at the option of concerned parties. Technically this type is called optional partnership e.g. joint purchase or joint acceptance of gift or a bequest and etc.<sup>96</sup> sometime such kind of Sharikat come into operation automatically without the consent of the concerned parties and in this case it is called compulsory partnership. For example after the death of a person all his legal heirs inherit his property which comes into their joint ownership as an automatic consequence of the death of the person. In Sharikat-al-Milk each and every one has ownership in every smallest part of the capital. In a partnership if the property is divisible and the partners still decide to stick together, the Sharikat-al-Milk is termed Iktiyariyyah (voluntary). However, if it is undividable and they are constrained to stay together then Sharikat-al-milk is characterized as “Jabriyyah” (involuntary). However, in the modern financial system there is no scope for Sharikat-ul-Milk. So its further description will not be of that much importance.

#### **4.4.2 Classification of Sharikhat-al-Aqd**

The concept of Sharikat-ul-Aqd is very much applicable in the contemporary financial system. It is also a true fact that majority of classical Islamic finance texts focus almost extensively on principles that are related to Sharikat-ul-Aqd. So, the classification of this type of partnership is of much importance. Different scholars and Muslim jurists classify Sharikat-ul-Aqd differently. The Hanafi school of thought

divides it into three classes.<sup>97</sup> And this classification will be discussed for convenience. Further emphasis in this division will be on “Inan” investment partnership or “Amval” by way of “Inan” because it is mostly applicable in the modern banking system.

The Hanafi School of thought divide Sharikat-ul-Aqd into three classes

- **a. Sharikat-ul-Amwal**

It is that kind of Sharikat-ul-Aqd in which two or more persons invest some capital into a commercial enterprise. This is the ideal class of Sharikat-ul-Aqd. For example if A and B agrees to form a partnership and they invest some money e.g. Rs.600 by A and Rs.400 by B, then it will be called Sharikat-mal

- **b. Sharikat-ul-Amal**

It is that kind of Sharikat-ul-Aqd where two or more persons undertake to provide some services for their customer and the fee which is charged will be distributed among them according to the agreed ratio or it is a kind of Sharikat-ul-Aqd where two or more persons contribute their skills and efforts to the management of the business without contributing to the capital.<sup>98</sup> For example if two persons A and B agree to undertake painting services for their customers on the condition that the wages which is earned will be distributed between them irrespective of the size of the work each partner has actually done. This type of partnership also called Sharikat-ul-Taqaoul (Acceptance of services partnership) and Sharikat-ul-Sanai (Manufacturing partnership).<sup>99</sup> This sort of partnership is too much applicable in the modern Islamic banking sector.

- **c. Sharikat-ul-Wujuh**

It is that kind of Sharikat-ul-Aqd in which two or more persons use their good-will, their credit worthiness and their contacts for promoting their business without contributing to the capital.<sup>100</sup> Here in this class the partners have no investment at all. They actually purchase the commodities on deferred price and sell them at spot. The profit so earned is distributed between them at an agreed ratio. The last two kinds of Sharikat-ul-Aqd in which the partners do not contribute any capital, would remain confined essentially to small scale business only.

It is to be noted that these are of course model. But practically it may happen that the partners may contribute not only investment (finance) but also labour management and skills, credit and good will, although not necessarily equal. It is also of worth mentioning that all these kinds have their own rules and regulations and it will be difficult to go in their minute detail. However, for the purpose of understanding the basic rules that are governing the contract of Musharakha will be discussed.

## 4.5 Governing rules for Musharakha

- Musharakha is a contract. It means that all the ingredients that are necessary for a valid contract must be present. So, it means that there must be offer and acceptance, both the parties to the contract must be competent to form a contract which means that they must be major, sane, and enter into the contract with their free consent. There will be no fraud, no misrepresentation, no duress, no usurpation and etc. Besides all these the subject matter must be lawful according to the principles of shariah. So, a partnership for trade in wine and other illicit things is invalid according to the above principles.
- Profit of the partnership will be distributed among the partners in the business on the basis of proportion settled by them in advance through mutual consent in the beginning of the contract. It means that the proportion of profit to be distributed between the partners must be agreed upon at the time of affecting the contract so; if no such proportion has been determined the contract will not be a valid one.<sup>101</sup>. A contemporary scholar Mufti Muhammad Taqi Usmani presents a very good example for the distribution of profit

It is pertinent to mention that the shares of profit to be divided between the shareholders must be related to the actual profit accrued to the business. The share of profit must be known by division of the actual profit e.g. one half 1/2, one third 1/3, or one fourth 1/4 or it may be in the shape of percentage of the actual profit e.g. ten percent 10% or twenty percent 20% and etc. the profit should not be determined in proportion to the capital invested by the partners e.g. twenty percent 20% of the investment or thirty percent 30% of the investment. Similarly the profit should not be determined in the shape of any division related to the investment e.g. one third of the investment 1/3, one fourth 1/4 of the investment and etc. on the similar foot it is not allowed to fix a lump sum amount for any one of the partners. For example if A and B enters into a partnership with investment of Rs.500 from each side. They agreed that Rs.300 will be given to A from the profit and the remaining will be given to B, it is not a valid partnership in the eyes of shariah because the basic nature of partnership is that there is always the involvement of profit and loss and no body knows that what would be the net result of the partnership. So, no fixed amount can be settled for any party.<sup>102</sup>

However, if Musharakha is applied to the banking sector, some rules which are mentioned above will create difficulty. For example now in these days the bank gives a lump sum amount or a certain percentage to the customer. It is usually mentioned in the beginning of the contract. The solution for this

problem is that the bank and its customer must have to mention in the contract that such lump sum or certain in percentage given to the customer must be subjected to the final settlement at the end of the term.

- Generally speaking the basis for entitlement to the profits of a Musharakha are capital, active participation in the Musharakha and responsibility. For the proper understanding of ratio of the profit in the perspective of Islam, we must have to answer to the question that is it necessary that the ratio of the profit of each partner shall be according to the capital invested by him?

According to Imam Abu Hanifa, it is lawful that the capital of each partner may be equal and yet the profit be shared unequally.<sup>103</sup> It means that according to him the ratio of the profit may differ from the ratio of investment. But it is to be noted that such view has been described by him for normal conditions.<sup>104</sup> However, for a special situation he says that if one of the partners explicitly says in the contract of partnership that he will never participate in work (Sleeping Partner) then his share of profit cannot be more than the ratio of his investment.<sup>105</sup> The Hanifis presents two arguments for the support of their view. The first one is the very famous tradition of the Holy prophet (sm) which is “the profit between partners should follow the agreement between them and the loss should be borne in proportion to their investment.”<sup>106</sup> This tradition explicitly says that the profit should be given according to the agreement and not according to the investment made by a partner. Some of the contemporary scholars like Mufti Muhammad Taqi Usmani considers it as a maxim of Islamic commercial law and not a Hadith.<sup>107</sup> The 2<sup>nd</sup> argument of the Hanafi School is a logical one. They say that a person is entitled to profit by virtue of capital or by virtue of labour. So it may happen in a partnership that one of the partners is more skilful and expert in business than the other, so, he is entitled to get more profit although he may invest less than the other partner.

According to Imam Malik, Imam Shafi and Imam Zafar that it is necessary for the validity of Musharakha that each partner will get share in the profit according to his investment in the joint venture. So if A and B enters into agreement. A has invested thirty percent 30% of the capital while B has invested seventy percent 70% of the capital, then A will be entitled to thirty percent 30% in the profit while B will be entitled to seventy 70% of the profit.

According to Imam Ahmed bin Hambal, the ratio of the profit may be differ from the ratio of investment. So in the above example it is possible that A may get 50% while B may get 50% of the profit. It is seemed that Imam Ahmed has the same logical reason as presented by the Hanafi school of thought.

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If all the above given views of the classical jurists are analyzed then the view of Imam Abu Hanifa is looking more suitable for the modern financing, because it is frequently happening that the banks advance financing on Musharakha basis but they do not involve themselves in the business

activities and mostly play the role of sleeping partners. So it is logical that their share should be according to their investment. This is a special situation described by the Hanafi school of thought.

- All the jurists are, unanimously of the view that the lost shall be borne by the partners according to their capital in all forms of Musharakha. So if a partner has invested sixty percent 60% of the capital and other has invested forty percent 40% of the capital, and the lost is Rs.1000, then they have to bear Rs.600 and Rs.400 respectively. All the jurists are unanimous on this principle.<sup>109</sup> From the above description is according to the following principles of Islamic commercial law “Profit is based on the agreement of the parties, but loss is always subject to the ratio of investment”.
- It is to be noted that the liability of a partner for the debt of partnership is unlimited and the Islamic law does not legitimate the concept of limited liability as it is mentioned in the modern law for corporation and limited partnership.<sup>110</sup>

In Musharakha each and every partner is an agent of other partner. He has the right to sell and purchase on credit by virtue of contract of partnership alone. So, if he buys or purchases something, he is doing that as an agent in respect of others, so all will be liable for his act. But if he goes beyond the amount of capital invested in the partnership in such a situation the remaining partners will not be liable for his act.

- Is this necessary that the capital of Musharakha should be always in the form of cash? Different jurists reply to this question in a different manner.

According to Imam Abu Hanifa and Imam Ahmed Bin Hambal that the capital of the partnership should be contributed in the form of cash. They agree that the literal meaning of sharikah is mixing up, so if the capital is in the shape of commodity then such mixing up is not possible. They have the view that the capital of partnership should be mixed in such a way that no body can distinguish his share because it is necessary for the establishment of co-ownership which is necessary for the formation of a partnership. Imam Shafi has the same view regarding mixing of the capital.<sup>111</sup> Imam Abu Hanifa and Imam Ahmed Bin Hambal also argue that agency is necessary attribute of partnership and agency is unrealized in goods as investment. A well renowned jurist and author of *Badai-al-Sanai* Imam Kasani says

“It is not permissible for one person to say to another, sell your goods so that we may share its price. And since agency, which is one of the indispensable features of partnership, is not permissible, partnership is also not permissible. However, it is permissible for one to say to another “Buy goods with the hundred Dirhums” belonging to you on the condition that what you buy be shared between us”.<sup>112</sup>

According to Imam Malik the liquidity of capital is not a condition for the validity of Musharakha and partnership in goods is permissible if their value is determined on the day at which the contract is concluded.<sup>113</sup> A well renowned Hanafi jurist Imam Alkasani attributed the same view to Imam Malik.<sup>114</sup> This view has also adopted by some Hambali jurists.<sup>115</sup>

Imam Shafi has a totally a different view from the previous two; he says that Dawat-ul-Amthal (similar goods) may be contributed to the Musharakha as the share of the partner in the capital while Dhawat-ul-Qimah (dis-similar goods) cannot become part of the share capital.<sup>116</sup> Imam Abu Hanifa and Imam Muhammad adds their view to the view of Imam Shafi and say that investment to the capital can be made in the shape of Dawat-ul-Amthal (similar goods) but with the condition if they are mixed with each other in such a way that none of the partner can distinguish his share in the capital.<sup>117</sup>

If all these views, presented by the classical jurists, are profoundly studied then it can be easily concluded that the view of Imam Malik is very simple, reasonable and meets the need of modern business.<sup>118</sup>

#### **4.6 Implementation of Musharakha to the agricultural sector**

Musharakha has been considered by many scholars to be the most authentic form of the Islamic financial system. A contemporary scholar Muhammad Taqi Usmani has the same view. By saying

“If the financing is meant for a commercial purpose, it can be based on the concept of profit and lost sharing, for which Musharakha and Mudarabha have been designed since the very inception of the Islamic law. There are however, some sectors where financing on the basis of Musharakha is not workable or feasible for one reason or another. For such sectors the contemporary scholars have suggested some other instrument which can be used for the purpose of financing, like Murabaha, Ijarah, Salam or Istihsan”.<sup>119</sup>

Keeping in view the above statement it can be easily said that Musharakha and Mudarabha both are the ideal commercial transactions of Islamic financial system.

It is pertinent to mention that most of the people, who are related to the agricultural sector, are poor and indigent individuals of the society. They have small lands which are in the real sense act as a source for their lives. Agricultural for such people is not a business but as a source of life. It is the duty of Islamic bank to improve their lives by giving them an opportunity to work with it. It must have to do such attempts which are extremely successful in reaching these small poor farmers instead of expecting such farmers to look for financing. Because how one can expect someone who is an illiterate to seek his way to traditional banks. In this exercise it is only logical to go out to these poor people rather than expect them to go to the banks while they are completely unbankable.

As said by Mulana Muhammad Taqi usmani that Musharakha is the ideal transaction of Islamic financial system. Let us to use this ideal financing mode for the betterment of the worst (in term of wealth) population of our society i.e agricultural sector. There are different ways by which Musharakha can be applied to the agricultural sector for the purpose to fulfil day to day expenses requirements of farmers for both crop and non-crop activities. The most important idea in this regard is presented by Professor Ali Abdullah Ali, Editor of Sudan Financial Times.<sup>120</sup>

The idea which is presented by the respected professor is very useful for the agricultural sector and also free from different complexities that are noticed frequently in other modes applied by the Islamic financial institutions. He has of the view that Islamic banks must have to reach to the small producers (former) instead of waiting for them to come to the banks. He says that the bank (Islamic bank) can help these poor people by giving them an opportunity to participate with it on the basis of profit and lost. This idea was first applied to the growing of potatoes among North Omdurman farmers. For this purpose a small department was suggested to be opened by the Islamic bank which could deal with the regulation of such arrangement that was based on Musharakha.

In the view of researcher this idea can be applied to the agricultural sector in a more general form for the purpose to fulfil all agricultural needs of a farmer both for crop and non crop activities

Actually most of our farmers are in need of money to full their requirements especially for crop activities. A mechanism can be improved which can be called "cultivating together" i.e. the combination of the factors of production under this proposed joint enterprise. The bank (Islamic bank) will act as a holder of the funds (because it will provide funds) and the other party will be the producer who wants to produce a commodity. The bank will invest in the enterprise funds while the producer will participate in the shape of the land that he provides. This arrangement clearly shows that it is a form of Musharakha. The Islamic bank may put the condition that throughout the business he will be a sleeping partner. In this situation its profit share will not be more than his investment as discussed earlier. As the business is managed by the farmer, so managerial expenses will be deducted from the profit and will be given to him. More precisely it can be said that the responsibility of the farmer, who is the land owner, is to undertake the cultivation responsibility. It is to be noted that the farmer must have to manage operation under the guidance of the concerned Islamic bank which provides the fund and also provides all other necessary inputs. In such a transaction it is necessary to mention that the producer does not borrow money from the Islamic bank rather it deals with it in the shape of Musharakha. This special nature of the above relation (that the farmer does not borrow money from the bank rather it deals with it) brings some results that are the basic causes for the abolishment of complexities due to which the transaction becomes very simple in nature. For example in such a situation the farmer is not in need to give any guarantee to the Islamic bank. He is also not in need to provide any other collateral or request to the Islamic bank for mortgaging his

property with it. So all the conditions set by the traditional and conventional banks which are advancing loan on interest basis, are not required here in the case of Islamic Musharakha and this is the fundamental difference between Islamic financing and conventional financing. This is a simple method which can be used by the farmer or producer and Islamic banks to enter into a Musharakha mode of Islamic financial system.

It is of worth mentioning that there must be an agreement between the Islamic bank and the farmer which will specify the responsibilities of both the parties of Musharakha contract. Both the parties must have to adopt all those methods that insure maximum profit for them. For example after the harvest the production can be stored for a while and when the prices improve then they can sell it and will divide the profit according to the agreed ratio. In the researcher's point of view, which may not be correct, the parties must have to share the profit equally because from one side the bank provides funds and also seeds, water pump, tractor and etc while from the other hand the farmer provides land plus labour.

From the above discussion it can be easily concluded that the farmer is not in need to kill itself by providing any interest (as it is not a loan transaction) or other collaterals or other assets for mortgage. Both the parties are well benefited and no body is hard press to repay until committing suicide. By this way the lifestyle of these farmers can be improved. A vital change can be brought in their lives by changing their donkeys into carts and carts into Toyota vans. They will be able to send their children and kids for education. It is to be noted that the above proposed scheme can be applied to the production of different agricultural commodities. It can be used for the purpose of different inputs for crop production i.e. seed, fertilizes insecticides, pesticides, herbicides, weedicides, mannal sprayers, purchase of agricultural implements (trailers, thrashers, power tiller, power and boom sprayers, plough, cultivators, riggers / drills, rotavators, driggers, cotton picker, saw machines for crate making, press machines for wheat strew and dry fodder, chisel ploughs, potato planter, sugarcane planter, rice trance planter, self propelled reaper for harvesting and rice crops and etc.<sup>121</sup> The bank can also make this transaction with a group of formers. In this situation the bank can purchase for such group of farmers tractors, refrigeration vans, motorcycles, small pickups, mini trucks and etc.

But some mistakes may be done by the Islamic bank in the application of such kind of Musharakha. So there is a tense need to highlight also these mistakes for the purpose to implement such kind of Musharakha in its ideal form. For example the Islamic banks must be careful regarding the aim of this profit and loss transaction. This is to develop and improve the living standards of poor farmers. This purpose should be preferred all over the remaining purposes. The transaction should not be used to enhance the business activities of landlords who are not in need of any financial assistance and in real sense not deserve to be assisted financially. So it should be used for the assistance of needy people and should not for the assistance of already able people and companies or corporations.

The following are the various steps which must be taken by the Islamic banks for the best result of such Musharakha transaction.

- Before entering into the contract, the Islamic bank must have to study carefully the feasibility of the concerned Musharakha for a particular place. It must have to send its experts to the concerned area for the profound and thorough observation of the place supposed for agricultural Musharaka.
- The bank must have to open a branch in the rural areas having well trained staff particularly in the Islamic banking. Such bank will provide the services to the farmer of rural areas.

If the above proposed transaction is studied carefully then it resembles with Muzarah which is legally acceptable contract and also suitable for financing agricultural operations. Muzaraha can take several forms. They are given as under

- The contract based on this arrangement can specify that the land and other physical factors of production for the enterprise could come from one party (which is the Islamic bank in this case) while labour could be provided by the other party (who is a farmer in this case).
- Alternatively only land can originate in one party (which is the Islamic bank in this case) while the other factors including labour could come from the other party(who is a farmer in this case) in the contract.
- Another form is that land and labour could come from one of the contracting parties while all other factors of productions may be provided by the other party in the contract. This last category has a resemblance with the proposed kind of Musharakha which is discussed thoroughly in the previous description.

The basic question which must be determined that whether a land can be a source for the entitlement of profit. Let us to describe the views of different scholars over the issue. For the better understanding it is necessary to describe first the concept of entitlement to profit in the perspective of shariah.

According to a well established principle of shariah a person is entitled to profit because of wealth (Mal) work and liability for bearing loss. A person is entitled to profit on the basis of wealth because profit is a growth in wealth and belongs to its owner. That is why in partnership (especially in Sharikat-ul-Amwal) the investor while in Mudarabha, the owner of the capital is entitled to profit on the basis of such principle. In Mudaraba the mudarib (worker) is entitled to profit on the basis of work. Similarly in partnership an extra amount is given to the partner who manages the business which is called managerial expenses. A person is also entitled to profit on the basis of Zaman as proved from the Hadith of the Holy Prophet (P.B.U.H) "Revenue is based upon the corresponding liability for loss". The Hanafi school of thought considers Sharikat-ul-Wujuh its typical example. Because in this case the partners takes the

liability for giving the price to the seller.<sup>122</sup> A well renowned Hanafi jurist Imam Alkasani presents a comprehensive statement in this regard as he says

”in our view entitlement to profit either due to wealth or work or by bearing a liability for loss. As for as entitlement due to wealth is concerned, it is because that profit is a growth in wealth and hence belongs to its owner. It is for this reason that the owner in the contract of Mudaraba is entitled to profit and like wise the other partner, but if the Mudarib were made to bear the loss then he would be entitled to the entire profit and this entitlement is due to Daman as said by the Holy Prophet (sm)” Revenue is based upon the corresponding liability for bearing loss.” Thus, if the liability for loss falls on him, the profit also belong to him”<sup>123</sup>

The views of Hanbalis are similar in nature as that of Hanafi school of thought as Ibn Qudama says

”Daman is a basis for the entitlement of profit on the ground of Sharikat-al-Abdan because the acceptance of work involves Daman for the person accepting the work and provides a basis for the entitlement of profit. It is, therefore, similar to the acceptance of work in the contract of Mudaraba in which the worker is entitled to profit; it is thus like a Mudaraba”<sup>124</sup>

It is to be noted that wealth is not a source for the entitlement of profit alone but it must be accompanied by Daman (liability for loss). So in Mudaraba contract the Rab-ul-Mal is entitled to profit because he has contributed wealth and also has undertaken to bear the liability for loss. Hanafi jurist Imam Al-Kasani supports the above mentioned idea. He says “If the Mudarib were made to bear the liability for loss, then he would be entitled to the entire profit and this is due to Daman.”<sup>125</sup> The logical inference from this statement is that if alone wealth is a source for the entitlement of profit then Mudarib would not be entitled to the entire profit.

The above description shows that there is no concept in the classical work of jurists that shows entitlement to profit on the basis of land. If it is so then the whole proposed scheme which is put forward in the previous description will become just an idea and not more than that. The question is still standing that whether a person is entitled to profit on the basis of land only (as the former in the proposed scheme only put forward land).

It is the basic principle in Mudarabah that if there is loss then it will be considered a loss in the capital of Rab-ul-Mal. Similarly the Mudarib will lose his work. This loss came in the original principal sum and in the work. So, when the Mudarib gives money then he will also accept the risk of loss. The same philosophy can be applied to the land. So if a loss can occur to the land, then the owner is entitled to profit otherwise not. While following such principle it can be stated that a land should not be a source for the entitlement of profit. Imam Abu Hanifa, Imam Malik, and Imam Shafi have the same view.<sup>126</sup> The

disciples of Imam Abu Hanafi, Abu Yousaf and Al-Shaybani have the view that a land can be a source of profit and in this case it should be assigned the status of real estate. In other words land will be considered as a capital invested by the land owner.

But the researcher got surprise when he searched the view of different schools of thought over the issue that whether a land is a basis for the entitlement of profit. During research it was found that the Maliki School of thought has two contradictory views in this regard. For example According to Imam Malik liquidity of capital is not a condition for the validity of Musharakha therefore, it is permissible that a partner contributes to the Musharakha in kind,<sup>127</sup> but his share shall be determined according to the market price prevalent at the date of the contract. This view is also adopted by some Hanbali jurist.<sup>128</sup> But on the other hand he says that land is not a source or basis for the entitlement of profit. In other words why Imam Malik does not permit muzarah?

After a long discussion it is concluded that land can be based as a source of profit on the principle of "istihsan" as said by the Hanafi jurist i.e. Imam Abu Yousaf and Imam Muhammad and the analogy advanced by Imam Abu Hanifa is given up on the basis of practice and necessity.<sup>129</sup>

#### **4.7 Muzaraha**

Before the discussion of muzarah it is necessary to mention that the partnership can be divided into two classes from the perspective of work i.e. the first category is that in which both the parties participate in the work e.g. Inan and Mufawada partnerships are its example, the 2<sup>nd</sup> category of partnership is that kind in which there is work from one side e.g. Mudarabha, Muzaraha, and Musaqah are its example. In the coming lines this second category will be discussed.

Before the discussion of Muzaraha it is necessary to mention that privately owned agricultural land could be exploited in one of the three ways

- **Directly by the owner**

It is an ideal use of the land, in which the owner of the land cultivates the land by himself. This situation normally occurs when the owner of the land is poor person, having small land, and he wants to cultivate it by himself. The majority of farmers are cultivating their land by themselves.

- **Indirectly by renting it**

It is that kind of use of the land in which the owner does not cultivate the land by himself but he gives it to another person on rent. This is usually done by those people who are usually the landlord. They do not participate actively in the agricultural activities.

- **By partnership**

It is the cultivation of land by the way of partnership. This can be divided into two further classes

**(a) Muzaraha and (b) Musaqah.**

#### **4.7.1 Technical meaning of Muzaraha**

Muzaraha is a kind of agricultural partnership. It means in English language "Share cropping". The technical meaning of Muzaraha as "it is a contract for cultivation of land in return for part of the produce in accordance with the condition stipulated by law"<sup>130</sup>. The Majallah defines it as "muzaraha is a type of partnership where one party contributes the land while the other party contributes work and the yield is shared between them according to the agreed ratio"<sup>131</sup>. The comprehensive definition is given by Dr. Mahmoud A Gulaid as "it is a partnership in farming where by one or more individuals enter into a contract to invest in an agricultural enterprise or operation."<sup>132</sup> He further says that the output and produce for the enterprise is shared between the partners in accordance with the agreement stipulated in the contract. The definition put forward by Majallah is not comprehensive in nature as it excludes several form of Muzaraha from its jurisdiction. It describes a particular type of Muzaraha in which one party provides labour. The definition does not tell that from where the physical factors of production would come? Which mean who will provide that? It is not comprehensive in the sense that it does not cover the situation where land and labour will come from one side while the other factors of production will come from the other side. It also does not cover the situation where three party form a Muzaraha partnership.

#### **4.7.2 Muzara as a controversial issue**

There is a difference of opinion among the jurists over the justification of Muzaraha. According to Hanafi, Shafi and Maliki school of thought Muzaraha is not a legal transaction in the eyes of shariah while according to Imam Muhammad, Imam Abu Yousaf and Imam Ahmed it is a legal transaction. It is suitable first to discuss the view of those jurists who consider it a legal transaction and then followed by the view of those jurists who do not consider it a legal transaction.

- **4.7.2.1 View of the Proponents**

According to Imam Muhammad and Imam Abu Yousaf, Muzaraha is a legal transaction.

<sup>133</sup>They argue that the Holy Prophet made the same contract with the people of Khyber with the condition

that they will give half of the produce to the Muslims.<sup>134</sup> Similarly it is practiced by the companions of the Holy Prophet (SM) and then by their successors without denial of the validity of the transaction. They also prove its legality by the way of Qiyas. They say that Muzaraha is a partnership where wealth comes from one side and labour from other, so it is similar to the contract of Mudaraba which is a valid transaction in the eyes of shariah. They also bring validity for it through the methodology of istihsan (necessity). For example an owner of the land may not have the experience to cultivate his land or he will not be in such a position to cultivate it while another person may have skills in farming but he may have no land. So, if the Muzaraha is not considered a valid transaction, both these parties will suffer.

- **4.7.2.2 View of the opponents**

Those jurists who are not accepting the legality of Muzaraha have also some arguments. But here only the arguments of Imam Abu Hanifa will be discussed. According to Imam Abu Hanifa the Holy Prophet (SM) concluded a contract of Mukhabaraha with the people of Khyber.<sup>135</sup> He further says that such contract was a type of "Kiraj" imposed on them and it was not a contract of Muzaraha. In his view Muzaraha contract violates some basic principles of shariah. For example it is a well established principle of Islamic commercial law that wages for the labour must be known. But here in case Muzaraha, the wages are unknown. Similarly another principle is that no compensation for personal labour can be shared while in case of Muzaraha the compensation for the personal labour of the farmer is shared between the owner of the land and farmer which is another violation of the basic principle.

While keeping in view the views of both classes of jurists and the existing circumstances it can be concluded that Muzaraha should be permitted on the basis of necessity otherwise, a lot of problems would be created for the agricultural sector. For example due such prohibition, the landlords would not be in position to handover their lands to the small farmers while the latter would not be in position to cultivate it. So the view of Imam Abu Yousaf and Imam Muhammad should be preferred because it is according to the need of the time.

### **4.7.3 Role of Muzaraha in the agricultural finance**

As mentioned in the earlier chapters that majority of our population are related directly or indirectly to the agricultural sector. Most of our farmers belong to the poor families and usually have no money in their pocket for the basic agricultural requirements e.g. insecticide, pesticides, herbicides, weedicides seeds and etc. They cannot get loan from the banks because they have to pay interest at the time of repayment. So there must be some alternative arrangements that can solve their financial problems in the best way. Muzaraha is the best choice in this regard. But it is to be noted that the required results can be achieved only when such transaction is applied in its real spirit and sense. It is the duty of the Islamic

banks and other Islamic financial institutions not to misuse the Muzaraha transaction purely for financing purposes. But if they really participate with the farmer in the business and provide him all the necessary requirements for agricultural sector not as a financier but as a partner in the contract of Muzaraha, then best results can be achieved

Muzaraha can be easily used for agricultural finance by the Islamic banks and other Islamic financial institutions. These institutions can participate with the farmer in many ways.

Firstly           The Islamic bank and the farmer may agree that the land and labour should be provided by the farmer while the physical factors of production will come from the Islamic bank.

Secondly         The Islamic bank will provide labour and other physical factors of production while land will be provided by the farmer .in such a case the bank can hire the personal service (Ijarat-ul-Ashkas) of some people who will do cultivation. But it is a very complex method by which the required objectives cannot be achieved and that is to help the poor farmer. This method is very useful for the landlord who have a land above the subsistence level, and for whom agricultural is a business and not a source of life. But this is not the ideal form of Muzaraha for the poor indigent farmer for whom farming as a source of life and not as a source of business.

Thirdly In this case the land will be provided by the Islamic banks and the labor, and other physical factors of production will be provided by the farmer. But according to the established role of law, the banks cannot own a property except the premises in which they are doing their business. So the question arises that how the Islamic banks will provide land? The answer to this question is very easy. The Islamic banks can take land from the farmers (especially from those who are landlords) on rent and then give it to the farmers on the basis of Muzararha. But the question arises that the renting of a land is permissible in shariah.A well renowned jurist Ibn-e- Rushd says that the Maliki school of thought permits the renting of land for every thing except for food.<sup>136</sup>They support their view by the tradition of Holy Prophet (SM) about Muzaraha.<sup>137</sup> The tradition prescribes the renting of land with its yield.

Fourthly         A three party Muzaraha partnership can also be made. In such a situation one Islamic bank provides land, the second provides a combination of required physical input and farmer provides labour. This method is very useful especially

for large lands where two banks are interested to participate in the agricultural finance.

Fifthly A financing arrangement can be made on Muzaraha bases. It will be subject to joint partnership in the mobilization of land, other physical inputs required for agricultural and labor.

The above discussion shows that Muzaraha can be effectively applied to the agricultural sector both for crop and non crop activities very effectively by different ways. If Muzaraha is applied along with all these rules and regulation then then it is a solid fact that such contract is the most suitable method which can be applied easily by the Islamic banks and other Islamic financial institutions to finance the agricultural sector.

## **4.8 Musaqaq or Muamalah**

### **4.8.1 Definition of Musaqaq**

According to Imam Al-Kasani, the technical meaning of Musaqaq as “it is a contract of work for part of the produce along with the condition of validity”.<sup>138</sup> Imam Kasani is a great Hanafi jurist but but it is not clear that why he mentions the term “along with the condition of validity” in his definition. Another definition which is given by Al-Ramli, is very comprehensive in nature as he says “it is a contract for the caring of trees for part of their fruits”. This definition shows the real characteristic of the contract of Musaqaq. According to Ibn-e-Qudamah, a well renowned Hanbali jurist “Musaqaq is the giving of trees to another so he undertakes to water them and perform all other associated work for a known part of their produce”.<sup>139</sup> According to Majallah Al-Ahkam Al-Adliya “it is a type of sharikah so that the trees are contributed by one party and their care is undertaken by another with their fruit being divided between them”.<sup>140</sup> Keeping in view all these definitions, a comprehensive definition may be as “A contract is termed Musaqaq when one party concludes a deal with another party calling for the latter to trim and water those fruits trees whose fruits are either one’s own or are at his disposal an exchange for an amounts of the fruits, as agreed upon “it is a comprehensive definition and covers all aspects of the contract of Musaqaq.

After a profound study of all above definitions it can be stated that majority of the Fuqaha agree that Musaqaq is an agreement between two individuals wherein one person provides the orchards or trees owned and the other person provides labour and enterprise for irrigation services and up keeps. It is to be noted that when the contract of Musaqaq is related to fruitless trees like willows and sycophants, then such contract will be a void one. It is because of the reason that such contract is mainly related to fruit

trees as almost all the jurists mention this fact in their definitions. However, it would be valid in such trees as henna whose leaves are used or those trees whose flowers are used.<sup>141</sup>

#### **4.8.2 Legal justification of Musaqah**

On the legal justification of Musaqah the jurists have different opinion. Imam Abu Hanifa does not consider it a valid contract. He presents and cites the same arguments as he presented in the case of Muzaraha while Imam Muhammad, Imam Abu Yousaf and Imam Shafi consider it a valid contract.<sup>142</sup> The Hanbali school of thought also considers this contract a valid one.<sup>143</sup> According to the Maliki school of thought it is permitted as an exemption from the following rules.<sup>144</sup>

- It is an Ijara with unknown wages.
- Renting of land with what it produces.
- Sale of fruit prior to the process of ripening, in fact prior to its existence.
- There is uncertainty also because the worker does not know that how much quantity would be produced.

Keeping in view all the above discussion it is concluded that majority of the jurists allow the contract of Musaqah. Most of them validate it on the basis of istihsan because the people are in extreme need of that.

#### **4.8.3 Rules and regulation for Musaqah**

It is necessary for the contract of Musaqah that both the parties must be sane. So if either of the parties insane, it will invalidate the contract. But it is not necessary that both the parties must be major. A minor of discriminative qualities can enter into such contract. Freedom is also not a requirement for such contract. All these conditions are similar to that of Muzarah.<sup>145</sup>

As mentioned earlier that Musaqah is a contract for caring of fruit trees; however, some of the jurists restrict it to certain fruit trees. According to Shafi school of thought Musaqah is permitted in date palms and grapevines only,<sup>146</sup> while according to Dawud it is permitted in date palms only.<sup>147</sup> Ibn Qudama after naming the fruit trees says "The conclusion is that Musaqah is permitted in all fruit bearing trees."<sup>148</sup> But according to Hanafi school of thought Musaqah is permitted in all fruit bearing trees whose yield improves with labour.<sup>149</sup>

In the researcher's point of view last view is preferable and more suitable for the modern agricultural finance because if the operation of Musaqah is restricted only to date-palms and grapevines then it will produce too much difficulty in respect of that area the land of which is not suitable for the growth of such fruits. So, it is indispensable because of different agricultural climates to give preference to the view of Hanafi school of thought. Another important rule is that share in the produce must be

mentioned in the contract. So if the entire produce is given to a party the contract will be void according to the basic principles of Islamic commercial law.<sup>150</sup>

The contract of *Musaqah* is binding in nature, so it is not allowed for a party to terminate it without the consent of the other party. So, if one of them refuses to perform the contract, he is to be forced to perform it because there is injury involved in it to the other party.<sup>151</sup> Because of binding nature of this contract Imam Malik says that the contract of *Musaqah* may be inherited.<sup>152</sup> Both the parties must have to determine the period of the contract before which none of the parties has the authority to terminate the contract as said earlier. There must be specification of the work to the party which is responsible for labour. It is also pertinent to mention that the entire work should be done by the worker. It is the duty of land owner to enable that worker to have access to the land and the trees.

#### **4.8.4 Application of *Musaqah* to the agricultural sector**

*Musaqah* by its nature a contract which is purely related to the agricultural sector and because of this peculiar nature it can be effectively applied for the agricultural finance especially for orchard financing. It means that the Islamic banks and other Islamic financial institutions can use it for the purpose to finance the agricultural sector. This contract is very useful particularly for those people who have a large piece of land, in other words the landlords. The Islamic banks and other Islamic financial institutions can enter into this contract with such landlords. For example if there is a *Musaqah* contract between the Islamic bank and the owner of the land then the previous will provide labour and will be responsible for the entire work while the latter will provide land of fruit trees. In this situation it is possible for the Islamic bank to hire the personal services of some other farmers of the same area who will water the trees and will do all other works that are related to their responsibilities. Another arrangement of *Musaqah* contract can be made in which the Islamic bank will provide land of fruits while the labour will be provided by the farmer. But a question may arise in the mind of a reader that a bank cannot own the property except the premises for their main business according to the existing law, then how it can provide land. In such a transaction the bank will take a land on rent from a farmer of an area, plant fruit trees on it and will hand over the garden to another farmer of the same area on the basis of *Musaqah*.

*Musaqah* is a very useful transaction especially in the rural areas. In the researcher point of view this will reduce the menace of unemployment in such areas to a great extent. The best result of *Musaqah* demands that the Islamic banks and other Islamic financial institutions should apply this transaction in its real spirit and should not misuse it only for financing purposes (just to give interest based loan). Before entering into the contract of *Musaqah*, duration of the contract and the time for the conclusion of the contract must be mentioned. It is because of this reason a majority of the Muslim jurists maintain that the

duration should not be uncertain.<sup>153</sup> Both the parties must have to specify their rights and obligations. It should be cleared that what would be the duties of Islamic banks and what would be the duties of the farmer. The duration of the contract must be specified.

#### **4.9 Appointment of Rural Farmer as an Agent and its benefits**

The Islamic banks and other Islamic financial institutions should be involved actively in the Musaqah operation but it is not necessary that their involvement should be direct one. They can appoint their agents who may be another farmer of the same area who will have a lot of experience in the agricultural sector. This is seemed a very good idea because of three reasons.

- Firstly it will reduce unemployment in the rural area because the Islamic banks and other Islamic financial institutions do not or even can not participate actively in the Musaqah contract with a farmer and resultantly they would be in need of some other farmers of the same area to act for them as their agents as mentioned earlier.
- Secondly By appointing local farmers as their agent, the Islamic banks can develop its business in the local area and this will create better opportunity for these Islamic financial institutions to make this sector more viable for themselves. It is therefore, suggested for them to earn comparatively less profit from the local farming as compared to the profit earned by them from other sectors. They are required to put their sole inclination to the expansion of their business which will pave a way for profit from the future perspective.
- Thirdly By appointing a local farmer as its agent, the Islamic banks and the Islamic financial institution create awareness in the local people regarding the importance of Islamic financial system in the agricultural sector. After getting such awareness they will never consider themselves as debtors of the Islamic financial institutions but as their business partners.

#### **4.10 Combination of Salam and Musaqah**

Another idea which may not be a reasonable one in the view of many scholars who are related to the field, that along with Musaqah, a transition of Bai-ul-Salam (advance payment) can also be made. But it is to be noted that both the contract of Musaqah and the contract of Salam should be independent of each other otherwise, it would be a violation of the basic principle of Islamic commercial law according to which two contracts in one contract is prohibited. The Islamic bank through its agent can enter into the contract of Salam with that person who is already an active partner of the Islamic bank in the contract of

Musaqah in case when no produce is yielded, then according to Islamic law no party will get anything. But it is pertinent to mention that under this situation the other party must have to deliver the salam goods in time by purchasing it from the local market.

#### **4.11 Diminishing Musharakha**

Before embarking on the discussion of diminishing Musharakha, it is necessary to define it. The shariah standards defines it as “it is a form of partnership in which one of the partner promises to buy the equity share of the other partner gradually until the title of the equity is completely transferred to him”<sup>154</sup>. In this transaction first there is the formation of a partnership which is followed by a sale transaction. This partnership and sale transaction are between the same parties. It is therefore, necessary that the buying and selling should not be stipulated in the partnership contract. The buyer will only enter into a promise to purchase the commodity at the end but it should be independent of the partnership contract. In other words it can be said that both these contract will be independent of each other and if their relation is found at any stage then the whole transaction will become void. It is to be noted that such contract is actually the combination of two commercial transactions i.e sale and lease. But the question arises that whether the gathering of two or more transactions into one arrangement is permissible in Islamic commercial law or not. According to a well renowned Hanafi jurist Imam Sharakhshi while giving answer to such question says that if all these transactions are related to each other in such a way that each of them depends on other then it is not permissible, but if they are independent of each other then there is no hurdle from the perspective of Shariah.<sup>155</sup> It is totally a new concept to the Islamic financial system envisaged by the contemporary scholars i.e Mulana Mufti Muhammad Taqi Usmani, Dr Wahba-al-Zuhali, Adullah bin Suliman-al-Manee, Abdurrehman bin Salih, Al-Saadiq Muhammad-al-Ameen, Ajeel Jasim, Yousf Muhammad and etc.<sup>156</sup>. It is because of this reason a single sentence is not found in the work of classical jurists regarding such transaction. It is pertinent to mention that according to the contemporary scholars the general rules of partnership are applicable to such transaction.

A profound study reveals that the concept of diminishing Musharakha is actually a transaction in which a financier and his client participate either in the joint ownership of a property or an equipment or in a joint commercial enterprise. The share of the financier is divided into small units and it is understood that the client will purchase the units of the share of the financier periodically, and by this way he will increase his own share till all the units of the financier are purchased by him so as to make him the sole owner of the property or commercial enterprise as the case may be. The following example which is given by the contemporary scholar Mufti Muhammad Taqi Usmani will clarify the theory in the best way.

The diminishing Musharakha is mostly used by the Islamic banks and other Islamic financial institutions in the house financing. In this situation the client wants to purchase a house for which he does not have adequate funds. He approaches the financier who agrees to participate with him in purchasing the required house. Twenty percent 20% of the price is paid by the client while eighty percent 80% by the financier. Thus, the financier owns eighty percent 80% of the house while the client owns twenty percent 20%. After purchasing the property jointly, the client uses the house for his residential requirements and pays rent to the financier for using his share in the property. At the same time the share of the financier is further divided in eight equal units, each unit representing ten percent 10% ownership of the house. The client promises with the financier that he will purchase one unit after three months. Accordingly, after the first term of three months, he purchases one unit of the share of the financier. It reduces the share of the financier from eighty percent 80% to seventy percent 70%. Hence, the rent payable to the financier also reduces to that extent. This process goes on in the same fashion until after the end of two years, the client purchases the whole share of the financier reducing the share of the financier to zero and increasing his own share to hundred 100%.<sup>157</sup>

From the above discussion, along with the example, it can be concluded that the diminishing Musharakha consists of different transactions.

- Firstly            There is the creation of joint ownership in the property by the contracting Parties
- Secondly        There is Ijara (lease) transaction because the financier gives his share to the client who is his partner in the joint ownership of the leased property. He will pay rent only to that proportion which is owned by the financier.
- Thirdly          There is a promise from the client that he will purchase the share of the financier gradually till to the time when he becomes the sole owner of the asset and it is the real spirit of this contract. According to the established principle of Islamic commercial law such promise will be binding in nature.<sup>158</sup>
- Fourthly        There is actual purchase of the unit at different stages of the partnership. This purchase is the outcome of that promise taken by the customer In the beginning of the contract

Fifthly            There is an adjustment of the rent according to the remaining share of the financier. A time will be framed for such adjustment in the beginning of the contract.

#### **4.11.1 Issue of promise in Diminishing Musharakha**

Promise is generally a statement to do something. It creates moral obligation on the promisor and cannot be enforced on him through the court of law. However, there are a number of Muslim jurists who opine that promises are enforceable through the court of law especially when they are related to commercial transactions. According to some of the Maliki and Hanbali jurists promises can be enforced through the court of law. The Hanafi jurists have the opinion that promises cannot be enforced through the court, however, on the other hand they accept the concept of a particular sale which is called “Bai-bilwafa”. Any how, the view of the Maliki and Hanbali should be preferred because the promises can be made enforceable at the time of need.

#### **4.11.2 Application of Diminishing Musharakha to agricultural finance**

- **4.11.2.1 Procedure for agricultural Diminishing Musharaka**

Diminishing Musharakha (Al-Musharakha Al Mutanqisah) is the most usable form of partnership in the agricultural sector for both crops and non-crops activities. The reason is that such contract is very useful and beneficiary for both landlords, for whom agricultural acts as a business, and for poor farmers, for whom agricultural act as a source of life. In term of agricultural sector diminishing Musharakha can be defined as “it is an agreement in which an individual may enter into a contract with a bank to finance package of physical inputs required by an agricultural operation”. It is pertinent to mention that both the parties to such contract must have to settle all the concerned issues in the very beginning. So each partner’s share from the enterprise will be specified in the contract. All the rights and obligations of both concerned parties must be mentioned. The agreement must also stipulate a certain pre defined portion of the clients net income will be provided to the financier as payment of the principle financed by the latter. As said earlier that in diminishing Musharakha the share of the financier is gradually reduced and the client share is increased. On the similar way the bank share of the equity will be progressively reduced through time until and unless the share of the bank becomes zero and resutantly the client becomes the sole owner.

As stated earlier that diminishing Musharakha can be used very effectively in the agricultural sector, so all sort of agricultural machinery and equipments can be financed by the Islamic banks and other Islamic financial institutions through this mode. The benefits which are expected from the diminishing Musharakha can only be achieved when the Islamic banks really use it in its true spirit and

actually participate in the business activities. But it is not necessary that they should actively participate with the farmer and their involvement may be through their corresponding agents.

As it is known that diminishing Musharakha is a kind of Musharakha and consequently all rules and regulation of partnership should be applicable to it. So some of the capital should be provided by the Islamic bank (as a financier) and some of the capital should be provided by the farmer or farmers (as a coopartner in the partnership). All partners including the Islamic bank, have the right to participate in the management of the business which is the ideal situation of the contract of partnership, however, if one of the parties explicitly says that he will be a sleeping partner and will never participate in the management of the business then his share in the profit will not be more than his investment. Usually the Islamic banks and other Islamic financial institutions do not participate actively in the management of the business and they mostly play the role of sleeping partner. But in the researcher's point of view, which may not be correct to a great extent, they have to participate in the business even if that is through their corresponding agent who may be a farmer of that area in which the diminishing Musharakha has been applied or any one else. But agency of a farmer will be more beneficiary for the Islamic banks and other Islamic financial institutions in many respects which are already described in the previous pages.

Before entering into the agreement, a farmer and the Islamic bank must have to agree over the profit ratio, but it should not be related to the investment or to any percent of the investment and should not be any fixed amount. So, it is not necessary that the profit should be the same as per capital their proportions. As for as the losses are concerned, it shall be distributed between or among the parties according to their capital which they provide for the project. This is the basic principle of Islamic commercial law that profit should be according to agreement of the parties while losses should be distributed according to the capital.<sup>159</sup>

It is a basic nature of the partnership that it does not survive forever and there is a time at which it will come to an end. So, at the time of termination, after a specific period, the capital along with the profit should be returned to the investors.

- **4.11.2.2 Application of Diminishing Musharakha to local farming**

The Islamic banks and other Islamic financial institutions use the diminishing Musharakha in the first instance for the transport financing which includes purchase of tractors, refrigeration vans, farm cooling tanks, motor cycles for milkman, small pickups, mini trucks, chillier carries and etc.<sup>160</sup> in this situation the Islamic banks and the farmer will acquire the vehicle collectively. So, they will become the co owner of the asset. After this the farmer will take the share of the Islamic bank on rent. The share of the Islamic bank will be divided into small units and the farmer will purchase these units periodically. This process will be continued until and unless the share of the farmer increases to that extent in which he

becomes the sole owner of the vehicle. All risks and liabilities which are related to the ownership will be divided by the parties according to their share in the ownership of the asset. But through mutual agreement they can agree otherwise. This method is very useful because most of our farmers are very poor and these assets are very expensive and at the same time very essential for farming, and they have no cash money in their pocket to purchase all these from the local market.

- **4.11.2.3 Application of Diminishing Musharakha to live stock**

The diminishing Musharakha can also be used for the financing of livestock. So in this situation the Islamic bank and the farmer will acquire the ownership of different assets or equipments that are necessary for such sector collectively. These assets include natural milk yielding buffaloes or cows, replacement of existing buffaloes or cows, purchase of young buffaloes, cows, sheep and goats for requiring for meat production, milk storage chilling tanks, refrigeration plants and milk carrying containers, refrigerated meat storages and refrigerated containers, distribution vehicles such as motorcycles, pickups, refrigerated vans, construction or procurement of permanent sheds, water tanks, water pumps, tube wells and generators.<sup>161</sup>

In the above situation the farmer and the Islamic bank or Islamic financial institutions will form a diminishing Musharakha in which the farmer will provide land which would be his share in the investment while the bank will provide cash money (as a financier) in the investment and they will become the co-owner of the livestock asset. After acquiring the asset the farmer will pay rent to the Islamic bank for his share and thus will increase his share. This process will be continued unless and until he becomes the sole owner of the commodity as discussed earlier.

The farmer and the Islamic banks can also apply diminishing Musharakha for the installation of tube wells, turbines, sprinkle / drip irrigation system, water management, solar energy plants, pumps for irrigation system and etc.<sup>162</sup>

- **4.11.2.4 Application of Diminishing Musharakha to poultry farming**

The diminishing Musharakha can also be applied effectively to the poultry farming which includes construction of broiler, layer, breeder of hatchery farms and feed mills, control sheds, generators, ventilators, table / breeder eggs storage refrigeration plants, purchase of machinery or equipment for poultry farmers, transport vans, eggs and poultry carrying vans, distribution vehicles such as motorcycles, pickups and etc, deepfreezes, slaughtering and defeathering machines and etc.<sup>163</sup>

- **4.11.2.5 Application of Diminishing Musharakha to fish farming**

The diminishing Musharakha can also be used effectively for fish farming. Different commodities which are necessary for fish farming can be purchased through this modes e.g. purchase of motor boats, purchase of marine engines (outboard and inboard), replacement of engines and spare parts, construction of cold storage by fishermen with the use of insulation materials / sheets for walls / roof, purchase of other deck equipments like winch, wire rope, gallows, net handler, navigational lights, communication equipments, radar, life jackets, life boats, anchors, direction finders, echo sounded (fish finders), life buoys, insulation materials, purchase of nets trawlers, fishing storage centre fish / shrimp hatcheries, purchase of mobile insulated, pickup, vehicles and etc. <sup>164</sup>

## **5. Trade –Based modes of financing and their application to the agricultural sector**

### **5.1 Introduction**

Trade based modes of financing form an integral part of Islamic financial system. These includes Murabaha, Musawama, salam, istisna and etc .Nearly 35% of Islamic commercial transactions are coming under the purview of such modes. It is because of this reason the classical jurists paid a great attention to such modes and discussed them with minute details. The Hanafi school of thought did an advanced study in this regard as compared to other schools of thought .The work of a great Hanafi Jurist; Imam Sharaksi can be cited as a solid argument in this regard .He devoted a major portion of his work to such modes of financing in the shape of Kitab-al-Bouy.

Trade-based modes of financing includes those commercial transactions in which there is trade of goods and commodities between an Islamic banks or other Islamic financial institutions and a customer .in the view of some contemporary scholars it means to provide finance to a potential customer by the way of trade .Their views indicate firmly that it is not mere a financing facility just like that provided by the conventional financial institutions but there is a real trade through the sale and purchase of goods and commodities .it is because of this reason these scholars demand as a condition from the Islamic banks and other Islamic financial institutions to be actively involved in the whole business. The Islamic banks, while following such condition purchase the required commodity and goods from the original supplier directly and take possession which may be ctual or constrictive.This will be an ideal situation, however, in the case of dire need they can purchase the commodity and take its possession indirectly through the involvement of customer who will act as their agent. But this is also allowed with certain conditions. Purchase of the commodity from the original supplier, appointing of the customer as an agent, liability for risk before the actual sale of the commodity, actual or constrictive possession of the commodity, negotiation for price, payment of insurance and other cost, direct payment to the originals supplier are some facts that can be cited for being its trade and not mere a finance

### **5.2 Murabaha**

One of the distinct features of Islamic financial system is that it does not deal in money. According to this philosophy the Islamic financial institutions do not price money but instead they deal in goods. They are always following the asset backed financing and here the main difference between Islamic financial system and conventional financial system arises.

If the conventional financial system is profoundly studied then it reveals that conventional financial institutions are entirely and exclusively dealing with money and monetary papers. On the other hand, according to Islamic commercial law, trading in money is strictly prohibited and because of this

prohibition if profit is made through trading in money then it will be tantamount to riba. After studying classical Islamic jurisprudence it becomes crystal clear that the classical Islamic financing is permanently based on non-liquid asset. In other words it can be said that Islamic financial system wants that money must be converted into something having intrinsic utility within Islamic financial transactions.

The above whole theory gives birth to the concept of Murabaha in Islamic financial system which can be effectively applied to the agricultural sector both for crop and non crop activities. The farmers are always in need of money to buy basic agricultural equipments for both forms of agricultural sector. It is generally noticed that they have no sufficient funds to purchase all these equipments, by utilizing their own resources, because these are usually expensive in nature.

In the coming pages the literal and technical meaning of Murabaha will be discussed thoroughly, followed by the concept of such mode in the Islamic banks and other Islamic financial institutions. There is always a criticism from different corners that Murabaha is a changed shape of loan financing advanced by the conventional banks. This issue will be dealt in details along with some discussion regarding rules and regulation of Murabaha transaction. After this application of Murabaha to the agricultural sector will be thoroughly discussed. Some new issues will be raised and will be analyzed critically. It is also tried to follow a simple procedure which would be totally different from the existing one discussed by Shariah Standards. Some sort of relaxation is also suggested for a poor farmer in different aspects of agricultural finance.

### **5.2.1 Meaning of Murabaha**

“Murabaha” is, in fact, a term of Islamic jurisprudence which literally means “profit”. This literal meaning shows, in the first glance, that it is sale with profit, while technically different scholars define it according to their own concept regarding it. But here only those definitions will be presented which are comprehensive in nature and by the help of which this concept can be easily understood. According to Imam Al-Qurrtabi”it is that kind of contract in which the seller describes price of the commodity to the buyer with conditional profit”<sup>165</sup>. According to a well renowned Hanafi jurist Imam Kasani”it is the sale of a commodity at its original price along with additional known profit”<sup>166</sup>. Imam sharakhsi defines Murabaha with the same words. He adds that it a trust contract.<sup>167</sup>

According to Dr. Muhammad Tahir Mansori, “Murabaha is a sale of good at a price covering the purchase price plus profit margin agreed upon between the contracting parties”.<sup>168</sup> According to a well renowned scholar, Imran Ahsan Khan Nyazee “Murabaha is a sale at a stated profit in addition to the cost price” he also define it “It is a sale with mark-up.”<sup>169</sup> According to Dr. Shahid Hussain Sidique “Murabaha means mutually stipulated margin of profit in a sale transaction where the cost of the commodity is made known to the buyer”.<sup>170</sup> It is also defined by Guidelines on Islamic Financing for Agriculture as

“Murabaha is a kind of sale in which seller discloses the cost of goods and the profit to buyer”.<sup>171</sup> The Accounting and Auditing Organization for Islamic Financial Institutions defines Murabaha as “it is the selling of a commodity as per the purchasing price with a defined and agreed profit markup.”<sup>172</sup> In the eyes of Justice Muhammad Taqi Usmani, one of the most respected and retained jurists by Islamic financial institution worldwide, define Murabaha as “it is a sale in which the seller agrees with the purchaser to provide him a specific commodity on a certain profit added to his cost.”<sup>173</sup>

After a profound study of all the above given definitions it can be stated, without any doubt, that Murabaha is a special kind of sale in which the seller expressly tells the purchaser that how much cost he has incurred over the commodity and how much profit he is going to charge in addition to the cost. It means that if the seller does not disclose the cost which he has incurred, that would not a Murabaha transaction but would be a Musawamah transaction.

### **5.2.2 The concept of Murabaha in Islamic banking**

As mentioned above, Islamic financial system treats money exclusively as a medium of exchange, and hence, prohibits profit made through trading in money. It means that Islamic financing is based on non liquid asset. While applying the above rule, the concept of Murabaha comes to the field of Islamic commercial transaction.

Murabaha financing is one of the oldest and most commonly used means of Islamic finance. A well renowned scholar Muhammad A-El-Gamal says “The full technical name of this contract should be “Al-Murabaha lil-amir bil shira ma a bay bi-thamani ajil”.”<sup>174</sup> Actually the respected scholar gives such name to Murabaha because of its practical utility which it has in the commercial market particularly in the banking sector. It is also a solid fact that such transaction (Murabaha) has great hidden potentials for profit which are now discovered by the Islamic banks and other Islamic financial institutions to a great extent. One of the earliest manifestations of this transaction as substitute for bank loans was first envisioned by Sami Hummd in his book “Tatwir al-Amal al Masrafia bi-ma Yatlafique wa al-Sharih-al-Islamiyya”. This shows that the scholars recognized the fact that Murabaha is the best alternative for interest bearing loans transaction.

But the assumption that Murabaha is an alternative or substitute for conventional bank loans is a wrong one and cannot be justified. The reason is that if this presumption is accepted then automatically it would mean that Murabaha and loan have same features and characteristics only with the difference of their names. This will also put doubts in minds regarding Murabaha transaction. A well renowned scholar Muhammad Taqi Usmani has the same view he says

“The first and the most glaring mistake is to assume that Murabaha is a universal instrument which can be used for every type of financing offered by conventional interest based banks”<sup>175</sup>

At another place he says that Murabaha is not a loan given on interest. It is the sale of a commodity for a deferred price which includes an agreed profit added to the cost. These assertions will satisfy a reader that why the statement of Dr. Sami Hummd is seemed beyond logic that Murabaha is a substitute for bank loans.

The assumption, which is put forward by Some Muslim scholars that Murabaha is an alternative for conventional interest based loans, was a main reason for diversion from the real spirit of Murabaha. Because of this wrong assumption, over the years, a number of additional alterations have been added to the contract of Murabaha for the purpose to close it to an interest based loans as possible. For example it is allowed for the Islamic banks and other Islamic financial institutions to appoint a customer as their agent, payment to the original seller through customer, insurance of the Murabaha commodity, lack of immediate payment, payment on installment basis, binding nature of the promise, payment of the earnestness money to the bank by the customer and etc. Because of this tendency and intention the real spirit of Murabaha was badly deteriorated. The reason behind the tense criticism over Murabaha is also the outcome of such assumption.

As discussed earlier a number of additional alterations have been added to the contract of Murabaha for the purpose to close it to an interest based loan. These additional alterations really changed the spirit of Islamic commercial transactions particularly that of Murabaha. A well renowned jurist of the modern era Dr. Yousf Al-Qardavi says that some of the scholars made binding the customer's promise to purchase property (the commodity for which he made a request to the bank) from the bank at the mark-up credit price, once the bank buys the property to finance its ultimate purchase by the customer.<sup>176</sup> Although according to the well established principle of Islamic commercial law fulfilling a promise is a noble quality and it is advisable for the promisor to observe it, and its violation is reproachable, but it is neither mandatory nor enforceable through courts. This is the view of majority of the jurists such as Imam Abu Hanifa, Imam al-Shafi, Imam Ahmad and some of the Maliki jurists.<sup>177</sup> While very few of the jurists have the view that promise is mandatory and a promisor is under moral and legal obligation to fulfill that. This is the view of Ibni Shubrumah, Ibn-al-Arabi, Ibn-al-Shat and Imam Al-Ghazali.<sup>178</sup>

Keeping in view the above description it can be said that majority of jurists are not in favor of mandatory nature of promises.

Another alteration was made in the shape that the bank can appoint the customer as its agent. It means that he will negotiate the price and will purchase the property on the behalf of the bank. This new alteration and suggestion exposes the Murabaha transaction to so many doubts. If the customer's agency

is accepted, then it means that the Islamic bank just provides a loan to the customer practically while theoretically it enters into the contract of Murabaha with the customer. It is because of this reason some of the Islamic banks conclude such contract with customer in one setting in which all activities of the transaction are settled. A wise man can easily understand the reality of this contract. While according to the real concept of Murabaha, the bank must have to be engaged actively in the whole transaction and this real engagement requires a reasonable time.

After a critical study of all these objections it is suggested that customary agency must be discouraged if not prohibited, otherwise, there would be no difference between the Islamic banks legitimate return on Murabaha financing and the forbidden interest which the conventional banks earn from lending operation. It is a basic principle of Islamic jurisprudence that when a particular concept is applied then all its rules and regulations will be applied along with its real spirit which can not be ignored at any cost.

In short words it can be said that Islamic banks and other Islamic financial institutions do not implement Murabaha in its real spirit and relate it to the conventional loans by one or another way. The jurists should have to pay a serious attention to this problem; otherwise it will become very difficult to argue for the case of Islamic banking before the masses, especially before the non-Muslims who feel that it is nothing but a matter of documents only.

### **5.2.3 Murabaha and conventional loan**

One of the most frequent criticisms of Murabaha is that it is just like a conventional loan transaction which is dressed up as Murabaha under such situation only the word "interest" has been replaced by the word "profit". This criticism is looking a justified one because if the net result of Murabaha and conventional loan is carefully looked then it appears very clearly that they are the same. This same result puts clouds of doubts in the mind of an illiterate person to a great extent, and because of this reason he is reluctant to enter into any commercial transaction with the Islamic bank particularly in Murabaha. Besides this many institutions financing by way of Murabaha, determine their profit or markup on the basis of current interest rate, mostly using LIBOR (London inter-bank offered Rate) as the criterion. This fact fuels the criticism of formalism within the contemporary Murabaha. Similarly after the conclusion of contract of Murabaha, the customer does not pay the whole price of the commodity but pays it in installments. This fact is similar to the fact in conventional loan in which the debtor repays the loan to the bank in installments. This also puts a doubt in the mind of a vigilant Muslim regarding the transaction of Murabaha. However, there are some basic reasons behind such similarities which are mentioned above. It will be strived to discuss all these one by one for the purpose to brush out doubt from the minds of masses.

Firstly, the ideal instruments for financing in Islamic commercial law are Musharakha and Mudarabha, and when financing on the basis of these two instruments is not possible for one or another reason, then other instrument of financing like Murabaha, Ijarah, Salam, Istisan and etc are used.<sup>179</sup> It means that musharakha (equity financing) and Mudarabah (participation financing) have not been widely utilized under the contemporary Islamic finance system. This, by itself, explains why the substantive features of Islamic finance are mainly absent. On the other hand, according to Islamic commercial law Murabaha is basically not a mode of financing but a normal business activity. Because of this reason it is a foreign intruder into the classical financial order.

Keeping in view the above description, the argument of the people that contemporary Murabaha does not achieve the main objectives and spirit of Islamic financing is not a surprising one. It is seemed a valid point because as already said in the above lines that Murabaha is originally considered to be irrelevant to financing in Islam. This fact should be kept in the mind during the evaluation of contemporary Murabaha as an Islamic financing tool.

Secondly, if the contemporary Murabaha is studied and analyzed with depth, then a conclusion can be drawn easily that such mode of financing is based on a number of exceptional rules of shariha, such as Islamic credit sale. Because of this exception it appears that it is similar in nature to the conventional loan.

Thirdly, if the modern Islamic financial system is studied profoundly then it reveals that such system is mainly based on the opinion of minority of jurists. Such methodology is applied because of the reason to put the Islamic finance on the way of conventional finance. This assertion may be looked an awkward to someone but a reality must be faced. But it is also a matter of fact that If the opinions of the majority of jurists are followed then it would create difficulty for the modern Islamic financial institutions. After following their opinions a severe complexity will come to the field of Islamic financial system. The similar methodology has been followed by the Islamic financial institutions in the case of Murabaha. For example as it is said that majority of the Muslim jurists do not accept the binding nature of a promise.<sup>180</sup> According to their view a person cannot be compelled through the court of law to fulfill his promise while on the other hand a minority of the Muslim jurists (especially that of Maliki school of thought) have the view that promises are binding in nature and hence a promisor can be enforced through the court of law to fulfill his promise.<sup>181</sup>

But the assumption that if opinions of the Muslim jurists are followed, it will become difficult to run the Islamic financial system. if economic system of Islam is followed along with the rules and regulations prescribed by shariha for such system, then there would be no difficulty at all. For the purpose to achieve such goals a pure Islamic economic institutions must be established. Besides this there must be

an Islamic state which will fully support such economic institutions. But the problem is that there is neither such Islamic economic institutions and nor an Islamic state that supports such institutions.

#### **5.2.4 Rules and regulation for Murabaha**

As said earlier that Murabaha is a simple kind of sale transaction. So, all the conditions for a valid sale must be present in the contract of Murabaha. Here in this discussion, rules and regulations of Murabaha will be divided into two kinds First those rules will be presented which are described by sharaih for a sale transaction followed by those which are particularly related to the contract of Murabaha.

- **5.2.4.1 General Islamic rules for sale**

The general Islamic rules for sale are given below

**a) The ownership of object**

Islamic rules in respect of ownership of object of sales have been largely affected by the prohibition of Gharar. It is necessary for a valid sale that the subject matter must be owned by the seller or he will be an authorised agent for the sale of such commodity<sup>182</sup>. In other words it can be said that what is not owned by the seller or he is not authorised agent, can not be sold. This rule has been adopted by a number of jurisdictions in the Muslim world. For example, Article 466 of the Eruption Civil Law No.131 of 1948 expressly provides that

“When a person sells a definite and ascertained thing of which he is not the owner, the purchaser may demand the annulment of the sale”.<sup>183</sup>

It is because of this reason it is necessary for the Islamic banks and other Islamic financial institutions to acquire the ownership of an asset before reselling it under a contemporary Murabaha.

**b) The contract of sale must be instant and absolute**

A contingent or conditional sale is void according to the principles of Shariha; it means that a sale must be instant and absolute unless the usages and customs of trade, as an element of the transaction, require such condition. So, if a sale is attributed to a future date or a sale contingent on a future event is void.<sup>184</sup> It is because of this reason the classical jurists do not allow option in the contract of sale for more than three days.<sup>185</sup> So if the parties wish to affect a valid sale, they will have to affect it a fresh when the future date comes or the contingency actually occurs.<sup>186</sup> It is pertinent to mention that the recognition of usages and customs of trade within Islamic commercial law, even when it principles differ from the

Islamic rules of sale transaction, shows further flexibility and understanding of trade needs within the Islamic legal system.

### **c) Certain Price**

It is necessary for a valid sale that the price must be certain. Such certainty entails the price to be precisely fixed and determined at the time of contract. This condition is put for the purpose to remove any sort of ambiguity which would lead to a dispute.<sup>187</sup> Moreover, once the price is fixed, it cannot be amended at any time latter. An uncertain price is sufficient to render the contract invalid.

### **d) Permissibility of the commodity**

The commodity should be any thing in which transactions are permissible according to shariha. This means that it should be a pure substance ritually and legally clean. So wine, pig, intoxicants, blood and the carcasses of an animal are not valid object of sale according to the Muslaim's jurists.<sup>188</sup>

### **e) Delivery of the subject matter**

As said earlier that for a valid sale it is necessary that the subject matter must be owned by the seller. But this condition is not sufficient alone and it is also necessary for the seller to have possession of the commodity. Such possession may be actual or constructive. This rule can also be described in other words as that the seller must be able to deliver the commodity to the buyer. Such delivery again may be actual or constructive. The nature of transfer or delivery of possession of a property depends upon the nature of that property. Ibn Qudama, a renowned Hanbali jurist, describes the same concept by saying "the sale of those commodities which can not be delivered is prohibited e.g birds in the air, fish in the water, escaped horse and etc"<sup>189</sup> The argument for such rule is a tradition of the Holy Prophet (SM) in which he (SM) has prohibited the sale of foodstuffs before taking their possession. This rule is also based on reason because sometime a person will have the ownership of a property but he would be unable to deliver that.

### **f) Certainty of the subject matter**

It is also necessary for the validity of a sale transaction that the subject must be ascertained at the time of the contract. Such ascertainment can be done either by the practical examination of the property if it is present in the session of contract or through a full pledge description of it. According to ibni Qudama if the commodity is not ascertained then the sale will be a void one.<sup>190</sup> It is the view of majority of the jurist except Imam Shafi who does not allow sale by description and stipulate actual examination of the subject matter at the time of contract.<sup>191</sup> But this later view is not suitable for the contemporary commercial transaction. For the purpose to abolish any sort of ambiguity regarding the subject matter of contract, Islamic commercial law recognizes the concept of law of option. Because of this reason a buyer can reject the goods if they are not according to the descriptions mentioned in the contract.

- **5.2.4.2 Special rules for Murabaha**

**a. Disclosure of original price**

It is necessary for the validity of contract of Murabaha that Murabaha purchaser must have knowledge regarding the price paid by the Murabaha seller to the original seller. So, if the first price is unknown to the Murabaha purchaser then it is a sufficient ground for the invalidity of contract. The importance of this rule can be revealed from the fact that the knowledge regarding the first price must be in the session of contract and if the contracting parties leave the Majlis without such knowledge then transaction will be invalid even if they get knowledge after that.<sup>192</sup> It is to be noted that the importance of such rule is not only necessary in the contract of Murabaha but also in other sale transactions like Bai-al-Tawliya, Bai-al-Shirak and Bai-al-Wadiya.<sup>193</sup>

**b. Fixation of Profit**

It is necessary of the validity of contract of Murabaha that the profit must be known to the purchaser. Actually this rule is the outcome of previous rules and there is no need to mention it again because of the reason that if the original price is known to the Murabaha purchaser, then automatically he will get knowledge about the profit. This rule is also based on logic because profit is always considered as a part of the price and the price should be known to the parties.<sup>194</sup>

**c. Knowledge of the Exact Cost**

Murabaha is valid only where the exact cost of the commodity can be ascertained. But the question arises that what sort of expenses can be included in the cost price. According to well renowned jurist Mufti Muhammad Taqi Usmani, that all the expenses incurred by the seller in acquiring the commodity like freight, custom, duty, and etc, can be included in the cost price and the markup can be applied on the aggregate cost.<sup>195</sup> Besides this the insurance cost can be also included in the cost price of the commodity.<sup>196</sup>

The above description shows that if the exact cost cannot be ascertained, then the commodity cannot be sold on Murabaha basis, however, musawamaha can be applied in this case.

**d. Validity of the First Contract**

It is necessary for the validity of Murabaha transaction that the first contract with the original seller must be a valid contract.<sup>197</sup> So if the first contract is void then it leaves no ground for the validity of the second contract on the same commodity. The reason behind this rule is that Murabaha is resale of a commodity with the addition of profit and the irregular sale is not allowed with the stated price. It is allowed only with the legal value, i.e. the market price.<sup>198</sup>

### **5.2.5 Structure of Murabaha in the modern Islamic banking**

As said earlier that Islamic banks and other Islamic financial institutions use the transaction of Murabaha as an alternate to interest based loan provided by the conventional banks. Typically, there are three parties involved with the structure of Murabaha, namely, the Islamic bank or Islamic financial institution, the customer or client who reaches to the bank for seeking Murabaha finance and the original or seller from whom or which the Islamic bank purchases the commodity for the customer.

First of all, a client is required to place a request before the Islamic bank or any other financial institution to purchase a commodity for him on the basis of Murabaha. This request may be in the shape of words or a written script.<sup>199</sup> At this particular stage the financial institution determines the financial status of the client through different means. His financial liabilities to other financial institutions are also investigated. The bank is also very careful about the fact that whether the client's name is included in the black list or not.

There are two separate relations (contracts) in the Murabaha financing. The first relation (contract) is between the Islamic bank and original owner or seller of the commodity while the second relation (contract) is between the Islamic bank and its customer. Both these relations (contracts) should be independent of each other. In other words the transaction of Murabaha is only between the financial institution and the client. After placing a request by a customer to the Islamic bank, a general agreement is signed between them which is called Facility Agreement or Master Murabaha Agreement. In such agreement all those terms and conditions are described which must be followed by both the parties to the Murabaha transaction i.e nature of the securities, determination of the profit, time for repayment, nature of repayments, liabilities of the bank and the client under the transaction, mode of the purchase and etc.<sup>200</sup>

It is pertinent to mention that the Islamic banks and other Islamic financial institutions must have to follow the specification prescribed by the customer in the Master Murabaha Agreement. In such MMA the Islamic bank and the customer exchanges two promises where by the client promises that he will purchase the commodity from the Islamic bank when it acquires the ownership of the property along with its actual or constructive possession, while the financial institution promises that it will sell the commodity to the client after its acquisition. But it must be kept in the mind that the promise to buy (by the client) and the promise to sell (by the Islamic bank) should not be binding in nature. It is because of the reason as discussed earlier that according to the Muslim jurists, a promise creates only a moral obligation on the party who makes that promise.<sup>201</sup> He cannot be enforced to fulfill his promise. Obviously; such non-binding nature of promises under Islamic commercial law will prevent the Islamic banks and other Islamic financial institutions from advancing the capital. But Accounting and Auditing

organization for Islamic Financial Institution has a different approach towards the promise. According to it the promise to perform Master Murabaha Agreement should not be from both the sides but will be from one side.<sup>202</sup> The reason is that bilateral promise is prohibited as it amounts to a contract ad contract on non-existent things is prohibited by sharia. So such promise must be unilateral and will be always from the buyer side. It also says that it is not necessary that there should be always a promise and if the bank is satisfied that the clients will purchase the commodity after it acquires that then there is no need of promise. It is pertinent to mention that if there is a choice for both the parties and any one of it to rescind the contract then the promise may be bilateral.<sup>203</sup> After the stage of promise and before the actual contract, both the parties by mutual consent can change any clause of MMA because still it is not a contract.

Generally the Islamic bank purchases the Murabaha commodity from the original seller on a return basis for the purpose that if the purchaser does not buy the commodity then it will return it to the original seller. This khyar or option will be considered operative till to the actual contract between the Islamic bank and client.<sup>204</sup> The expenditures that occur in the preparation of Murabaha transaction must be borne by both the parties unless they agree otherwise. The customer can designate to the Islamic bank a particular seller. In this case it is the duty of the Islamic bank to buy commodity from that seller. In such a situation the Islamic bank can ask the customer to provide guarantee for the good performance of the seller designated by him if the original seller does not provide the commodity according to the specification, then in such case the customer will be liable. It is immaterial for this liability that whether the customer buys the commodity or not.

It is permissible for the Islamic bank to ask the customer to provide a security that he will buy the commodity. Such security can be used for different purposes e.g to ensure the purchasing power of the customer, to compensate the loss in case the customer does not purchase the commodity and etc. After the actual contract, the bank has no right to deduct anything from earnestness margin (security) but by mutual consent it can be regularized in the actual price of the commodity.<sup>205</sup> It is also permissible for the Islamic bank to take a portion of the price from the customer as an advance, and after the conclusion of the contract it will be included in the price. But if the customer refuses to purchase the commodity from the bank then the latter can deduct its actual loss from such advance payment. It is permissible but not preferable for the bank to keep the whole of advance payment in case of refusal of the customer to buy the commodity.<sup>206</sup> It is to be noted that the actual contract must take place when the Islamic bank takes the possession (which may be actual or constructive) and ownership from the real buyer.

It is an ideal situation in Murabaha that the Islamic banks and other Islamic financial institutions must have to be engaged in the practical purchase of the commodity and cannot make the customer as its agent exceptionally in some cases. It means that customary agency is not encouraged but not

prohibited. Before customer's appointment as an agent, the bank must have to observe some facts e.g whether the customer really wants to purchase the commodity or he just wants to get money from the bank, whether the commodity that he wants to purchase is already owned by him, whether his contract with the bank would amount to buyback transaction or not and etc.<sup>207</sup> Even after such observations, the Islamic bank must have to fulfill the following conditions after customer's appointment as an agent.

- a) The Islamic bank must have to pay the price of the commodity to the original seller directly.<sup>208</sup> It is for the purpose to remove ambiguity from the mind of an individual who considers Murabaha as a second name for interest based loan.
- b) In the bank draft the name of the seller must be mentioned. The banks now use this method. But in some cases the payment is made through transitional account of the buyer. It is nothing but just like the financing of a customer as the conventional banks are doing.

There are two types of risk and liability. One risk and liability is taken by the bank and the other is taken by the customer (client). The bank's liability and risks starts when it makes the customer as its agent. In such a situation there is no liability of the customer. Actually his liability starts after the actual transaction of Murabaha. It is to be noted that there must be some specified time between these two liabilities and risks. So if the commodity is destroyed before the actual transaction, then the bank will bear the losses and not the customer, but if after the contract some losses occur, then that must be borne by the customer.<sup>209</sup> All documents, deeds and contracts must be on the name of the bank and not of the customer. The reason is that the customer has no relation with the original seller. Upon the conclusion of an agency agreement, the client, on the behalf of the financial institution, purchases the item from the supplier. This contract is an actual sale contract whereby the ownership of the sold item is transferred to the financial institution. Here the possession may be actual or constructive. Moreover, according to Islamic commercial law, possession of the agent is the possession of the real person. It means that the bank or its agent is obliged to take the item purchased into possession. Otherwise it would not be permissible to resell it.<sup>210</sup> After the transfer of ownership to the financial institution, another and separate sale contract should be concluded by the client and financial institution.

After a profound study of Murabaha transaction a conclusion can be drawn that usually both first and second sale agreements are simultaneously concluded in order to rest the ownership with the financial institutions for a few minutes if not seconds. All these features supports the arguments of those people who have the view that Murabaha is nothing but only a second name for interest based loans.

### **5.2.6 Application of Murabaha to the agricultural sector**

The most important characteristic of Islamic financial system is that it presents a comprehensive system of financing which is based on asset backed commercial transactions. The conventional banks and other conventional financial institutions are dealing in money. They mostly advance loan on interest basis and that is their whole source of profit. Islamic financial system, on the other hand, does not follow the same way and it has a total different approach. It does not recognize money as a subject matter of trade, except in some special cases.<sup>211</sup> The philosophy which this system has at its back is that anything which has no intrinsic utility cannot become a subject matter of trade. While following such philosophy, the Islamic banks and other Islamic financial institutions always deal with illiquid assets unlike conventional banks.

It can be said with solid arguments that the transaction of Murabaha can be easily and effectively applied to the agricultural sector for the purpose to fulfill all the agricultural requirements of a farmer both for crop and non-crop sectors. These two sectors are quite different from each other and similar is the case of their financial requirements. The cash flow in these both sectors is also different to a great extent.

After a deep and careful study of Murabaha transaction, it is revealed that such mode of Islamic financial system is more beneficiary for the upper and middle class farmers for whom mostly, agriculture is a business and not a source of life. On the other hand, it is less beneficial for the lower class of farmers for whom agriculture is a source of life and a candle for the achievement of their ambitions. It is a fact, with solid reason, that agricultural is a source for these poor farmers to feed their families.

The above facts and description may be considered a fake or fallacy or myth especially by those people who are directly or indirectly related to the Islamic banks and other Islamic financial institutions. They may be blamed the researcher severely for this kind of approach and at the same time may be considered him a blind and ignorant person who does not know anything about the Islamic banks and their procedure sec. But our dilemma is not to accept any reality particularly that which is against our interest. It will be tried to prove those facts which are discussed in the above lines during the description of murabaha's implementation to the agricultural sector in the coming pages. Moreover, some suggestions will be putforward that will turn the Murabaha transition more and more beneficiary for the poor and indigent farmers whose help is the purpose of the present work.

Murabaha is a trade-based mode of financing which means to provide finance through trading of goods and commodities. In such modes the Islamic banks and other Islamic financial institutions act as traders and supplies goods on demand of the farmer (customer). While applying Murabaha to the agriculture sector for crop and non-crop activities, first it is necessary to determine the basic needs of the farmers especially of those who belong to the lower class and whose help is the real spirit of agriculture finance. In the beginning of work a tense difficulty was faced for the determination of such needs. The

“Guidelines on Islamic Financing for agriculture” was resorted first in this regard. After a profound study of the above said guideline, particular that part which is related to Murabaha financing, it was recognized that it is specially designed for the benefits of middle class and upper class farmers (who can be said landlords) and no attention had been paid to help out the poor farmers. The agricultural requirements given in such guideline were also thoroughly studied. None of those requirements, in the real sense, were the requirements of a poor farmer. Some objectionable points in the procedure mentioned there for Murabaha transaction, were also pointed which would be discussed later on. After this disappointment it is decided to have a visit to the farmers for the purpose to know about their real agricultural requirements and to fulfil them by applying Murabaha transaction.

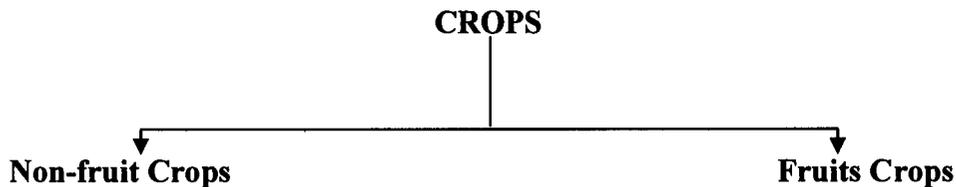
### **5.2.7 Application of Murabaha to local farming.poultry farming, Dairy farming, Fish farming**

- **5.2.7.1 Application of Murabaha to local farming**

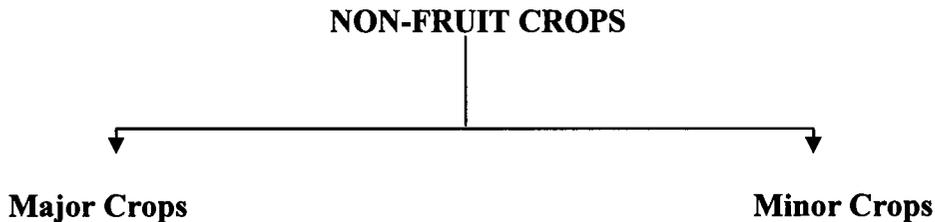
It is concluded , after a practical study, that the basic needs for the agricultural sector, particularly in the rural area, are the inputs for crop production e.g. seeds, fertilizers, insecticides, pesticides, herbicides, weedicides, manual sprayers and etc. in the researcher’s point of view this is the real area which must be facilitated by the way of agricultural finance. The reason is that if inputs are of superior quality then these will give best production both in term of quality and quantity. During the study, a conclusion is drawn with solid facts that most of the farmers, particularly in the rural area, buy seeds from the corresponding local market .Usually these seeds are of inferior quality. In addition to this the local traders do not provide such seeds on guarantee basic.

Murabaha can be effectively applied to agriculture sector both for crops and non-crops activities. So, it is suitable to discuss first agricultural needs of farmers in crop and non-crop sector. The crops which are required by a farmer are different in respect of time and place, because there are different times for the cultivation of different crops and similar is the case of place. However, here only those sorts of crops will be discussed which are almostly cultivated by the farmers of all regions (particularly in Pakistan).

Generally the crops can be divided into two classes i.e. non fruits crops and fruit crops as shown in the figure



The non-fruit crops are the most important from the perspective of farming. They can be further classified into two classes i.e. Major crops and minor crops as shown in the figure.



The major crops are those which are cultivated by almost majority of the farmers. They can be divided into four types i.e. Wheat, Paddy, Sugarcane, and Cotton while minor crops are more in numbers because they mostly depend upon on a particular environment i.e. Potato, Mustard Mung, Tobacco, Rape Seed, Maize (Hybrid), Maize (Local) Mash, Canola, Lentil, Soyabean, Groundnut, Sunflower and etc. As for as the fruits crops are concerned, they are also more in number i.e. pear, Dates, Loquat, Strawberry, Plum, Tea, Apple, Guava, Papaya, Pomegranate, Almond, Palm, Coconut, Olive Oil, Lichi, Walnut, Cherry, Persimen, Mano, Zizi, Apricot, Melon, Banana, Water Melon, Peach, Mush Melon, Citrus and etc.

All the above mentioned details show the basic needs of a farmer. Besides all these, he is also in need of some agricultural equipments and implements i.e. rake, trowel, Shovel, spade, Fork, hoe, Hand Fork, Wheel Barrow, Watering Can. Besides this, a transport financing can also be helpful for a lower class farmer e.g. Motorcycle, Cycle and etc.

During practical study of agricultural sector, it is concluded that agricultural needs of lower class of farmer and middle class of farmers are totally different from each other and because of this reason their agricultural needs would be discussed separately. As for as the middle class of farmers are concerned, they have similar needs as those of lower class of farmers as for as the crops are concerned, but they have different requirements of agricultural implements and equipments. The reason is that a lower class farmer who is unable to purchase for him the basic inputs for crop production then how he can purchase the expensive agricultural equipments and implements. The basic agricultural equipments and implements that a middle class of farmers need, are threshers, power tillers, power & boom sprayers, plough, cultivators, riggers, drills, motivators, draggers, cotton pickers, saw machines for crate making, press

machine for wheat straw and dry fodder, chisel ploughs, potato planter, sugar can planter, rice transplanter, self propelled reaper for harvesting wheat and rice crops.<sup>212</sup>

- **5.2.7.2 Application of Murabaha to poultry farming**

For the poultry farming Murabaha financing can be used for the purpose to purchase different commodities like feed, birds, feed raw material, vaccination, vitamin and other medication for poultry birds, saw dust wood, coal, water filter cartages, utensils for poultry bird feed and etc.

- **5.2.7.3 Application of Murabaha to Dairy farming**

As for as dairy farming is concerned, Murabaha transaction can be used for the purchase of animal fodder and feeds, feed grinders, toaks, feed mixing machines, feed or mild container, vaccinations, vitamins, and other medications for animals, utensils for animal feedings, calf feeders, berngles, rope, iron chains and etc.

- **5.2.7.4 Application of Murabaha to Fish farming**

As for as the fish farming is concerned Murabaha financing can be equally applied to it for the purchase to purchase fuel, ration and ice, packing and cleaning items for export of fish, consumable items for curing and drying. Procurement of insulated boxes, purchase of plastic fish crates for packing of fish, plastic baskets for carrying of fish and etc.

## **5.2.8 Procedure for agricultural Murabaha in Islamic banking**

In the previous pages different needs of the agricultural sector for both crops and non crops sectors are thoroughly discussed. Now in the coming pages, it is endeavoured to discuss the practical implementation of Murabaha to the agriculture sector to fulfill these entire requirements by the best way. It is tried to apply all rules and regulations of such contract in their real spirit along with the basic philosophy of Islamic financial system. The complexity will be removed as much possible from the procedure without any damage to its qualitative structure. Further the existing procedure followed by the contemporary Islamic banks and other Islamic financial institutions will be critically analyzed along with the necessary suggestions, where they need.

Before embarking on the procedure followed by the Islamic banks and other Islamic financial institution while applying Murabaha financing to the agricultural sector, it is necessary to define banking Murabaha with a special reference to the agriculture sector. In this regard it can be defined as “It is a contract wherein the Islamic bank or Islamic financial institution, upon the request of a farmer (customer or client), purchases the agricultural commodity from a third party, usually a supplier or vendor, and resells the same to the farmer either against immediate payment (Bai-al-Ajil) or on deferred payment

(Bai-al-mojil) basis". This definition looks very comprehensive in nature as it addresses all those issues which are directly or indirectly involved in the Murabaha transaction during its application to the agriculture sector.

- **5.2.8.1 Master Murabaha Agreement in Agricultural finance**

For the purpose to enter into the transaction of Murabaha, the farmer will resort to the bank to satisfy a number of financing needs for the agricultural sector. Before anything else, the Islamic bank and the farmer must have to enter into Master Murabaha Agreement (MMA). Some of the scholar also called it Master Murabaha Facility Agreement (MFA) or General Agreement.<sup>213</sup> But the question arises that what would be the contents of such agreement. It will include different details about the contract e.g. cost price of the agricultural commodity, profit, quality and quantity specification and other characteristics of the goods required by the farmer, the mode of payment (immediate or deferred), the nature of delivery, promise from the bank that it will purchase the required commodity for the farmer, promise from the farmer that after acquiring the asset he will purchase it from the bank and etc. It is pertinent to mention that both the parties by mutual consent can bring any change in the details of Master Murabaha Facility Agreement before the actual contract.<sup>214</sup>

- **5.2.8.2 Feasibility report for agricultural Murabaha**

It is a matter of fact that agriculture works in an environment of its own. This sector is prone to many natural risks e.g. drought, floods, hail storm, earthquakes, mudslides and a multitude of other mishaps.<sup>215</sup> The Islamic banks and other Islamic financial institution must have to keep all these risks in the mind before investing in this sector. The purpose behind this discussion is that the Islamic banks and other Islamic financial intuitions must have to study profoundly the feasibility of the specification required by the farmer. After the study, if the Islamic bank is satisfied that it is a reasonable margin of profit, then it will inform the farmer about the original price of the goods (cost price) along with the profit margin. It is to be noted that the Islamic banks and other Islamic financial institutions must have to take a reasonable margin of profit from a farmer. But it is pertinent to mention that such margin of profit must be lower than the margin charged from other customers other than farmers. The reason is that the farmers generally belong to the lower class and for them agriculture is not a business but a source of life. Being a legal personality, the Islamic bank must have to help out a poor farmer in the fulfillment of his agricultural requirements. This concept is based on the philosophy in which a Muslim is asked to help out another Muslim in his dire needs. Similarly the idea can also be supported on the concept that Islamic commercial law is based on cooperation and prosperity of the society. A well renowned scholar Mufti Muhammad Taqi Usmani lays down the same idea while saying

“The Islamic banks should develop their own culture. Obviously Islam is not restricted to the banking transaction. It is a set of rules and principles governing the whole human life. Therefore, for being Islamic, it is not sufficient to design the transactions on Islamic principle. It is also necessary that the outlook of the institution and its staff reflects the Islamic identity, quite distinguished from the conventional institutions.”<sup>216</sup>

While charging a reasonable profit from a farmer, there is an indirect benefit also from the future perspective of business, because after purchasing a commodity with a reasonable price; a poor farmer will continue his resort to the Islamic bank for any mode of Islamic financing. It is also possible that he will start to deposit his saving with the Islamic bank. If the Islamic bank intends to increase its business in the agricultural sector, particularly in the rural area, then it must have to ignore too much percent profit and keep its eagle eyes on future business on broad basis. Such tactics must be used by the Islamic bank for its bright future. After the feasibility report, the Islamic bank will put forward some terms and conditions to the farmer and if the latter accepts, then further steps will be initiated for the Murabaha transaction. It is pertinent to mention that the Islamic banks and other Islamic financial institutions must have to show flexibility to a great extent while framing such terms and conditions.

### **5.2.9 The concept of customer’s agency and its application to the agricultural sector**

Banking Murabaha consists of a bunch of contracts. Among such contracts one is the contract of agency.<sup>217</sup> It must be kept in the mind that agency contract is not a condition for Murabaha transaction and it will be an ideal situation if the Islamic bank purchases the commodity by itself from the supplier. But usually the Islamic banks and other Islamic financial institutions have no time to go to the market directly and purchase the Murabaha commodity. Because of this reason they normally appoint an agent. But there is another reason also for the appointment of an agent and that it has no experience to identify the asset and negotiate an efficient price.<sup>218</sup>

- **5.2.9.1 A realistic approach to the customer’s agency in the agricultural finance**

Customer’s agency is not advisable according to Accounting and Auditing Organization for Islamic financial institution. it describes

“The original principle is that the institution itself purchases the item directly from the supplier. However, it is permissible for it to carry out the purchase by authorizing an agent, other than the purchase ordered, to make the purchase, and the customer should not be appointed to act as an agent except in a situation of

dire need. Further more the agent must not sell the item to himself. Rather, the institution must first acquire the title of the item and then sell it to the agent".<sup>219</sup>

The above statement shows that customer's agency is not prohibited but it is not desired also. So, the Islamic banks and other Islamic financial institutions can appoint a farmer as their agent but with the condition that they must pay the price of the commodity to the supplier directly and will also obtain documents that confirm sale transaction.

As for as the agricultural sector is concerned, the Islamic banks and other Islamic financial institutions must have to appoint a farmer as their agent for the purpose to buy the commodity required by a farmer for the agricultural sector. The reason is that agricultural financing is totally a new experience for the Islamic bank and it does not know anything how to identify the required agricultural commodity. In such a situation it must have to appoint the farmer (who is also a customer) as its agent to purchase the commodity. It will be beneficiary both for the Islamic bank and the farmer. It will be beneficiary for the Islamic bank in the sense that it will acquire the right commodity without its active participation and hence would save its time and cost. It will be beneficiary for the farmer in the sense that he will receive charges for his agency from the Islamic bank and automatically it will reduce price of the commodity for him. Secondly he will acquire the commodity according to his own choice .

But as said earlier that customer's agency is not desirable although it is not prohibited. Keeping this fact in the mind, another view can be presented in the shape of following suggestion. The Islamic banks and other Islamic financial institution can appoint another farmer other than the farmer who requested to the Islamic bank for the purchase of the commodity. Such farmer will have a lot of experience and it will be easy for him to identify the asset and negotiate an efficient price on the behalf of the Islamic bank. The Islamic bank can appoint such customer for a series of Murabaha transactions. The appointment of such farmer other than the customer is the best solution in the sense that the bank will get rid from the headache to buy the commodity by itself, and, secondly it will also avoid customer's agency which is not advisable from the perspective of shariha. The agency agreement between the farmer and the bank needs to be signed by both the parties. The period for which such agency will be effective must be mentioned in the contract. It is the duty of Islamic banks and other Islamic financial institutions to provide funds for the purchase of the commodity required by the farmer. The farmer also has a duty to define a comprehensive list of assets and commodities that he, as an agent of the banks, may procure during the course of business from time to time.

According to Islamic commercial law, there are two kinds of agency i.e. the general agency and particular agency. The details of both these will come in a separate discussion. However, in the banking sector both these are called global agency (where the purchase of commodity is not of consistent nature)

and specific agency (when the purchase of commodity is of consistent nature). The Islamic bank and the farmer can enter into both these kinds of agency agreement.

There may be another approach to the use of agency by Islamic banks and other Islamic financial institutions. It is possible and suitable for the Islamic bank to enter into specific agency agreement with the farmer who resorted to the bank as a client to purchase the required agriculture commodity. On the other hand, it is also suitable for the Islamic bank to enter into global agency agreement with such farmer (customer). However, such global agency agreement would be more effective if it is concluded between the Islamic bank or other Islamic financial institutions and a farmer (other than the customer) particularly if he belongs to the rural areas. This will not only develop the agriculture sector in the rural areas but will also help the Islamic bank to expand its business effectively in such areas.

- **5.2.9.2 Sahriah's position on remuneration for a farmer as an agent of the Islamic bank**

It is the established principle of Islamic commercial law that an agent can charge his principal or master for agency and also have an option to remit the same. It means that he can take service charges from his principal. According to well renowned contemporary jurist Dr. Wahba-al-Zuhaili

“It is permissible for an agent to take charges from his principal and he can also do the same (agency) without any consideration”.<sup>220</sup>

Ibni-Qudama a Hambali jurist says

“If the agency is without any consideration, then it will be just like a charity from the agent side, but if the agency is for some consideration, then it will be considered as Ijarah (hiring of services)”<sup>221</sup>

But it is a surprising fact, which cannot be ignored by any person who is conversant with the principles of Islamic commercial law, that why the contemporary jurist, particularly those who are directly or indirectly related to the modern Islamic banks or any other Islamic financial institutions, do not pay any attention to this basic principle of Islamic commercial law that an agent can charge his principal for agency. Books of many contemporary scholars on Islamic Commercial law and even Shariha Standards are searched out for the purpose to find this concept, but it is not found anywhere. They always talk about the customer's agency nearly in each and every mode of Islamic financing, its legality, rules and regulation from the Shariha perspective but, however, they ignore, intentionally or unintentionally, the fact that an agent can also take service charges on the customary agency from the Islamic bank. It is a dilemma that why we do not apply a particular shariha' concept (Here concept means agency along with its full pledge rules and here one of the rules is that an agent can take service charges)

and philosophy. The Islamic bank, if it wants to work ideally according to shariha's principle, must have to pay certain consideration for the customary agency to the customer.

As for as the agricultural financing is concerned, the Islamic bank must have to pay a certain consideration to the farmer both in global agency agreement and specific agency agreement. A question may come to the mind of a reader that why such a tense emphasis is given on the suggestion that the Islamic banks must have to pay for customary agency especially to a farmer who approaches to the bank for the purpose to purchase for him a required agricultural commodity, and the latter appoints him as its agent. The answer is very simple and that is that most of the farmers belong to the lower class and agriculture is a source of life them. So, it is the moral obligation of the Islamic banks to help out them. Moreover if it is allowed by Shariah then why it should be avoided?

A critical minded reader may put a question that if it is allowed in Shariah to give remuneration to a farmer as an agent of the bank, then automatically it will be included in the cost price of the commodity in which case the farmer have to pay more in the shape of price, and, if it is so then there is no benefit of this theory. The answer to this question is very simple in nature. It is to be noted that only direct expenses can be included in the cost price and because of this reason the shariha standards prohibits the inclusion of employee's salary in the cost price.<sup>222</sup> Similarly remuneration of an agent is not a direct expense, then how it can be included in the cost price? The shariha standards says clearly while talking about the conclusion of Murabaha transaction

“The institution is not entitled to include in the base cost of the item for the purpose of calculating the Murabaha price, any amounts other than the direct expenses that are paid to third party. It is not permissible for example, for the institution to add to the cost of the item payment made to its own staff for their work and the like”.<sup>223</sup>

After a profound study of Murabaha transactions practiced by different Islamic banks and other Islamic financial institution it came to the knowledge that they considered and referred Murabaha not a regular sale but a promise to buy or sell something. If it is so, then it means that they do not enter into an actual contract of Murabaha transaction with a customer or client because promise to buy or sell is not a contract according to the well established principle of Islamic commercial law. In such a situation if the farmer changes his mind and retract from his promise then he cannot be enforced by any legal means to fulfill his promise. So, the level of risk is therefore greater for the islamci banks and other islamci financial institutions in the case

of promissory document to buy or sell as compared to the risk involved in the actual contract. The Islamic banks must be careful about this fact while buying an agricultural commodity for a farmer by the way of Murabaha transaction. Dr. Muhammad A. Gulaid has the same view as he says

“In some banks nomenclature, this (Murabaha) is referred to as a promise to buy / sell document rather than a contract. As such, this is not synonymous with a contract in the sense that a promise to buy or sell cannot be enforced through the court of law as the case is with a contract”.<sup>224</sup>

### **5.2.10 The concept of urbon and Hamesh Jediya in agricultural finance**

The Islamic bank can ask the farmer to pay a sum of money as Hamish Jiddayah (earnest money) which will ensure his financial capacity. The institution will also be able to deduct from earnest money its actual damages suffered by it because of breach of the contract by the farmer. It is to be noted that Hamish Jiddiya is different from urban (advance payment) in the sense that the previous is taken before the contractual stage while the latte is paid after the actual contract of sale.<sup>225</sup> But the question comes to the mind that whether demand for such security before the Murabaha transaction is permissible in Shariah or not? According to Imam kasani it is permissible for a creditor to ask a debtor for pledge property before the loan transaction.<sup>226</sup> Dr. Mulan Ejaz Ahmad Samdani has the same view in this regard.<sup>227</sup>

As for as the agricultural finance is concerned it seems very appropriate to demand from a farmer for security before entering into the Agricultural Murabaha. The reason is that such sector is prone to many risks i.e incidence of drought, floods, hail storm, earthquake, mud slides and etc. All these factors needed to be taken into the decision making process.<sup>228</sup> Because of these factors it is necessary to demand from a farmer a security; otherwise, in case of any mishaps if he is not in position to pay the price of the agricultural commodity, then it will be extremely a difficult job for the bank to recover its liquidity.

As for as the urbun is concerned, it is not seemed suitable to be taken in the agricultural murabaha. The reason is, as already said that most of the farmers belong to the lower class and they are unable to buy the basic agricultural needs in the beginning of a season i.e. seeds, fertilizers, herbicides, weedicides, manual sprayers and etc, so how they can pay urban (advance payment) in the Murabaha transaction? However, being a permissible concept, urban can be taken from the middle and upper class of farmers. It is advisable for the Islamic banks and other Islamic financial institutions to take the price on installment basis from the lower class of farmers.

As for as the concept of Hamish Jeddiah is concerned, some strict observations can be put against it. Instead of the fact that a resolution has been issued by the International Islamic Fiqh Academy in the connection of its legality<sup>229</sup> on the basis of Hadith in which Umar Ibn al-Khattab, may Allah be pleased with him, used to obtain the earnest money to secure performance. If we resorting to the books of classical jurists, then such terminology will be never found. This is a new term especially introduced by those contemporary scholars who are directly or indirectly related to Islamic banks. The idea is just introduced for the purpose to protect the bank's interest. If this idea is jurisprudentially analyzed then it

can be easily concluded that it is not an essential element of the sale and because of this reason the classical jurists never discussed it even with a single glance.

As for as the agricultural finance is concerned, the application of Hamish Jeddiah does not look a logical one. The reason is that the purpose of agricultural finance is to cooperate and help out the farmer by providing them the basic agricultural needs and requirements. So, taking of Hamish Jeddiah from a poor farmer, who is unable to buy for himself the basic agricultural requirements in the beginning of a season, is looking against the basic philosophy of agricultural finance. By taking Hamish Jeddiah, more burdens are put on his weak shoulders. After a practical study of the farming sector, particularly of rural areas, a fact was found that most of the farmers belong to very poor families and agricultural is a source of life for them. So, it is the obligation of the Islamic financial institutions, if they are really Islamic, to help out such poor farmer rather than to increase their burden. But on the other hand interest of the Islamic banks should also be kept in the mind. There must be some alternatives in the Islamic financial system for the safeguard of their interest; otherwise, they would not be in position to compete the conventional banks. The basic principle of Islamic commercial law that commercial promises are binding in nature can serve this purpose.<sup>230</sup> For example if the farmer retracts from the promise and breaches it, the aggrieved Islamic bank can easily resort to the court of law for the purpose to receive its actual lost from him. It is the duty of Islamic state to establish an effective judicial system which can play its rule in the development of Islamic financial system.

#### **5.2.11 Rules for securities in agricultural finance**

The Islamic banks and other Islamic financial institutions can recover its damages through securities received by them in the shape of guarantees from a farmer. Taking of such guarantees from a farmer by the Islamic bank to ensure the payment of price is according to the principles of sharia because in a sale contract the price becomes debt on the buyer, and taking securities for the protection of debt is permitted by shariha.<sup>231</sup> Dr. Mulana Ejaz Ahmad Samdani has the view that an Islamic bank can even demand security before the actual contract.<sup>232</sup> So, the Islamic banks and other Islamic financial institutions may ask the farmer to provide lawful security in the contract of Murabaha transaction which may be in the shape of a third party guarantee or the pledge of investment account of the farmer or mortgage of his immovable property or even in the shape of subject of Murabaha.<sup>233</sup> But the best among these is to receive guarantee in the shape of mortgage of a property (immovable property) owned by a farmer. Another method to protect the banks interest is that it can postpone the registration of the agricultural asset on the farmer's name as a guarantee of the full payment of the selling price.

While keeping in view the above discussion it can be claimed that if the Islamic banks and other Islamic financial institutions apply the Islamic law of guarantees in its real spirit and philosophy, then they can effectively protect their interest without any doubt. But such goal cannot be achieved without active support from the concerned Islamic state.

### **5.2.12 Possession of the agricultural commodity by the Islamic bank**

As said earlier that Islamic bank cannot sell the commodity by the way of Murabaha transaction before taking its possession. Such possession may be actual or constructive.<sup>234</sup> The actual and constructive possession depends on the nature of property. It is an ideal situation if the bank acquires the commodity by itself. But if it authorizes the farmer as its agent, then it is necessary to separate the two liabilities as mentioned earlier. In most of the cases, the Islamic bank takes the constructive possession of the property. Before the actual contract of Murabaha, all documents and contracts concerned with the execution of the sale of the Murabaha commodity must be on the name of the Islamic bank and not of the farmer, even if the latter acts as the Islamic bank's agent. In such a situation the payment will be paid by the Islamic bank directly to the supplier (agricultural dealer). Generally the Islamic banks and other Islamic financial institutions are acquired the commodity from the supplier on discount basis. It is because of the reason that the banking institutions are the regular customers of the suppliers. They while dealing with such institution is satisfactory in term of payment of price and because of this reason they do not treat the latter as ordinary customers. A concession is usually given to them. If the concession or discount is given to the Islamic bank, then it will be passed on to the farmer. Usually the government gives subsidy on the basic agricultural requirements especially those which are related to crops activities i.e. seeds, herbicides, pesticides, weedicides, manual sprayers and etc. so a farmer must be vigilant of this fact while entering into Murabaha transaction with the Islamic bank.

### **5.2.13 Advantages of banking Murabaha for a farmer**

It is suggested, which may not be correct to a great extent that it is better for a farmer to buy a commodity from the Islamic bank and he has to avoid purchase from the local market. There are three reasons for this i.e.

- First                    He will acquire the commodity of good quality but if he buys the same from the local market he may face deception.
- Secondly            If he buys the agricultural commodity from an Islamic bank then he has to pay the price in installments but if he purchases it from the local market then he has to pay the price on spot.

Thirdly In case of purchasing commodity from the Islamic bank, the farmer will receive two discounts i.e. discount received by the Islamic bank from the original supplier, and discount in the shape of subsidy given by the government on that commodity.

After acquiring the required commodity from the supplier, the Islamic bank and the farmer will enter into Murabaha transaction and the ownership will be transferred to the latter.

After a deep study of Murabaha transaction, it is revealed that it is the most suitable mode of Islamic financial system to help out the poor farmers because it can be applied to the said field. The following description will prove this fact. As far as the price is concerned in Murabaha transaction, it is not necessary that it must be paid on the spot. The Islamic bank and the farmer may agree that it will be paid on the spot or will be paid in installments. In such a situation the Murabaha transaction is called Bai-al-Murabaha Lil Amir Bi al Shira. But there is another variant of Murabaha transaction in which the Islamic bank and the farmer agree that the delivery of Murabaha goods will be made on the spot or immediately after the contract while payment of the price will be postponed to a latter date. This variant of Murabaha is called Bai-al-Ajil or Bai Bi al Thaman Al Ajil or simply Bia-al-Muajil (deferred sale).<sup>235</sup>

The above division is based on the time of payment in a Murabaha transaction while there is another division which depends that how payment and price are negotiated between the Islamic bank or Islamic financial institution and a farmer. For example Bai-al-Tawliya in which the Islamic bank does not charge any profit from the farmer and only receives from the latter the cost price of the commodity. There is another version of Murabaha transaction which is called Bai-al-Wadiah in which the Islamic bank sells the commodity to the farmer at a price less than the cost price paid by the Islamic bank to the original supplier. But it is to be noted the Islamic banks and other Islamic financial institutions do not use these two latter variants of Murabaha in a normal situation. But under certain circumstances they are compelled to resort to such transaction for one reason or another.<sup>236</sup>

## **5.3 Salam**

### **5.3.1 Introduction**

According to a well established principle of Islamic commercial law, a commodity which is going to be sold must be present at the time of contract otherwise it will be considered a void contract .If such principal is strictly followed then so many problems will arise in the smooth running of commercial activities. For example in this industrial era there are so many industrial contracts in which the subject matter is not in existence at the time when the contract is concluded .Even at the time of the Holy Prophet (saw), the inevitable nature of such contract was accepted and because of this reason it was validated by him as an exception to the general rule

The contract of Salam has a vital importance in Agricultural finance. If the Arabian history is studied then it reveals that the basic purpose of such contract was to meet the needs of small farmers who were in tense need of money to grow the crops. It serves the same purpose in the modern age. Most of farmers belong to poor class and consequently they are unable to buy basic agriculture inputs like seeds, fertilizers, weedicides, herbicides, insecticides, manual sprayers and some important agricultural tools. Being a Muslim farmer ,he is prohibited by shariah to get loan from any person, conventional bank or any other conventional financial institution on interest basis. This fact is also responsible for a rapid and sharp increase in the demand curve of salam for agricultural sector .in the modern era some industries like flour mills, sugar can and etc are in need of a great quantity of wheat, sugar can and etc respectively. Similarly the formers are also in need of money in the beginning of the season to buy basic agriculture inputs and to feed their family till to next harvest. Under such circumstances, the contract of Salam becomes indispensable for both the parties

### **5.3.2 Meaning of Salam**

Before embarking on the discussion of Salam, it deems fit to define it literally and technically, along with its legal justification. The word "Salam" is Arabic word which means "to advance". The literal meaning of Salam has been incorporated in its technical meaning also. Different classical schools of thought define it differently. According to Hanafi school of thought "it is a sale in which the price is paid on immediate basis while delivery of the commodity is delayed"<sup>237</sup> According Hanbali school of thought"it is that kind of sale in which a present commodity is sold for the deferred price related to the liability of the buyer"<sup>238</sup> According to Imam Shawkani"it is the sale of an ascertained property with a delayed price"<sup>239</sup> .According to Dr.Wahba-al-Zuhaili"it is the sale of an ascertained commodity with debt"<sup>240</sup>Dr Muhammad A. Gulaid defined Salam as "it is a contract in which the payment is made in advance while the delivery of the goods may be postponed"<sup>241</sup> A very technical definition is given by Imran Ahsan Khan

Nyazee. He says “it is a contract in which “Dayn” is made on the spot while the “Ayn” is delayed”.<sup>242</sup> If we are looking to this definition then it describes the principles laid down by Imam Sharksī in his book “Al-mabsoot” that price becomes a debt which must be paid. According to another contemporary scholar Mufti Muhammad Taqi Usmani, “it is a sale whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at spot”.<sup>243</sup>

### **5.3.3 Legal justification of Salam**

The history of Arabia shows that Salam was prevalent in the pre-Islamic age. Most of the Madina’s people were practicing such mode. When the Holy Prophet (Saws) migrated to Madina, he allowed the Salam transaction with some conditions. So, the concept of Salam is inherited by Islam. Some of the jurists derive the legality of Salam from the verse of the Holy Quran “O ye who believe when you contract a debt for a fixed term, record it in writing”.<sup>244</sup> The legality of Salam can also be proved from the Hadith of the Holy Prophet (S.a.w.s) which says that whoever wishes to enter into a contract of Salam, he must effect the Salam according to the specified measure and the specified weight and the specified date of delivery”.<sup>245</sup> The hadith is reported by all six famous books of Hadith.<sup>246</sup> The contract of Salam opposes the basic principle of Islamic commercial law which is the sale of a thing that does not exist. Besides it also opposes another rule that of the prohibition of riba.<sup>247</sup>

Imran Ahsan Khan Nyazee, a contemporary scholar, says that the rule of prohibition of riba prevents the sale of wheat for barley, unless they are exchanged at once .it is for this reason that the jurists state that the contract of Salam is permitted as an exemption to the general rule. Actually the respected teacher has the view that it is not necessary that a price should be always in the form of cash and it may be in the form of another commodity also. So, a bag of wheat may be paid in advance for two bags of barley to be delivered on a fixed date in the coming season.<sup>248</sup>

### **5.3.4 Historical background of Salam**

As said earlier that the contract of Salam was prevalent in the pre-Islamic age which means before the advent of the Holy Prophet (sm). So it means that Salam was known at the time of the Holy Prophet (sm). It was looked as a mean of finance. The basic purpose of such contract was to meet the needs of small farmers of Arabian who were in tense need of money to grow their crops. It was also used by the farmers to feed their family up to the time of harvest. After the prohibition of riba, the demand for the contract of Salam increased up to the great extent because the people could not take loan on interest basis. Therefore, it was allowed for them to sell the agricultural products on advance. Similarly, the trader of Arabia used to export goods to other places and to import other goods to their homeland. They needed money to undertake this type of business. They could not borrow from the users after the prohibition of

riba. It was, therefore, allowed for them that they could sell goods in advance. After recovering their cash price, they could easily undertake the aforesaid business.

The above discussion shows that Salam was existing before the advent of the Holy Prophet (sm), and later on he recommended this contract. The people of Madina were using such contract frequently. So, the concept of Salam has been inherited by Islam.

### **5.3.5 Speciality of the contract of Salam**

The contract of Salam is a special contract of sale in two senses .firstly it allows the sale of a commodity that does not in existence. But this perception is not true and the contract of Salam is not the sale of a commodity which does not exist but it is actually the sale of a commodity which is not available at the time of a contract.it is because of this reason Ibni Qudama, a Hanbali jurist says that the salam commodity will be generally available in its place.<sup>249</sup> Secondly, it is a special contract in the sense that it is equally beneficiary for the seller and buyer. For the seller in the sense that he gets money in advance and fulfill his financial needs, otherwise he will wait for the time of harvest. For the buyer, it is beneficiary in the sense that he gets the required commodity at a cheaper price because Salam sale is usually cheaper than a cash or normal sale.Because of all these peculiar characteristics it is tru to say that Salam sale is a special one.

### **5.3.6 Conditions for Salam**

The contract of Salam is an exception to two general rules i.e first it is the sale of a thing which is not in existence at the time of contract and the second is that of the prohibition of riba. Because of these reasons some strict conditions are prescribed by Shariah for its validity which can be summarized as follow.

a. It is necessary for the validity of Salam that the buyer pays the price of the object in full to the seller in advance.<sup>250</sup> It is because that the basic wisdom behind the permissibility of Salam is to fulfill the instant needs of the seller. So if it is not paid to him in full, then the basic purpose of the transaction will be defeated.<sup>251</sup> Secondly, if the price is not paid in full then it will be the sale of debt for debt which is strictly prohibited by the Holy Prophet (sm).<sup>252</sup> So, all the jurists are unanimous on the point that full price should be paid by the purchaser.<sup>253</sup> Similarly not only the full price should be paid but it should also be made immediately during the session of the contract. However, Imam Malik, well renowned jurist, is of the view that a seller may give concession of two or three days, but this concession should not form part of the agreement.<sup>254</sup>

b. The Salam contract can be affected only on fungible goods i.e. the goods which are weighable, measurable and accountable by number.<sup>255</sup> It means that Salam can not be affected on non fungible things

such as precious stone. So precious stone cannot be sold on the basis of Salam. Another reason for this prohibition is that precious stones are normally different from each other in its quality or in its size or weight and because of this reason their exact specification is not generally possible.<sup>256</sup>

c. Using debt owed to the purchaser by the seller as a price of the Salam commodity is prohibited.<sup>257</sup> It is because of some reasons. Firstly, it will violate the principle that the price must be received by the seller in advance and secondly, and more importantly, it is exchange of debt for debt which is prohibited by the Hadith of the Holy Prophet (sm) Ubadadha Ibni al Samit (Allah be pleased with him) reported Allah's messenger (May peace be upon him) as saying Gold is to be paid for gold, silver by silver, wheat by wheat, barley for barley, dates for dates, and salt by salt, like for like and equal for equal, payment being made hand to hand if these classes differ, then sell as you wish if payment is made hand to hand. In this regard Imam Ibni Qudama says such contract is not permissible in Ribavi commodities.<sup>258</sup> So, an outstanding loan due on the seller cannot be fully or partially fixed as price nor loan outstanding on a third party can be transferred to the seller in future adjustment towards price.<sup>259</sup>

d. A full description of the Salam object should be given for the purpose to remove any sort of ambiguity which may lead to a dispute. It means that the genus, species, clone, country of origin and all other minute description of the commodity should be given. According to Imran Ahsan Khan Nyazee even the genus of payment must be specified, i.e. whether it is being made in dirhums or some other currency.<sup>260</sup> So, according to him not only the commodity should be known from all aspects but the genus of payment for such commodity should also be also known. It is for the purpose to avoid any expected involvement of riba

e. Salam cannot be affected on a particular commodity or on a product of a particular field or formative or garden, because it is possible that crop of that farm or fruit and leaves of that tree is destroyed before delivery. According to Imam Sharakhsi if it is conditioned in the contract that the salam commodity must be a product of a particular village or a particular field then such contract will be considered invalid.<sup>261</sup> This rule is laid down by the scholars for the purpose to remove uncertainty about the delivery of the Salam commodity.

f. According to Hanafi school of thought the object of Salam must be in existence at the time of the contract. They have the view that the commodity of Salam must be available in the market right from the date of the contract up to the time of delivery.<sup>262</sup> It means that if the commodity is not available in the market at the time of the contract, Salam cannot be affected in respect of that commodity, even though it is expected that it will be available in the market at the date of delivery.

Actually, the Hanafi School of thought gives emphasis on the fact that the property should be in existence at the time of the contract, although it may not be available in the session of the contract. Actually they give emphasis on this rule for the purpose to act upon the tradition of the Holy Prophet

(SW) in which he prohibited the sale of non-existent things. According to Imam Malik, Imam Shafi and Imam Ahmed ibn Hanbal, on the other hand, it is not necessary that the commodity should be available in the market at the time of the contract but it is necessary that it can be delivered at the time of due date.<sup>263</sup> If both these views are critically analyzed then it becomes clear that the view of Imam Malik, Imam Shafi and Imam Ahmed Bin Hanbal is more applicable in the present scenario. A well-renowned religious scholar, Ashraf Ali Thanvi has the same view.<sup>264</sup>

While summarizing the above description it can be said that if even the goods are not available at the time of the contract but the suppliers have been identified and are capable of producing such goods then the possibility of uncertainty in such a situation is minimum. It is to be noted Salam sale is not an absolute sale of non-existent goods; it is rather a special sale of non-available goods at the session of the contract which would be available at the time of delivery.

**g.** In the contract of Salam both the parties must have to determine the proper time for delivery. According to Hanafi and Hanbali School of thought, the time for delivery should be after at least one month of the contract,<sup>265</sup> and, if it is fixed before such duration then it will render the contract void. They support their view by saying that Salam contract has been allowed for the needs of small farmers and traders and, therefore, enough opportunity should be given to them to achieve the commodity. They also argue that price in Salam is generally less than the price in spot sale. This concession may be justified when a reasonable time is given to the seller to deliver the commodity. Moreover, a period less than one month usually does not affect the price. According to the Shafi school of thought, the Salam contract can be immediate or delayed. According to Maliki school of thought the minimum time for the contract of Salam should not be less than fifteen days because the rate of markets may change in a fortnight.<sup>266</sup>

The view of Shafi school of thought is more reasonable in nature as they give more importance to the consent of the contracting parties. The parties may agree on any time keeping in view their corresponding interest. This view is more applicable in the present time, and some of the jurists also adopted this view being more suitable for the modern transactions.<sup>267</sup>

As for as delivery before the time is concerned, the majority of the Muslim jurists have the view that the seller can discharge his obligation before the agreed time. In such a case, the purchaser will be forced to accept the delivery if it does not harm him, and, if it harms him then he cannot be enforced to accept delivery before the time which is mentioned in the contract. According to Malik School of thought the delivery should be made at the time which is mentioned in the contract and if it is before the time then the buyer has the choice either to accept or not, and he cannot be enforced in any case.

**h.** It is not permitted to exchange goods other than those specified while the contract of Salam still exists because it results in the sale of awaited goods before they have been received. Besides, this falls

under the prohibition of selling goods before possession. The Holy Prophet (S.A.W.S) said “whoever buys food stuff should not sell before he receives or possesses it”<sup>268</sup>

**i.** In the contract of sale there is exchange of a valuable property for another valuable property. Both are considered in Islamic law as a price for each other. So, when the buyer pays the price of the Salam commodity to the seller, the transformation of the commodity to the former becomes the liability of the latter. According to Imam Sharakhsi, a price of the commodity becomes a debt which is related to the liability of a person.<sup>269</sup> So, if it is a debt, then the purchaser can take surety or pledge or both from the seller to ensure that the latter will supply the required commodity according to the description mentioned in the contract.

**j.** In the contract of Salam the buyer will acquire the commodity after the time which is mentioned in the contract. Before the arrival of such time, he is not allowed to sell the commodity to another person before its possession according to Imam Abu Hanifa and Imam Ahmad Bin Hanbal.<sup>270</sup> Because in this case it will be considered the sale of a commodity that is not in existence and which is prohibited by Shariah.

Salam is a special kind of sale. So all rules and regulations laid down by shariah for the contract of sale must be observed by the parties in such contract. These conditions are given below-

- a.** Both parties to the sale must be voluntary participants. So, no body can compel another person to enter into the contract of sale.
- b.** Both the parties to the contract must have the legal competency to enter into a contract so a minor cannot enter into the contract of Salam.
- c.** The object of the contract of Salam must be a property (mal). The definition of property varies but generally means an object having a legal value.
- d.** The subject matter of the contract of sale must be in the ownership of seller or he will be an authorized person to sell it. Such authorization without ownership comes by several ways e.g. partnership, agency (wakala) or guardianship of a minor.
- e.** The seller must be able to deliver the object of the contract. So, the sale of a lost object or an escaped animal is forbidden.
- f.** The buyer and seller must take cognizance of the object of sale, either by examination or by an adequate description.
- g.** The price must be determined precisely and should be known to both the parties without any ambiguity.

- h .In the event of intrinsic defect existing in the object, the buyer has the unconditional right to rescind the sale; this right is called the option of defect (kiyarul-Ayub)

### 5.3.7 Application of Salam to the agricultural sector

As mentioned earlier in the history of Salam that such contract was originated basically for the benefit of the farmers of Arabia who needed money to grow their crops and to feed their family up to the time of harvest. Keeping in view this fact, it can be stated that such contract is the most effective mode of financing for the purpose to fulfil the agricultural requirements both in crop and non crop sectors. It is also very suitable in the sense that most of the farmers are very poor economically and they have no money in the beginning of a season .if they go to the conventional bank, the latter will provide a loan and that will be indeed based on interest. This will never assist the poor and indigent farmers in his agricultural activities but will create more problems for them, because they have to pay more than the debt received. On the other hand if they go to Islamic banks for the purpose to get loan, they will never get their purpose. The reason is that the Islamic banks do not give loan on interest basis, and most precisely they are not charitable institution to give loan without any interest. So, the Islamic banks do not usually provide loan finance but they have an alternative system which is properly recognized by shariah. This recognized system is called “Bay Ul Salam”.

Salam comes under the trade based modes financing which means providing finance through trading of goods and commodities.<sup>271</sup> Under these modes, an Islamic bank acts as a trader and supplies goods on demand of the customer.

It is to be noted that Salam contract should not be misused by using it as a tool for lending of money. But it is the duty of the Islamic bank to ensure its active involvement in the real sale by itself directly or indirectly through its authoritative agent who may be a farmer of the same locality as discussed earlier.

The application of Salam to the agricultural sector is indispensable and inevitable because a survey which is conducted recently shows that 64.5 percent families belong to categories where one and two members are full time engaged in agriculture. Farm income on an average represents 65 percent of total family income. Only 10.1 percent families are fully dependent on agricultural income. The state bank report on rural of financing (2002) admits that 70% of the agricultural credit requirements are met by informal credit providers who charge high interest rate. The survey shows that 46.5 percent of the total respondents return their loans after the sale of crop while 45.5 percent return their loans whenever they receive money from other sources. About 61.5 percent of the farmers admit they are facing financial problems during the cultivation of crops.<sup>272</sup>

### **5.3.8 Problems of small farmers and their solution by the way of Salam**

There so many agricultural problems faced by a farmer particularly that of rural area .Because of illiteracy they do not know how to overcome these problems.it is necessary to know about such problems and to forward suggestions for the same.For this purpose, a survey which is conducted by Dr.Ahmad Kaleem, is studied profoundly.<sup>273</sup>It is concluded that small farmers always face financial problems. They need money to purchase agricultural inputs and rental machinery. In the survey it is observed that the farmers face some problems at the time of selling their crops. They have no option but to sell their crops to the person from whom they have taken the loan. They have unavailability of transport to bring crop, do nearby markets. They also complain that they do not find customers who give them cash and they also do not receive money in time. Improper way of auction and dishonesty in weight also create problem for them. They have the view that if they take loan from the bank, they must have to follow a tedious procedure, which is another problem for a simple farmer. They also complain that the buyer of their crops pays their money late and it is difficult for them to recover money once crop is sold. Beside of these entire problems, borrowing of money is indispensable and inevitable for them because they have to purchase inputs (Seeds, fertilizers, insecticides, Pesticides, Herbicides, weedicides manual sprayers etc), to pay for the labors, to hire rental machinery to pay the lease of agricultural land, to feed their family and etc.

The proper solution to all these problems can be found in the shape of contract of Salam. After entering into the contract of Salam, they will never face the above mentioned problems. For example they will get rid from the problem of transport, will receive the price of their crops in cash, will receive their money in time, will not be deceived in auction or in weight, will not follow the tedious procedure for loans and will get money in the beginning of the season for the purpose to fulfill all their agricultural needs both for crop and non crop sectors. Thus, the Islamic banks and other Islamic financial institutions can render great services to overcome all these problems of the farmer community and to able them to achieve their production targets.

### **5.3.9 Areas of application of Salam in the agricultural sector**

Salam is more applicable to the agriculture sector as compared to other modes of Islamic financing. It is because of the reasons which are thoroughly discussed in the previous topic. Besides these reasons, there are some other reasons also. For examples Bay al-Salam contains two Islamic forms of transactions.

- Firstly

It contains the element of an interest free loan in which the farmer has an advantage of advanced loan made to him which he returns in the term of agricultural goods rather than money. He will not pay any sort of interest as he pays in the case of conventional loan. He uses the advance payment to purchase seed, fertilizers, pesticides, herbicides, weedicides, pays to the labors, hires rental machinery and pays rent of the agricultural land if he is not the owner of the land. The harvest in this case is the result of advance paid to the farmer as a price rather than of his own capital investment.

- Secondly

It resembles with a Mudaraba set up whereby the Islamic bank provides the capital and the farmer uses his agricultural expertise to employ the capital productivity.

Islamic banks and other Islamic financial institutions use Salam as a mode of financing for the agriculture sector. They finance the needs of farmers who need money for the purpose to grow their crops and to fulfil their other needs. Most often, the price which is paid in the Salam used to finance the production of raw material (often seen in agriculture finance seasoned agricultural purchases), where the advance payment made by the Islamic bank is used to buy for example, seeds, and repayment is made against the sale of the crop. It has also been used to finance cattle where the price paid is used for the purpose of calves. It can also be used to buy other goods in cases where the seller (farmer) needs the working capital running finance. in such a situation the Islamic banks and other Islamic financial institutions buy the out put from the farmer which will be deliverable in future against the full spot payment of the price and the amount received by the farmer as a price for his out put may be utilized so to fulfill his financing needs.similarly it can also be used easily in fish farming e.g. maintenance of farm, machinery, implements and other working capital needs in term of labor charges, water charges, utility charges and etc .<sup>274</sup>

### **5.3.10 Procedure followed by the Islamic banks for Salam transaction**

A specific procedure will be followed by the Islamic bank for the purpose to enter into the contract of Salam with a farmer. The Islamic bank can withdraw a general framework or a master agreement with the farmer .it will be considered a memorandum of understanding in which all details regarding the contract of Salma will be mentioned e.g. intention of the bank to buy and intention of the seller to sell the Salam commodity, quantity, quality and other necessary specification of goods, the time of delivery, the manner of delivery, the price, the manner for its determination, the time for payment and etc.<sup>275</sup>

Salam is a contract of sale in which the price of the commodity, after the contract, becomes liability of the buyer, and the delivery of the commodity becomes liability of the seller. Because of this reason the Islamic banks are allowed to ask the seller to provide guarantee or mortgage. This will be a

type of security from the seller. If the Salam contract is concluded, the contents in the memorandum of understanding will become part of the contract.

It is a misconception that the capital of Salam (Price paid by the bank to the farmer) should be always in the shape of cash. But it is not necessary to be so, and it may be in the form of fungible goods such as wheat and other cereals, or may be in the form of general usufructs of a particular asset such as living in a house. It is because of this reason Dr. Wahba-al-Zuhali says that the specie of the price must be determined at the time of contract i.e weighable, measurable or countable and etc.<sup>276</sup> But when the capital of Salam is in the form of fungible goods such as wheat, rice, dates and etc, then in such a case the parties must have to be careful so, they may not fall in riba as mentioned in the Hadith of Obada ibni Samit.<sup>277</sup> While applying this rule it can be said that the Islamic bank can provide to the farmer wheat, rice, maize and etc as a price for the Salam commodity which will be delivered later. This is a good way to provide seeds of good quality to the farmer. It is to be noted that the capital of Salam should be known to both the parties. So, if it is in the shape of currency then the amount and the manner of payment must be described and if it is in the form of fungible goods then the kinds, type, quality, quantity and other necessity specification must be described.

But in the agriculture Sector, the capital of Salam which will be given to the farmer must be in the form of cash. It is preferred because of two basic reasons; firstly, usually a farmer is not only in need of seed but he is also in need of cash to feed his family till to the next time of harvest. So to give him cash, will be more beneficiary for him to use the capital of Salam as he deems fit, and, it is the basic philosophy behind the contract of Salam. Secondly, if the capital of Salam is in the form of cash, it will protect both the parties to fall in the expected riba as mentioned earlier.

The Islamic bank must have to pay the purchase price at the time when the contract is conducted. Because if it does not so then it will defeat the basic purpose of the Salam contract which is to fulfill the instant needs of the farmer and this is the view of the majority of jurists.<sup>278</sup> However, the bank may delay the payment of price for two or three days because the bank is not a real person but a juristic personality and it has some procedure to follow unlike a real person. It has no money always in its pocket to pay on the spot. This view can be supported by the view of Imam Malik. According to him that the seller may give a concession of two or three days to the buyer, but this concession should not form part of the agreement.<sup>279</sup> But it must be kept in the mind that such delay should not exceed more than three days in any case.

Farmers mostly belong to the poor class of the society. Because of this reason it is possible that a farmer may have taken loan from the Islamic bank. In such a situation the latter cannot use such debt as a price of the Salam commodity because it will lead to the violation of three basic principles of Islamic commercial law. First, it will violate the principle that the price of Salam commodity must be received by

the Seller in advance as said by majority of the jurists and secondly,<sup>280</sup> and more importantly, it implies exchanging debt for debt which is strictly prohibited by shariah<sup>281</sup> and, thirdly paying the Salam commodity by debt may lead to the exploitation of farmer and will defeat the purpose of helping the farmer to finance his production.

As stated earlier that price of the Salam commodity must be paid by the Islamic bank to the farmer at the time of the contract. But it is possible that when the bank gives price of the commodity to the farmer, the latter may not keep it with safe custody, then in such a situation it is permissible for him to hand over back the amount to the bank for the purpose to keep it in the safe custody. In other words it can be said that depositing of the received price with the purchaser is permissible if the seller (farmer) receives it at the time of signing the contract and then deposit it with the purchaser. It is not permissible for the Islamic banks and other Islamic financial institution to stipulate in the contract with the farmer that the commodity should be from his land, farm or garden because there is possibility that crops of that gardens destroyed before delivery. It is because of this reason Imam Sharakhshi says that if it is conditioned in the contract that the salam commodity must be a product of a particular village or a particular field then such contract will be considered invalid<sup>282</sup> The farmer can deliver the crops of his own land or from somewhere else but in both cases it must satisfy and meet the specification which are mentioned in the contract. The reason behind this rule that agriculture is always prone to many natural risks e.g. drought, floods, hail, earthquake, mudslides and other mishaps. All these factors affect the product of a land. It is not allowed for the Islamic banks and other Islamic financial institutions to stipulate any penalty in the contract of Salam for delay; however, if the farmer is unable to deliver the goods, then it is allowed them to obtain legal sanction against the farmer through the court of law. But a conscious farmer may misuse this clause and because of this reason it is the duty of the jurists to find out a solution for this problem.

If the farmer is unable to deliver the commodity, the following can be done.

- The farmer agrees with the Islamic bank to postpone the delivery till to the next crop. But this option is not reasonable one and too much risk is involved in it for the bank because of two reasons. First, it will lose the opportunity to use the capital of Salam and, secondly it will wait for another period till to the availability of the Salam commodity.
- If the bank does not agree, then it is also possible that the farmer may return to him the price paid without any increase. But this option may also be misused by the farmer. Because as said earlier that price in Salam is less than the Price paid in cash sale. The farmer may sell the commodity somewhere else at a higher price, then he will return the Price paid to him by the Islamic bank along with the pretence that he is unable to deliver the goods for one or another reason.

- The contract of Salam can also be cancelled by mutual agreement and the Islamic bank will recover the paid capital.

### **5.3.11 Application of parallel Salam to the agricultural sector**

There is a problem in Salam contract which may agitate the modern banks and financial institutions. For example in Salam contract the Islamic bank receives a commodity from the farmer and not cash. At the same time it is not suitable for the bank to receive such commodities from the farmer and to sell them in the local market. Because of this reason the Islamic banks generally do not like to be involved in the actual handling of commodities. But they must have to do that and there is no other way. It is because of this reason a contemporary scholar Mulana Muhammad Taqi Usmanin says that if the Islamic banks want to earn Halal profit, they must have to deal in commodities on one way or on the other, because no profit is allowed in Shariah on advancing loan only. So, it is indispensable for these institutions to establish a special cell for dealing in commodities. Such cell will sell the commodities received by the Islamic banks from the farmers in the local market. However; there are some other ways for the Islamic banks to take benefit from the contract of Salam.<sup>283</sup> After purchasing a commodity by way of Salam, the financial institutions may sell it through a parallel Salam for the same date of delivery.

But before the discussion of concept of parallel Salam, it is necessary to determine that whether such contract is allowed in Shariah or not. The shariah supervisory board of Rajhi banking and investment corporation issued a Fatwa permitting the practice of parallel Salam on the Condition that the execution of second Salam should not be made dependent on the execution of the first one.<sup>284</sup> It means that both the contracts should be separate contracts and will not depend on each other. The 'Accounting and Auditing Organization for Islamic financial institutions has the same view.

“The obligations and rights under the first contract should not be linked with the obligation and rights of the second contract. Therefore, if one party breaches his obligation under the first salam contract, the other party has no right to relate this, damage or loss to the other party with whom he concluded a parallel Salam, consequently, he has no right on the basis of his loss or damage under the first salam contract to terminate the second salam contract or to delay its performing.”<sup>285</sup>

So, the Islamic banks can enter into a parallel Salam. The period of salam contract in the second transaction is shorter than the first one, so the price in it is higher than the price in the first salam, and this difference of price between the two transaction is a profit which is earned by the bank. By this way the bank will get back immediately its money which it has paid in the first contract.

If the parallel Salam is not feasible for one or another reason, then the Islamic banks can arrange another way. The bank will obtain Promise from the expected buyer. It is to be noted that such promise will be unilateral and not bilateral because bilateral promise leads to a contract, and contract on non existing things is prohibited by Shariah. Being merely a promise, and not the actual sale, the buyer will not have to pay the price in advance.<sup>286</sup> When the commodity is received from the farmer, the buyer will purchase the commodity from the bank at a higher price as compared to the price paid by the Islamic bank to the farmer. This difference, between the two prices will be a profit of the bank.<sup>287</sup> Sometime after the first contract, the Islamic bank enters into another contract with the same farmer to sell him the same goods at the same specific date but at a higher price. But this suggestion is not according to the basic principle of Islamic commercial law because it leads to a buy back transaction which is a way towards riba and it is strictly prohibited by Shariah.

### **5.3.12 Risks involved in Salam financing and their solutions**

In the contract of Salam there is not only risk for the financial institutions but also for a farmer. Because of these risks, the Islamic banks and other Islamic financial institutions are reluctant to enter into the Salam contract.

- **5.3.12.1 Risks related to the farmer**

It is a matter of fact that market risk is the most notable risk in the financing. As said earlier that usually the price in slam contract is cheaper than the market price. This difference between the two prices is the profit of the Islamic bank. But it must be kept in the mind that such differences must be reasonable. When the market price of the commodity upon the delivery is higher than the Salam price, it will be a matter of great shock for a farmer. Before entering into the contract of Salam, he must have to have knowledge of such risk Usually the farmers agree with such potential loss because generally they have no money at the beginning of a season for seeds, fertilizers, herbicides weedicides, insecticides and etc. It is a duty of the famer under the Salam contract to deliver the commodity according to quality, quantity and other specifications mentioned in the contract .if he provides the commodity to the bank on the settled date but the latter rejects it due to its inferior quality as it is not according to the contractual specification. In this situation he has to buy the commodity from the local market and it is possible that he may buy it at the higher price as compare to that he received from the bank as a price of slam commodity. In the contract of slam the price of the commodity is cheaper than the price in cash sale and the difference in two sales is the profit of the bank which is normally a reasonable amount. Usually it is equal to the amount of the interest taken by the commercial bank on the same amount as paid by the Islamic bank as a price of the slam commodity. It is a risk for the farmer because if he sells it in the local market at the time

of harvest, he will get higher price as compared to the price received by him from the bank in the contract of slam.

While coming across such factor in the contract of Salam it does not look a suitable contract for a farmer to enter. But a question may raise by some one that farmer usually belong to the poor class and how they would full fill their agricultural requirements? The idea of free interest loan which is discussed in the second chapter would give answer to this question. A farmer can free interest loan from the Islamic bank and will return it after a reasonable time. This taking of debt is more beneficial for him as compared to the price he received in the contract of slam. However, if there is no Islamic bank that advances free interest loan, then he may enter into such contract otherwise, he will take conventional loan from the conventional banks which is strictly prohibited by shariah.

- **5.3.12.2 Risks related to the Islamic bank**

As for as the risks which are related to the Islamic bank, they are given below-

In slams contract, the Islamic financial institutions will pay the farmer in advance, while the delivery of the agricultural product is deferred to a specific further date which is mentioned in the contract. It is a matter of fact that a continuous change in the prices of a commodity is a common practice of the market and the prices of a commodity decreases and increases with the passage of time. So, it is possible that the market price of the delivered products is cheaper than the contract price paid to the farmer by the Islamic bank. But this problem can also be solved very easily. Usually the Islamic banks are not entering into the contract of slam unless and until they study and examine it from all angles. The price which is paid to the farmers in advance is determined by the bank keeping in view the market risks along with the past experience in other slam contract. So, the price which is determined is of such nature that accommodates decrease of prices in the market. Besides this there is another jurisprudential view to solve this problem. According to Islamic commercial law a person is entitled to profit because of capital, liability for risk and work.<sup>288</sup> While applying this principle, the Islamic bank is entitled to profit because of the risk of decrease of price. if the Islamic bank wants “Halal” profit then it must have to take the risk . As said earlier that banks generally do not like to be involved in the actual handling of commodities, and because of this reason they generally close out their position by entering into a parallel salam and in situation it is necessary for the bank to find a ready third party buyer before executing the slam contract. The Accounting And Auditing Organization for Islamic Financial Institutions describes the same idea.<sup>289</sup> If the parallel slam is not feasible for one or another reason, the bank must have to obtain a promise from a third party that he will purchase the slam commodity from the bank.<sup>290</sup> These extra arrangements bring extra expenses for the bank and consequently decrease its profit as compared to its profit in other from of business transaction like murahaba, istisna, musawama, ijaraha. This problem can

also be solved very easily. In the case of parallel Salam, the Islamic bank can charge high price from the third party while in case of ordinary slam it can include all these expenses in the cost price of the commodity.

It is a recognized rule that a farmer must have to deliver the commodity at the time which is mentioned in the contract. But if he fails to deliver the goods on time, the Islamic bank has authority to declare the contacts as void and reject the item. In event of revocation of contact the former will only return the advance payment which he received from the Islamic bank and no penalty can be put on him.<sup>291</sup> According to Islamic commercial law, in such situation no payment in excess can be stipulated because the delivery of commodity is considered a debt on the buyer and any excess on debt is strictly prohibited by shariah. But this problem can also be solved. As said earlier that the delivery of Salam commodity is considered a debt which can be secured by a pledge or a guaranty or any other permissible means of security of payment.<sup>292</sup> As in the case of Murabaha, it is permissible for the Islamic bank to deduct its actual loss from the security deposited by the former if he refuses to buy the commodity or does not pay any installment or delays that. The same principle can be applied if the farmer fails to deliver goods on due date. If deduction of actual loss is permissible in Murabaha, then why it should not be in the case of Salam, because the latter is more exposed to risk. The reason is that the bank enters into a parallel salam with a third party and if the farmer is unable to deliver the commodity at the specified date mentioned in the first contract, the Islamic bank must have to purchase another commodity from the local market and deliver it to the buyer in the parallel salam, as both are independent contract and the Islamic bank must have to fulfil its obligation under the second contract. Similarly if the farmer does not provide the commodity according to the quality, quantity and other specification which are mentioned in the contract .in this situation the bank may have some other options also. For example if the farmer fails to meet the quality specifications, it will reject the item and will compel him to buy the item as specified in the contract from the local market while the delivery period would be extended to a new period. Another option with the bank is that it will accept lower quality items brought by the farmer but in this case the quantity will be increased.

## **5.4 Istisna**

### **5.4.1 Introduction**

Before the discussion of Istisna, it is pertinent to mention that Islam laid down detailed rules for ibadat and hence left a very narrow space for Ijtihad in this sphere. The reason is that ibadat do not change with the change of time and place. But as for muamalat are concerned, Islam does not lay down a detailed rules and regulations for it. It just provides broad principles and guidelines for the commercial contracts and transactions. The Muslims scholars particularly the classical jurists developed a comprehensive system of commercial laws after a profound study of the basic principles laid down by the Holy Quran and Sunnah of the Holy Prophet (SM) in this connection. They classified the commercial contracts and transactions into different categories with regard to their objects and principal features. They exercised Ijtihad in the sphere of commercial transactions and framed new rules according to the need of the time.<sup>293</sup> Besides this it is also a fact that Islam does not put strict rules as for as the commercial laws and contracts are concerned rather it provides basic philosophies which are very flexible in nature that can be moulded according to the need. It goes to the extent that if even a commercial transaction is against the basic principles of shariah but at the same time the people are in extreme need of that, the law of exception comes to the spot and makes it permissible. It is for this reason that some of the commercial transactions are justified on the basis of exception even they are against the basic principles and general rules provided by shariah e.g. Bai-al-Salam (advance sale), Bay-al-Istisna (Manufacturing sale).

### **5.4.2 Definition of istisna**

Istisna is an Arabic word which literally means “to ask someone to make or manufacture something”. This word originates from “Sana” which means manufacturing. As for as the technical meaning of “Istisna” is concerned, the statements of Fuqaha vary about it. According to Ibni-al-Abidin “It is a demand from a manufacturer to manufacture certain goods according to a given description”.<sup>294</sup> A well renowned Hanafi jurist Imam Al-Kasani defines Istisna as “It is a contract of something sold on guarantee in which the work is conditioned”.<sup>295</sup> After presenting the definition he further says that if the manufacturer brought a commodity which has already been manufactured before the contract and the manufacturer consented on that then it would be permissible and if the condition of work come from the same contract, it would not be permissible because the condition applies to a work in future not in the past. A contemporary Dr. Wahba Al-Zuhali defines it as “it is a contract concluded with a manufacturer to manufacture a specific commodity on guarantee, which means that the contract is concluded to purchase the commodity manufactured by the manufacturer provided that the raw material is supplied by the manufacturer and the work is also performed by him. If the raw material is supplied by the customer then the contract becomes a hiring contract”.<sup>296</sup> Another contemporary scholar, Mulana Muhammad Taqi

Usmani defines Istisna as “Istisna means to order a manufacturer to manufacture a specific commodity for the purchaser.”<sup>297</sup>

If all the above given definitions are analyzed then it can be said, without any doubt, that the definition given by Imam Ibni Abidin is more comprehensive in nature because it tells about the basic principles of Istisna. In the light of all these definitions istisna can be defined as “it is a contract of acquisition of goods by specification or order, where the price of the commodity is paid in advance or in instalments while the required goods are manufactured and delivered at a latter date mentioned in the same contract”.

#### **5.4.3 Legality of istisna**

All the jurists unanimously agree on the lawfulness and consequently the permission of Istisna. However, their view points have differed with respect to the way in which the permission was to be granted.<sup>298</sup> The majority of Hanafi school of thought have ratified and approved the contract of Istisna as an exceptional case to the general principle of Islamic commercial law in which sale of non-existent thing is strictly prohibited. They have the view that such a contract is made permissible because the people are in tense of it and in case of its prohibition they would face difficulty which is against the basic principles of shariah in which it describes easiness for the whole mankind. Imam Al-Kasani says that according to analogy, Istisna is not permissible on the ground that it is a sale of commodity which is not inn existence at the time of contract, and it is, therefore, considered as a Salam.<sup>299</sup> He further says that it is permitted on the basis of Istehsan due to unanimity of the people on it because they do that in different eras without any denial. Imam Sharakhsi has also the same view. In addition to it, he also presents a hadith of The Holy Prophet(sm) in this regard which is “What the Muslims have seen as a good thing it is good and what they see as a bad thing is bad”.<sup>300</sup>

The Maliki school of thought did not pay a required attention to the concept of Istisna and hence their view point regarding the permissibility of Istisna contract is not found even in their famous book which is known as “Mutha”. Anyhow such book (Mutha) discusses the concept of Istisna, but not as a separate concept, in the chapter of Salam. The Shafi school of thought like Maliki school of thought does not discuss such concept separately; however, they discuss its some important aspect. Similar is the case of Hambali school of thought.

Keeping in view the above discussion, it can be easily concluded that only the Hanafi school of thought presents the concept of Istisna as a separate discussion and describes its rules and regulations thoroughly, and because of this reason a renowned Hanafi jurists and author of Badai-al-Sanai Tarteeb-al-Sharia, Imam Kasani locates a separate chapter to such concept. Imam Sharkhasi, another Hanafi jurist, says in his famous books “Al-mabsoot “the Prophet (sm) ordered a manufacturer for a ring of gold, a

barber to cut his hair.<sup>301</sup> So, this discussion shows that the Holy Prophet (SM) not only permitted the contract of Istisna but also practiced that.

#### **5.4.4 Application of istisna to the agriculture sector**

Istisna is one of the most important modes of financing in Islamic financial system which has the object to cooperate in the development of the society by helping the poor people. As said earlier that nearly sixty percent of our population directly related to the agricultural sector, and consequently the phrase “Development of the society” means development of the agricultural sector. This discussion leads us to think over the importance of istisna in the agriculture sector.

Istisna can be effectively applied to the agricultural sector to help out the poor farmers both in crop and non crop sectors. But unfortunately the contemporary scholars, particularly those who are directly or indirectly related to the Islamic banks, did not pay a required attention to the application of such contract to the agricultural sector. However, it cannot be ignored that they have discussed thoroughly the modern application of istisna by the Islamic banks and other Islamic financial institution in a general way and by the help of which its application can be extended to the agriculture sector. But it is not sufficient only to discuss the general applicability of istisna to different sector. They must have to discuss its application to the agricultural sector as a separate discussion. The reason is that agriculture finance is very peculiar in nature as compared to other areas of financing and implementation of Islamic modes of financing to such sector requires more details from the shariha perspective. It is because of this reason that the classical jurists, particularly those of Hanafi school of thought i.e. Sharks, Kasani, Jassas and etc, pay a great attention to the agricultural sector and that is why the concept of Muzaraha and Musaqah are shining as separate concepts in a separate chapters. But the contemporary scholars did not develop the ideas envisaged by the classical jurists. The reason that the agriculture sector is prone to many risks i.e. bad weather, insect infestation, diseases, incidence of drought, floods, hail storm, earthquake, mud slides and etc.<sup>302</sup> But latter on they recognized the importance of agriculture sector and resultantly started work on the application of Islamic modes of financing to the agricultural sector. So, they discussed the application Musharakha, Mudarabha, Murabaha, Ijara, Salam and etc to the agricultural sector. But here too they provided a broad skeleton without minute details. But unfortunately istisna is ignored even in this broad framework. Dr. Mahmood A. Gulaid has recognized this fact as he says

“Istisna is unique in that it is predisposed to cater for the technology intensive input needs of the farm enterprise. It is sufficient to say that the potential for this mode to fill in the technological gap in the agriculture sector is great unfortunately, not much use has hitherto been put to this very bright financing alternative in the contemporary agriculture”.<sup>303</sup>

The above statement clearly indicates that the contemporary scholars did not pay due attention to the applicability of istisna to the agriculture sector. The guideline on Islamic Financing for Agriculture issued by the State Bank of Pakistan also profoundly studied to find out the applicability of istisna to the agricultural sector but it too doesn't deal with the matter in details.<sup>304</sup>

The istisna mode of financing has a great potential for the development of agriculture sector both for crop and non crop activities. Unlike murabah contract which is more suitable for the middle and upper class of farmers, this contract is more beneficiary to help out the lower class of farmers as well the middle and upper class. So, it is more comprehensive in nature in term of its utility as compared to other modes of Islamic financial system. The above fact will be proved with solid arguments in the coming pages. As said earlier that sixty percent of our population are related to the agricultural sector and most of them belong to the poor class. They usually have no money in the beginning of a season to buy the basic agriculture inputs of production e.g. seeds, fertilizers, herbicides, weedicides, insecticides, manual sprayers and etc. Agriculture for such people as a source of life and not as a source of business as said earlier. Because of lack of money, they prefer to buy something on instalment basis or on deferred payment basis. Both these options are available to them in the shape of istisna transaction because in this contract the payment of price can be deferred until the delivery of the product or it can be paid in instalments according to the consent of the contracting parties.<sup>305</sup> It is because of this peculiar characteristic of this contract; the farmers have a natural tendency towards it. So, from this discussion it can be easily conclude that the price may be paid full in advance or it may be fully deferred till to the time of delivery or it may be fully deferred till to the time of delivery or it may be partially advance and partially at the time of delivery.

There is another reason for the farmer's tendency towards this contract of Istisna that they get their required commodity according to their own specifications through this contract. Because the Islamic banks and other Islamic financial institutions must have to manufacture the agricultural commodity according to the specification asked by the farmer. This is a peculiar nature of this contract which is totally different from other modes of financing of Islamic financial system. By this way the farmers acquired their required good according to the quality which they envisaged in their minds before entering into such contract. Another reason which is responsible for the tendency of a farmer towards the contract of Istisna that some times they are in need of some agricultural commodities that are not available in the local market. They make a demand from the Islamic bank to produce or manufacture such commodities for them, sometime from the raw materials which are selected by these farmers themselves. It is basically according to the philosophy of shariah behind the istisna transaction. According to such philosophy this contract is allowed only for such products which are not primary goods and which will be produced only

when there is a specific definite demand already established. The example includes buildings, bridges, factories and etc.

#### **5.4.6 Application of istisna to different agricultural sector**

Before embarking on the discussion that how the Islamic bank and the customer will conclude the contract of istisna, it is better to discuss first those areas of the agriculture sector to which the application of such contract can be extended. After this it will become easy to understand the procedure followed by the Islamic banks and other Islamic financial institutions.

- **5.4.6.1 Application of istisna to local farming**

It must be kept in the mind as a basic principle of Islamic financial system that istisna is mainly a contract for manufacturing. Imam Kasani has the same view.<sup>306</sup> Following this principle it can be said that such contract cannot be concluded for natural goods or commodities. In other words it cannot be applied for financing fruit crops and nor for non-fruit crops activities. It means that such contract cannot be applied for financing wheat, paddy, sugarcane, cotton, potato, mustard mung, tobacco, rapeseed, maize (Hybrid), Maize (local), Mash, canola, lentil, soybean, groundnuts, sunflower, pear, dates, loquat strawberry, plum, tea, apple, guava, papaya, pomegranates, almond, palm, coconut, olive oil, litchi, cherry, persiment, mango zizi, apricot, melon, banana, water melon, peach, mush melon, citrus and etc. This description shows that istisna contract has no role in the production of such natural products. This restriction minimizes the application of istisna to the agriculture sector. It can be stated from another angle that the contract of istisna is allowed only for such products which are not primary goods and which will be produced (manufactured) only where there is a specific definite demand already established. Because of this limited applicability of istisna to the agriculture sector as compare to other modes of Islamic financial system, the contemporary scholars do not pay the required attention to its application to the said sector. But it does not mean that such contract has less importance for the agriculture sector. After a practical study of the agricultural sector, particularly that of rural area, it is found that our farmers, especially those who belong to the poor class, are facing a lot of problems to fulfil their agriculture needs. These needs are totally different from the basic agricultural needs. These problems are not related to the crop activities but mostly related to non-crop activities. A best effort will be made to describe all these problems in details in the coming lines.

During a visit to the rural areas to know about the basic problems of the agricultural community, it is concluded that most of farmers are facing problems in watering their crops. It includes both fruit crops and non-fruit crops. Although our weather is rainy one but it cannot fulfil their needs. Because of this reason they are in extreme need of some alternative arrangements which can overcome

their problem. It is possible for them to get all these requirements by entering into istisna agreement. They can ask the Islamic banks and other Islamic financial institutions to construct for them water tanks, water pumps, tube wells, pipelines, channels of water from water resources, other small passages which can be used to water their fields crops, and etc. This is not only viable for Islamic banks or Islamic financial institutions but also for a farmer to the same extent.

The farmers of hot and cold areas are in need of permanent sheds to protect themselves from sun heat and cold. Study reveals that these sheds are very important because the farmers work normally from six to eight hours in their field both in summer and winter season and they are in extreme needs to have sheds to take rest there for sometime. Secondly, during practical study of the agriculture sector, it is found that usually the farmer's houses are very remote from their fields and consequently they are unable to bring and take back some necessary equipments like rake, hoe, fork, shovel, spade, hand fork, trowel, wheel barrow, watering can and etc. They need a permanent sheds or small rooms to keeps all these tools in safe. Thirdly, the farmer in rural areas uses these permanent sheds or rooms to keep their fruits or corps in it and protect the same from the bad weather.

It is a solid truth that majority of our farmers are facing a severe problem to supply water to an area of their land through pipes or channels. In other words they are facing serious problem in irrigation. As it is known that irrigation is very necessary for the proper grow of crops and its absence may cause a serious problem for the farmers in the production. So, they are in tense need of tube wells to overcome this problem. Not only the construction of tube well is necessary for a farmer but he is also in need of a proper system of pipes and channels by the help of which he can supply water to an area of his land to grow up his crops. The installation of tube well for water and its regular flow through a proper system of pipes or channels can be done easily through the contract of istisna between the farmer and Islamic bank or Islamic financial institution. In village installation of pump can also be made for the same purpose.

In hilly areas another problem is noticed regarding irrigation faced by a farmer of such area. After a thoroughfull study it is laid that their source for irrigation is not the river nor the sea, but cold springs which are available in excess in such areas. For them it is necessary to have a proper system of channels and canals for the regular supply of water to their fields. In the absence of such facility, their production level will become low. The Islamic banks and other Islamic financial institutions can help the farmers of such area in this regard by entering with them into istisna contract.

- **5.4.6.2 Application of istisna to livestock**

The Islamic banks and other Islamic financial institutions can also help a farmer in livestock by the way of istisna. They can conclude such contract for the installation of milk storage chilling tanks, refrigeration plants, milk carrying containers, refrigerated meat storages and refrigerated containers,

distribution vehicles such as motorcycles, pickups, refrigerated vans, construction or procurement of permanent sheds, water tanks, water pumps, tube wells and generators, fencing and enclosures, establishment of slaughter houses<sup>307</sup> for cows, sheep, buffaloes, goats ,installation of tube wells, turbines, sprinkle or drip irrigation system, water management .

- **5.4.6.3 Application of istisna to fish farming**

Istisna can also be applied to fish farming effectively for its development by the Islamic banks and other Islamic financial institutions. This can be done by the construction of cold storage, chilling or freezing plants, fish storage centre, pickups, vehicles, life boats, fish or shrimp hatcheries and etc.<sup>308</sup>

- **5.4.6.4 Application of istisna to poultry farming**

Istisna is very also effective in its implementation to the poultry farming. It can be used easily for the construction of broiler, layer, breeder and hatchery farms, feed mills, control seeds, automatic drinkers, tube feeders, generators, ventilators, table or breeder eggs storage refrigeration plants, transport vans, eggs and poultry carrying vans, distribution vehicles such as motorcycles, pickups, deep freezers, slaughtering and de-feathering machines and etc.<sup>309</sup>

- **5.4.6.5 Miscellaneous application of istisna to the agricultural sector**

The contract of istisna can also be used for other purposes like dairy farming, establishment of green houses, construction of cold storages, construction and improvement of live stocks laboratories, setting up seeds processing and milk chilling units, installation of fruit and vegetable machines and etc.<sup>310</sup>

All these agricultural needs are fulfilled by the Islamic banks and other Islamic financial institutions by entering into a sub-contract with the construction company. In other words it can be said that they are entering into a parallel istisna with a construction company after they enter with a farmer in the contract of istisna. In this case it is necessary that both the contracts should be independent of each other which mean that the rights and obligations created by one contract should not be effect by the rights and obligations of the other contract.<sup>311</sup> In such a situation the Islamic bank expresses (after a request for the construction of something by the farmer) its desire to order for the manufacture of the commodity (same which is required by the farmer) it has undertaken to manufacturer in the first istisna contract. The specifications which are mentioned in the parallel istisna must be same to the specifications mentioned in the first contract with the farmer. But it is not necessary that the time of delivery and price in the second contract would be the same as in the previous one; because of it is so then what would be the benefit of the bank. After the commodity is manufactured it will be delivered to the bank directly or to any party in the place decided by the bank in the contract.<sup>312</sup>



two prices is the benefit of the Islamic bank. Due to the inclusion of a separate contract, price of the commodity increases and because of this reason it is not wrong to say that parallel istisna contract is not in the interest of a poor farmer.

Fourthly The contract of parallel istisna brings complexity in the procedure which can create difficulty for an illiterate farmer. So, if there is a direct contract between the farmer and the Islamic bank that the latter will manufacture the required commodity or construct the required building, then it will be easy for him to understand the contents of the contract easily. He will also understand easily his relation with the bank and will properly fulfil his duties in this regard .He will also be able to know about his rights

Fifthly The degree of risk for a farmer is more in the parallel istisna contract as compared to direct Istisna contract. It is because of the reason that after the first istisna contract between the bank and the farmer, the previous enters into a parallel istisna contract with the manufacturer (seller) or construction company, then in such a situation it is possible that the concerned manufacturer or construction company may not manufacture the required commodity or the required building within the stipulated time period which is mentioned in the contract. Under such circumstances, the Islamic bank cannot buy the required commodity from the local market because usually the istisna commodity is manufactured by order. They are not primary goods as mentioned earlier but produced when there is a specific definite demand already established.

Because of the reasons mentioned above in details, parallel istisna contract is not a suitable contract particularly when it is applied to the agriculture sector. May be because of the above mentioned reasons, a contemporary scholar Moulana Muhammad Taqi Usmani does not pay a required attention to the contract of parallel istisna and even he does not mention it as a separate discussion in his famous book "An Introduction to Islamic Finance". It does not mean that its application should be entirely left for the agricultural sector rather it should be limited only to those commodities which cannot be manufactured without a particular company. For example, if the farmer request to the Islamic bank to manufacture for him a tractor or motorcycle or pickup or refrigerated van, then in such a situation the bank has no alternative except to enter in the contract of parallel istisna with the manufacturing company of such vehicles. But as for as the common construction is concerned e.g. buildings, bridges, factories, tube wells, permanent sheds, water channels and pipelines, digging wells other then tube wells, fencing and enclosure, establishment of slaughter houses, water tanks, water pumps and etc, it would be an ideal situation if the Islamic banks or other Islamic banks or other Islamic financial have their own construction

company and expert contractors to discharge the task. A contemporary scholar Dr. Muhammad Tahir Mansori has the same view when he says

“But if the contract concluded between the bank and the client, and the latter provides specifically that the work will be carried out by the financier himself, then the sub contract (parallel istisna contract) is not valid in such a case, it is necessary that the bank should have its own construction company and expert contractors to discharge the task”<sup>316</sup>

The contract of istisna is basically a production contract.<sup>317</sup> This characteristic is totally different from a Salam contract which is basically a trading contract. Thus, a seller who agrees to provide a product in future under this contract to a farmer will have to be a manufacturer or constructor or producer in the first instance. If this is not possible, then he must have to establish a contract with another producer or manufacturer or constructor, as the case may be, before entering into istisna contract with a farmer, and this is the real difference between istisna and salam contract, because in the latter it is not necessary for the Islamic bank to enter into another contract before entering into the contract with a farmer because the salam goods, are generally available in the market, and in this case it is not necessary that the seller must be a producer. He can purchase from the market the required goods which is to be supplied according to the promise.

The above statement explains the idea which presented in the previous pages that the Islamic bank or any other Islamic financial institution must have to act as a producer or manufacturer or constructor in the istisna contract and if it is not possible for one reason or another, then it can resort to a parallel istisna contract.

#### **5.4.8 Procedure for Agricultural Istisna (a practical approach)**

After a thorough-full discussion of these agricultural areas (both for crops and non-crops activities), now it is easier to discuss the procedure which will be followed by the Islamic bank or other Islamic financial institutions and a farmer to enter into the contract of istisna. It will be endeavoured in the best way to keep the procedure very simple as much as possible without damaging its real structure discussed by the contemporary scholar. Some changes will also be suggested where it deems necessary in the existing procedure discussed by the Accounting and Auditing Organization for Islamic Financial Institutions. It will be endeavoured to simplify the procedure of parallel istisna, so to keep it in conformity with the intellectual level of an illiterate farmer.

Before the discussion of any other issue it is pertinent to describe that the Islamic banks and other Islamic financial institutions can utilize istisna contract by three ways

Firstly           It is permissible for the Islamic banks and other Islamic financial institutions to buy a commodity required by the farmer from a seller and then after taking possession (which

may be actual or constructive) sells it to him either for cash installed or deferred price. Here the best arrangement is the arrangement of murabha transaction, and it is not the right place for it to be discussed.

Secondly It is also permissible for the Islamic banks and other Islamic financial institutions to enter into istisna contract with a farmer. This is the ideal form of the istisna contract that should be applied to the agricultural sector both for crops and non crops activities. Here it is necessary for the Islamic bank to have its own construction company and experts to accomplish the work according to the details given by the farmer. This is very ideal situation from the Islamic perspective, because if the farmer specifically mentions in the contract that the manufacturing or construction must be done by the Islamic bank itself then no other way can be applied except this one.

Thirdly It is also permissible for the Islamic bank and other Islamic financial institution to enter into istisna contract as a seller with a farmer who demands for the purchase of a particular commodity and then draw a parallel istisna contract with another manufacturer or constructor in the capacity of a buyer.<sup>318</sup> The subject matter of this contract and the previous one will be the same. The first istisna contract may be immediate or deferred and similar may be the case of second one. A simple procedure will be followed in both contracts. It is pertinent to mention that there must be non-existence of any legal relation or financial obligation between

- The farmer requesting istisna (the end user) in the first contract,
- The maker or manufacturer or builder or constructor (seller) who manufactures the article in accordance to the parallel istisna contract.

So, any disagreements that may arise are settled under each contract separately according to the provision therein.

#### **5.4.9 Procedure for agricultural istisna**

A farmer expresses his desire to buy a commodity and concludes an istisna contract with the Islamic bank or any other Islamic financial institution. He must have to give some specification for the required commodity which includes its type, kind, quality and quantity. Besides this the price of the commodity, date of delivery, place of delivery and etc must be mentioned in the contract. The Accounting and Auditing Organization for Islamic Financial Institutions adopts the view of Imam Abu Yousaf and

Imam Muhammad who are of the view that the time for the completion of work and delivery should be fixed. But according to Imam Abu Hanifa the time for the completion and delivery should not be fixed.<sup>319</sup> After a profound study of the arguments presented by Imam Abu Hanifa and his disciples for the supporting of their view, it is found that jurisprudentially the view of Imam Abu Hanifa is stronger, while the view of his disciples is more logical.

As for as the istisna contract between an Islamic bank and a farmer is concerned, the view of Imam Abu Hanifa can be preferred because it will provide some sort of relaxation to the Islamic bank. It can also be adopted on the ground that the agriculture commodities are usually peculiar in nature and primarily not available in the local market although it is not a necessary condition. But as for as the parallel istisna is concerned, the view of Imam Abu Yousaf and Imam Muhammad can be followed. It is because of the reason that if the time for completion of work and delivery is fixed, it will bring perfection in the services of the Islamic banks and other Islamic financial institutions. While keeping this description in mind, it can be said that in the first istisna contract the view of Imam Abu Hanifa is more suitable to be followed while in the second contract the view of Imam Abu Yousuf and Imam Muhammad is seemed very fit. But it is not necessary that such suggestion should be followed and resultantly time for delivery and completion of work can be fixed in both contracts (istisna contract and parallel istisna contract), however, in this case the Islamic bank must have to satisfy itself that the due date for the completion of work and delivery in the first contract is the same or after the due date for the delivery and completion of work in the parallel istisna contract.<sup>320</sup>

After the farmer expression to buy the commodity, the Islamic bank or any other Islamic financial institution will also express its desire in ordering the manufacture of the commodity which it has undertaken to manufacture in the first istisna contract. Here, it is necessary that the specifications which are mentioned in the first contract must be mentioned in the second contract. According to the classical jurist istisna contract can be concluded for the production of subject matter having unique description.<sup>321</sup> This principle can be made very beneficiary for the agricultural sector. During practical study of the agricultural sector, it is found that different tools which are required by a farmer are very peculiar in nature and having a unique description. These tools are also very important in nature and they are using these frequently throughout the year. They buy such tools from the local market usually having inferior quality. These include rake, hoe, hand fork, trowel, shovel, spade, watering can, wheel barrow and etc. The Islamic banks and other Islamic financial institutions can provide all these materials to a farmer by the way of istisna contract. In such a situation the Islamic bank can enter into a contract of parallel istisna with a manufacturing company which will manufacture these tools according to the specifications mentioned by the farmer in the first istisna contract. This idea may not be suitable in the view of some people particularly those who are conversant with the Islamic bank, but this carries a great potential of

profit for the Islamic banks. It is also suggested that the Islamic bank should appoint a farmer of a particular area to conclude istisna contracts on its behalf with the farmers of that area. The advantage of this agency is that Islamic bank will not actively participate in the business and hence, will spend its time in some other viable activities. Secondly, the agent of that area will know better about the financial ability of a farmer, and by this way, the risk of default will come to its minimum level. Islamic bank can give a particular share to such agent as a remuneration of his work. He will not only represent the Islamic bank in the istisna contract, but will also act its agent in all other commercial transactions. Before pointing a finger to the weaknesses of such idea, it must be tested in the shape of its practical implementation.

It is a matter of fact that seventy percent people of our country are related to the agricultural sector and most of them belong to the lower class. It is a solid and real fact that usually they always in need of money to fulfil their basic agricultural needs and feed their families till to the time of harvest. At the same time, being the Muslims they are not allowed to take loan from the conventional banks on interest basis. On the other hand Islamic banks are not providing free interest loans because they are not charitable institutions to advance money without any profit. Because of this reason it is likely possible that the istisna contract may be used as a device like extending interest based finance. For example it is possible that the Islamic bank or any other Islamic financial institution may buy an agricultural commodity from a farmer on immediate payment basis, and then sell the same commodity to the same farmer at higher price on deferred payment basis. It means that there should be an actual istisna contract between a farmer and Islamic bank or Islamic financial institution and should not be used as a device for interest. When the agricultural commodity, which was required by a farmer, manufactured or constructed or produced, then there is no need for a farmer and Islamic bank to renew the offer and acceptance for the sale or purchase of the required commodity. Here at this particular point the difference between istisna and murabaha transaction arises because in the latter case the actual sale or purchase of the required agricultural commodity must take place. So, it is easier for an illiterate farmer to understand the procedure of istisna easily as compared to that of Murabaha.

It is a well established principle of istisna contract that it is not necessary that the price should be always in the form of cash, but it may be in the form of cash or tangible goods or the usufructs on an asset for a particular duration, whether such usufructs are related to an asset other than the subject matter or to the subject matter itself. While applying this philosophy, istisna contract can be made more useful for the agricultural sector. As mentioned earlier that usually a farmer has no money in his pocket and after entering into the contract of istisna if it is permissible for him not to pay the price in the form of cash, but to pay it in the form of any agricultural product i.e. wheat, maize, barley, rice, apple, peach, nut and etc, then the conclusion of such contract will become more easy for him. That is why it is suggested that each and every Islamic bank or any Islamic financial institution must have its own subsidiary company for the

purpose to deal with such commodities when these come in its ownership as a price for the istisna commodity. Such company will not only be beneficiary for the Islamic bank to deal with istisna price, but will also be helpful in other modes of Islamic financial system e.g. Salam, Ijarah, Murahaba and etc. It will also resolve many other issues which are related to the Islamic bank.

After a practical study of the agricultural sector it is revealed that most of the farmers are having residency remote from their field, and some of them are not even having the ownership of a house, and hence living on rent. For the purpose to solve both these problems, the contact of istisna, in the view of researcher, is the best solution, because according to a well established principle of Islamic commercial law, it is permissible to draw up an istisna contract for real estate developments on designated land owned by the ultimate purchaser. While applying this principle along with the principle that the price of istisna contract may be in the form of cash or tangible goods or the usufructs of an asset for a particular duration, a farmer can request to the Islamic bank or any other Islamic financial institution to construct a house for him on the land owned by him. When the construction of the house is completed, the farmer will transfer its usufructs (residence) to the Islamic bank as a price for istisna contract. After this, the Islamic bank will lease the house to the farmer on rent for a particular period of time.

It is permissible for the Islamic banks and other Islamic financial institutions to appoint the farmer as their agent by concluding a separate and independent contract of agency with them. This is the most suitable way especially when the contact of istisna is applied for house financing or even project financing. The reason is that it is extremely difficult job for the Islamic bank to supervise the manufacturing or construction process itself and its practical involvement is not possible in the real sense. It is the duty of the farmer, after being appointed as an agent of the bank to supervise the manufacturing or construction process for the purpose to ensure that the manufacturer or constructor is working according to the contract and the commodity is produced according to the specifications which are mentioned in the contract. After being appointed as an agent, the farmer can take two sorts of charges from the Islamic bank

- First            He can take charges from the Islamic bank for the agency contract. It is in conformity with the Islamic commercial law because according to its well established principle charges can be taken for agency.<sup>322</sup>
- Second        He can also take additional charges as cost for supervision of an istisna contract. But it depends upon the provision of the contract that which party will bear the additional cost of supervision.

Some of the scholars, particularly those who are directly or indirectly related to the Islamic bank, may criticize the above idea for one reason or another. But if it is desired to establish an Islamic bank with its real spirit, then it is compulsory to apply a concept of shariha as a whole and it is not permissible

to apply only those concepts which are in the benefit of Islamic bank and ignore those which are against its benefits.

When the required commodity is produced, then before delivery, the commodity will remain at the risk of the Islamic bank, but when the possession is transferred to the farmer, which may be actual or constructive, then risk will also be transferred to him. It is to be noted that transferring of authority from the Islamic bank to the farmer to use the property, utilization and consumption will be considered constructive possession. It is the duty of Islamic bank to deliver the commodity on the due date (if it is mentioned in the contract because in the beginning it is suggested that in the contract between the Islamic bank and a farmer, the time should not be fixed, while in parallel istisna contract which is between the Islamic bank and a seller, the time should be fixed) and not before that because according to Islamic commercial law, if the manufactured goods are delivered before the due date, the farmer can refuse to accept the delivery and in this case it may create problem for the Islamic bank.

While summarizing the whole procedure of istisna contract which must be followed by the Islamic bank is that first a farmer will express his desire to buy a commodity and will conclude istisna contract with it. It should be mentioned in the contract that whether the payment will be on spot or deferred. After this Islamic bank will put itself under obligation to manufacture the said commodity and to deliver it in a specific period subject to the agreement. It will also express its desire in ordering the manufacture of the commodity it had undertaken to manufacture in the first istisna contract with farmer and agree with the manufacturer (seller in the parallel istisna) on the price and the date of deliver. The seller in the parallel istisna contract will put himself under the obligation to manufacture the specific commodity and will deliver it on the due date. After the delivery is made to the Islamic bank, it will also delivery the commodity to the farmer directly by itself or will authorize any party to deliver it on its behalf. At the end the farmer will satisfy himself that the commodity is according to the specifications which are mentioned in the contract.

## **6 Rental Based Modes of Financing and their application to the agricultural sector**

### **6.1 Introduction**

In Islamic commercial law there are two types of commercial transactions. The first one is called sale transaction while the other is called ijarah. This division is based on the philosophy that whether the ownership is transferred to the transferee or not, so if it is transferred then it is called sale transaction, and if it is not, then it is called ijarah. Like the first one, the latter plays an important role in the development of commercial activities.

It is a solid fact that there are some people who are not in position to buy a commodity because of its expensive nature in the local market but at the same time they are in tense need of that, and at this particular situation the concept of ijarah comes to the spot to play its role. By the way of this transaction they are in position to acquire the commodity for their use for specific time at a specific consideration. As it is said that in such transaction only the usufructs of the commodity is transferred and not its ownership, so the consideration for use is very cheaper in nature and thus, affordable.

The concept of Ijarah in Islamic commercial law reveals that the basic philosophy behind it is to help out those people who are unable to buy for themselves the products of daily life. They take such things from the rich people who have the capability to buy these, on Ijarah basis. They use the leased asset, pay rent which is agreed upon, and after the termination of Ijarah return back the leased asset to the owner. It is pertinent to mention that above philosophy is only limited to the concept of Ijaratul-Ashya (lease of usufructs of a commodity).

As for as the agricultural sector is concerned, the contract of ijarah can be effectively applied to it. The farmers usually belong to the lower class who have no resources even to fulfil their needs of daily life. They are in need of money in the beginning of season for crops and non-crop activities. In the very first chapter it is tried to envisage the idea of Qardh- i- Hasan in the banking sector in order to fulfil their basic agricultural needs. These basic needs can also be fulfilled by the way of Bai-al-Salam. However, there are some other needs, for example machinery that cannot be satisfied through these modes as these are short term financing modes that contain small loans while the basic machinery required by the agricultural sector is more expensive in nature and cannot be fulfilled by small loans. On the other hand, the farmers are not in such an economic position to buy even small input for crop production i.e. seeds, fertilizers, insecticides, pesticides, Herbicides, weedicides, manual spray etc, then, how they can buy such expensive machinery for their agriculture. In order to fulfil such expensive needs of the farming sector for crops and non-crop activity the concept of Ijarah comes to the spot. It has the ability to be effectively implemented in the agricultural sector.

Under this chapter, first the literal and technical meaning of Ijarah will be discussed along with its basic principles, followed by the description of its different types, application, and its practical implementation to the agricultural Sector.

## 6.2 Definitions of Ijarah

The word Ijarah literally means “to give something on rent” or it means “lending of some object to somebody in return for some rental against a specified period”. But before any other discussion, the jurisdiction of the word "something" must be determined. Here the word “something” means “benefits or services”. This meaning shows that its jurisdiction is limited to benefit and services. In this connection Ijarah means “to give benefit or services on rent”. Different scholars define Ijarah according to their own concept regarding it. According to Ibn Qudama, a Hanbali scholar “it is the sale of usufructs”.<sup>323</sup> According to Hanafi School of thought “it is a contract on usufructs for a known consideration”.<sup>324</sup> The same definition is given by Imam Sharakhsi.<sup>325</sup> But this definition is also not comprehensive in nature, because it does not provide the idea of such usufructs which may be in the shape of benefit of something or personal services. A contemporary scholar Dr. Wahba-al- Zuhali define Ijarah as “it is the sale of usufructs”.<sup>326</sup> This definition is similar to that of Hanbali school of thought.

The Shafi and Maliki Jurists' definitions are not given here because of their lengthy nature however, it is a matter of fact that they give more emphasis on the conditions of Ijara, rather to discuss its essential elements. Ibn- e- Rushd Put forward a new idea by saying that lease is a kind of sale in which the use or benefit of something changed for a price in the shape of rent. But when the definition of sale is studied profoundly then it reveals that it is the exchange of property for a property by mutual consent. The question arises that whether the benefit or services of something is a property? If the answer is in the shape of "no" then why Ibn- e- Rushad says that lease is like a sale? According to another contemporary scholar Mufti Muhammad Taqi Usmani, "it is a contract to employ the services of a person on wages or to transfer the usufructs of a particular property to another person in exchange for a rent claimed from him".<sup>327</sup> According to Imran Ahsan Khan Nyazee, Ijarah means technically “the acquisition of benefits or services with a counter value as compensation”.<sup>328</sup> Between these two definitions, the definition which is given by Muhammad Taqi Usmani is more comprehensive in nature because it conveys both aspect of Ijarah which is lease contract (to transfer the benefit of something as well as the hire contract for the hiring of services of a person). A profound study of all these definition reveals that almost all school of Fiqh are agree that Ijarah is a contract which permits ownership of the use rights of an asset.<sup>329</sup>

It is pertinent to mention that the concept of Ijarah presented by Islamic Commercial law is more comprehensive in nature as compared to the concept of lease in English commercial law because the previous includes the contract of lease as well as the contract of hiring.

Study reveals that the contract of Ijarah is different from other Islamic commercial transactions in two aspects. First, for example in a sale transaction it is necessary that the subject matter of contract must exist at the time of contract. In other words sale of a thing not in existence at the time of Contract is prohibited by Sharia. But in the contract of Ijara the services or benefits being sold does not exist at the time of contract.<sup>330</sup> They are generated periodically after the contract has been concluded. If the above principle is strictly followed then the contract of lease would be a void contract. But the Hanafi School of thought permits it on the bases of Istehsan relying on the need of people for such contract.<sup>331</sup> Secondly there are so many numbers of verses in the Holy Quran that also support the permissibility of such contract. The second distinction is that unlike most other Islamic commercial transaction, this contract is for a fixed period and sometime there is no limitation at all on the time. So, it has a dual nature unlike other contracts. Because of this reason the Hanafi jurists have the view that the contract of Ijarah when it is concluded for a series of fixed periods being renewed automatically for each period.

### **6.3 Legitimacy of Ijarah**

On the basis of Istehsan, the legitimacy of Ijarah can be proved from the Holy Quran, Sunnah of the Holy Prophet (sm) and Ijma.<sup>332</sup>

According to the Holy Quran "And if they suckle your offspring, then give them their recompense."<sup>333</sup> According to another verse "Said one of the (damsels),"O' my father engage him on wages, truly the best of men for thee to employ is the man who is strong and trusty".<sup>334</sup> Both these verses show that the contract of Ijara is permitted by Islam because they talk about the hiring of Jacob's services by his father-in-law as well as the payment of wages to foster mother. According to a tradition of Holy Prophet (SAW) wages of the person hired are to be paid before his perspiration dries up. The Holy Prophet (sm) says; "Give wages of the person hired before his sweat dries up"<sup>335</sup> According to another tradition of the Holy Prophet (SAW) "If someone hires a person, let him inform about the wages he is to receive."<sup>336</sup> All the companions of the Holy Prophet (Saw) unanimously held Ijarah is a lawful contract. They not only accepted its legal status but also practiced it in their lives. This contract has its approval almost in all schools of Fiqh.<sup>337</sup> They not only approved Ijarah but also discussed its general principles and conditions. Besides all these arguments, the jurists also throw legality over Ijarah because of Istihsan, which is a departure from the general rule. According to a general rule of Islamic commercial law an object which does not exist at the time of contract, may not be sold. However, Ijarah is valid despite its being sale of the usufructs which are non-existent at the time of contract.

## 6.4 Basic Principles of Ijarah in Islamic Commercial Law

There are some basic principles of Ijarah which must be observed in the contract of Ijarah. These are given below.

- It is a condition for the validity of Ijarah that the object leased must not be a perishable or consumable. So, Ijarah must be affected only on the non-consumable things. The reason behind this rule is that in the contract of Ijarah there is transfer of the usufructs and not of the ownership. The lessee must have to return the commodity to the owner after the termination of Ijarah and it is not possible if the commodity is consumable. Ibn Qudama has the same view.<sup>338</sup> Therefore, the lease cannot be effected on money, eatables (wheat, rice, maize etc.), fuel and ammunition etc.<sup>339</sup> The reason behind this prohibition is that the use of such things is not possible unless and until they are consumed. The consequences of this principle are that if the consumable commodities are given, then in such case the rules of Ijarah should not be applicable but the rules of loan should be applicable. So, any rent charged in this case would not be a rent but would be interest charged on loan. So, the Islamic banks and other Islamic Financial institutions must be careful in the application of Ijarah as a mode of financing.
- In the contract of ijarah the lessor gives the property to the lessee for a particular purpose. Such purpose must be lawful and should be mentioned in the contract of Ijarah.<sup>340</sup> It is incumbent upon the lessee to use the property according to such object which is mentioned in the contract. But if such object or purpose is not mentioned in the contract for one reason or another, in such a situation the jurisdiction of custom begins and comes to the spot, and the lessee must have to use the commodity according to the prevailing custom. But the question arises that when the custom is silent then how the commodity would be used? In such a situation the lessee must have to use the commodity according to the reason of a man of ordinary prudence .if the lesser wishes to use the commodity for any purpose other than which is mentioned in the contract, then he must have to take explicit permission from the lessor in this regard.
- In the contract of Ijarah, the owner does not transfer the ownership but only the usufructs and because of this reason the leased asset shall remain at the risk of the lesser throughout the lease period. So, if there is any harm or loss caused by the factors beyond the control of the lessee e.g. earthquake, storm, flood etc, must be borne by the lessor. This rule can be discussed in another way that the hands of lessee, according to Islamic law, are the

hands of a trustee and there is no liability on him, if there is loss or harm to the leased asset in a normal situation.<sup>341</sup> But if the loss or harm occurs because of his negligence, misconduct, breach of the contract etc, then in such a situation he will be responsible because according to Islamic law a person should be stood responsible for his own deeds.

The outcome of this discussion is that the lessor must accept responsibility for any defects of the leased asset which impair the intended use of the asset wholly or partially, and, he cannot exclude his liability for any impairment that the leased asset may sustain even if that impairment is the result of events out of his control.<sup>342</sup> But if the benefit from the leased asset is impaired wholly or partially as a result of the lessee's misconduct or negligence or breach of contract, then the lessee is responsible and he has the obligation to restore or repair the usufructs, and he has also to pay the rent for the time in which the benefit is lost.<sup>343</sup>

- As said earlier that in the contract of Ijarah the ownership remains with the lessor and only the use is transferred to the lessee, so those liabilities which are related to the ownership must be borne by the lessor e.g. property tax, insurance cost, major maintenance etc., while the liabilities which are related to the use of the leased asset must be borne by the lessee e.g. water bills, electricity bills, gas bills etc.<sup>344</sup> However, it is possible by mutual consent of the lessor and lessee, that the latter will pay the property tax which will be settled down in the shape of rent.
- The rental must be determined at the time of the contract for the whole period of lease. But it is also possible that different amounts of rent are fixed for different phases during the leasing period but it is subject to condition that rent for each phase must be specified. So rentals in Ijarah can be fixed for the whole lease period or floating/ variable subject to mutual understanding. It can also be agreed upon that the rent shall be increased after a specified period like a year or so. The contemporary scholars have also allowed to tie up the rent with a well-defined reference rate or benchmark or to enhance the rent periodically according to a mutually stipulated proportion (e.g. 7.5 per cent per year) subject to the condition that other requirements of Shariah for a valid lease are duly fulfilled.
- Like rent, the leasing period should also be fixed, and it is immaterial that whether such period is long or short. Ibn Qudama describes the same rule in his book *Al-Kafi*.<sup>345</sup> A majority of the jurists have the same view. However, according to Imam Malik a commodity should not be given for a long period on lease because, according to him, it may lead to a dispute between the contracting parties. For example he does not allow renting of a house for more than two years.<sup>346</sup>

- The rental may be in cash or in goods or benefit. But it should not be paid in the same genus or species. Imam Kasani presents a full pledge description in this regard.<sup>347</sup> Thus, a house cannot be rented in exchange for another house. The rent should be paid in term of money or other marketable value. In reality this condition is directed against transaction involving riba. Thus, money cannot be rented in term of money as this leads to loan transaction bearing interest.<sup>348</sup>
- The aim and object of the Ijarah contract must be according to Shariah.<sup>349</sup> It must be a lawful one. So, it is not permissible to hire a house for the purpose of gambling or manufacturing wine. If the object of the contract is lawful in the beginning, but it becomes unlawful latter on, the contract will become void automatically, and in such a case the lessee have to pay rent only for that duration for which the contract was valid, and for void period, the lessor cannot put any claim.
- The contract of Ijarah is binding in nature and none of the parties has the right to terminate it without the consent of the other party. So, for the termination of the contract, the consent of both parties or mutual consent is necessary. According to Imam Sharakhsi Ijarah is a contract of exchange the essence of which is its binding nature, so it can not be terminated without a reasonable reason.<sup>350</sup>

The contract of Ijarah comes to an end when there is a defect in the leased asset in such a way that it cannot be repaired; however if the defect is temporary in nature then the contract will become ineffective only for that period, and when the defect is removed, the contract will become in activation. If some of the parties secure the option to terminate the contract in the beginning of the contract, then he can exercise such option at any time and can terminate the contract unilaterally without the consent of the other party. This is the view of the majority of the scholars.<sup>351</sup> Based on the similar principle, the lessor can stipulate in the beginning of the contract that if the lessee fails to pay the rent or to pay it in time,<sup>352</sup> then the Ijarah contract will come to an end automatically. The Ijarah contract does not terminate with the death of the lessor or lessee. In case of death of the lessor, his legal heirs will collect the rent and will distribute it according to their corresponding shares in the property (here the property means the property which is rented to the lessee) of the deceased person. Ibn Qudama describes this rule in details.<sup>353</sup> It is pertinent to mention that such rule is applicable only to Ijaratul-Ashya (hiring of things) and not Ijaratul-Ashkhas (hiring of services) particularly when such services are personal in nature. For example if a person hires the services of a particular painter to paint his house and then that person dies, the contract of Ijarah will come to an end. In case of death of the person, the legal heirs will pay the rent. However, if they prove that the contract of Ijarah which is made by their ancestor, is too much difficult for them to continue because it is out of their resources and in excess of their needs. The contract of Ijarah also comes

to an end if there is total destruction of the leased asset. It also comes to an end at the expiry of the period which is mentioned in the contract. However, this rule is not strict in nature, and the contract may remain operative for a good cause such as the late arrival to the place intended in the lease of transportation vehicles, and in the case of late harvesting period of land leased for crop cultivation etc. In such situations the rent will be paid by lessee to the lessor according to the custom prevailed in that area.

## **6.5 The Concept of Ijarah in Islamic Banking**

Before embarking on the concept of Ijarah in Islamic banking it is necessary to define it in the same context which means "the process by which usufructs of a particular property is transferred to another person in exchange for a rent claimed from him/ her". A profound study reveals that banking ijarah resembles to the concept of leasing practiced by the conventional banks. It is pertinent to mention that the concept of Ijarah presented by Islamic Commercial Law does not apply to the banking sector completely and this application is limited to a part of it. It presents only usufructs of assets and properties and not the services of human beings. It is a fact that conventional banks are advancing loans on interest basis. The Islamic bank can also advance Qardh-i-Hasana which is actually a loan without interest. But it is not willing to do so because there is no benefit for it. However, they must have to fulfil the needs of that person who is resorting to conventional banks to get loan. For the purpose to attract such customer, the Islamic bank adopts leasing as a mode of financing instead of long term lending on the basis of interest. A well renowned scholar Mufti Muhammad Taqi Usmani says

"When interest free financial institutions were established in the nearest past, they found that leasing is a recognized mode of finance through out the world. On the other hand, they realized that leasing is a lawful transaction according to Shariah and it can be used as an interest free mode of financing."<sup>354</sup>

As mentioned earlier in the previous pages that leasing originally is not a mode of financing in Islamic commercial law but because of its peculiar characteristics it can be used for financing but in this latter situation the Islamic bank has to be careful because it has a number of characteristics similar to the loan transaction. So, if the contract of ijarah is not applied in its true spirit and principles which are prescribed for it by Shariah, then it may become a contract of loan and in this case all rules and regulations of loan will be applicable.

The above discussion shows that the contract of Ijarah can be used as a mode of financing but with the condition that certain basic principles must be observed. So, it is not enough to substitute the name of 'interest' with the name of 'rent' and replace the name of 'mortgage' with the name of the leased asset.<sup>355</sup> Under the arrangement of lease, the Islamic bank leases equipment, a building or other facility to the

client against an agreed rental. The rent is so fixed that the bank gets back its original investment plus a profit on it.

Leasing is emerging as a popular technique of financing among the Islamic banks in these days. Many of the Islamic banks are now actively involved in the implementation of Ijarah, and Islamic Development Bank (IDB), Bank Islami, Al-mezan Bank and even some commercial banks such as Askari Bank, Alfalah Bank and etc are very active in this regard. Under this scheme of financing, an Islamic bank purchases a required commodity on the request of a client, according to the specification mentioned by him in the application. For example a person having insufficient money or having the money invested somewhere else, want to purchase some type of machinery or a car and etc. He approaches the bank for getting the required asset on ijarah.<sup>356</sup> After this the Islamic bank leases it to the client for a rental fee for a specific duration. The rental fee and period for Ijarah must be determined by the Islamic Bank and its client according to the nature of the asset which is leased out. During the period of lease, the asset remains in the ownership of the bank but its right to use is transferred to the lessee. Keeping the principle in view it is necessary that the leased asset should be a non consumable thing so that it may remain in the ownership of the owner such as car, house and shop etc.<sup>357</sup> After the expiry of the agreement, this right reverts back to lessor.

Lease as a technique of Islamic finance holds a lot of promise and potential to develop into a viable and power tool to financing. At present many Islamic banks are experimenting with various forms of leasing one of which is the lease purchasing agreement. In this scheme, the lessee can purchase the equipment at the end of the lease period at a price that is agreed in advance by the concerned parties. In most cases, the payment may constitute of two components i.e. variant rents and a portion of the price to be paid in the instalments. In another variant of lease purchase agreement, the rent may itself constitute the part payment of the price. But the lease and purchase agreement should be independent of each other and hence should not be concluded in one document.<sup>358</sup> It is pertinent to mention that Islamic banks use Ijarah to a very limited extent. The reason is that many Shariah's experts do not approve it, and those who approve it also limit it to the non-consumable goods only.

If Ijarah is compared with other modes of Islamic Finance then it seems very peculiar in nature by providing variable profits margin because the lease payment for different periods varies. It is generally determined according to Libor rate at a particular time, plus a fixed fee. But it is not necessary that Libor should be used as a bench mark and it may be any other bench mark that should be based on a clear formula.<sup>359</sup> Apart from retaining ownership over the asset that is financed, the bank requires an additional security through the payment of the lessee of an amount to be mutually agreed upon by the parties as a security deposit, technically called Hamesh Jeddeya. However, some of the scholar consider both these different things. In this regard a well renowned scholar Mulana Ejaz Ahmad Samdani says

”it should be clarified here that Hamesh Jeddeya and Security Deposit are two different things. The role of Hamesh Jeddeya is limited to the execution of Ijarah.....While the security Deposit can be used to recover all actual losses up to the termination of Ijarah”<sup>360</sup>

The lessor can use this in any manner it wishes in case of a rent default. To ensure timely payment, liquidated damages are included in the contract, specifying extra payments that need to be made for any day of delay. The bank can issue Ijarah bonds for placement with the Islamic investors. In Islamic commercial law such bonds are called Sukook. These are permissible from the perspective of Shariah because in lease only the usufruct of the leased asset is transferred to the lessee and not the ownership. It is for the purpose that Islamic bank wants to refinance itself. Alternatively, special Islamic funds can be set up to engage in Ijarah financing. Much of the recent growth in Islamic finance has been through the creation of such funds.

Different banks of different countries operate Ijarah differently. For example more conservative Shariah Board stipulate that management, insurance and maintenance is the sole responsibility of the Islamic bank as a lessor which is totally a different concept from the conventional banking because in the latter case all these responsibilities are attached to the lessee. These risks leaving the lessee with little incentive to properly manage and maintain the assets. But in the researcher’s point of view this purpose can be achieved through insertion of strong undertakings in the lease contract. The Islamic banks can also combine Ijarah with other modes of financing. It is generally done for financing of expensive assets. In such a situation the construction part can be financed through an Istisna, and once the asset is constructed and handed over to the Islamic bank, the Islamic bank will lease it or sell it on deferred payment terms to the company that will operate it.

## **6.6 Application of Ijarah in Agricultural Sector**

The basic rules and regulations of Ijarah, in the perspective of Shariah, are discussed thoroughly in the previous lines and now its practical utility for the agricultural sector will come under discussion. The farmers usually belong to the lower class who have no resources even to fulfil their basic agricultural needs. They are in need of money in the beginning of season for crops and non-crop activities. In the second chapter it is tried to envisage the idea of Qard- i -Hasan in the banking sector in order to fulfil all these basic needs. These can also be fulfilled by the way of Bai al-Salam as discussed in the fourth chapter. However, there are some other needs, for example heavy agricultural machinery i.e. tractor, thrashers, and etc that cannot be satisfied by these modes because of the reason that these are short

term financing modes that contain small loans while such machinery is more expensive in nature and cannot be fulfilled by small loans. On the other hand, the farmers do not have such an economic position to buy even small input for crop production i.e. seeds, fertilizers, insecticides, pesticides, Herbicides, weedicides, manual spray etc, and then how they can buy such expensive machinery for their agriculture. In order to fulfil such expensive needs of the farming sector for crops and non-crop activity, the concept of Ijarah comes to the spot. It has a great potential to be effectively applied to the agricultural sector.

The concept of ijarah in Islamic commercial law reveals that the basic philosophy behind it is to help out those people who are unable to buy for themselves the products of daily life. They take such things on Ijarah from the rich people who have the capability to buy these commodities, an Ijarah basis. They use the leased asset, pay rent which is agreed upon, and after the termination of Ijarah return back the same to the owner. It is pertinent to mention that above philosophy is only limited to the concept of Ijaratul-Ashya (lease of usufructs of a commodity).

The contract of ijarah is more suitable for the agriculture sector as compare to other modes of financing. It is because of two reasons.

- First there is some tax relaxation given by the government. So for a farmer it is a cheaper mode of financing. Because of this relaxation, the institution's cost over the commodity becomes less and resultantly the farmer has to pay normal rent.
- Secondly in other modes of financing, a farmer has to pay on spot, and if he is not required to pay on spot then he has to pay high rate. However, in the contract of Ijarah a farmer has to pay in instalments and to pay a normal amount of rent. So, in the researcher's point of view a farmer should have to have more inclination towards the contract of Ijarah as compared to other modes of financing.

Islamic banks and other Islamic financial institutions use ijarah as an alternative to loan facility advanced by the conventional banks. Actually the farmer does not want to get an asset on lease but he wants to purchase it. This aim cannot be achieved through the adoption of a normal sale transaction because it is not possible for him to pay the whole amount at a time. Ijarah is the cheaper transaction that solves such problem. For the solution of the same problem the Islamic bank envisaged the idea of "Lease and Purchase".

Ijarah is a long term financing which is for the purpose to meet long term financial requirements of farmers for both crop and non-crop activities. It shows that Islamic banks and other Islamic financial institutions will purchase heavy equipments like machinery, equipments, tractors, vans etc and then will hand over such assets to a farmer on lease. It is to be noted that Ijarah is generally used for the purpose to provide heavy equipments or machinery like tube-well, tractor and etc<sup>361</sup> to the agricultural sector for both crop and non-crop activities. It can be used effectively for farm mechanization financing. In this situation

the Islamic banks and other Islamic financial institutions will acquire the required asset and rent it out to the farmer. These equipments and implements may consist of trailers, threshers, power filler, power and boom sprayers, plough, cultivators, riggers, drills, rotovators, driggers, cotton picker, saw machines for crate making, press machine for wheat straw and dry fodder, chisel ploughs, potato planter, sugar cane planter, Rice trance planter, self propelled reaper for harvesting wheat and rice crops etc<sup>362</sup>. After acquiring the asset it is the duty of Islamic banks and other Islamic financial institutions to deliver the asset to the farmer. Such delivery may be actual or constructive because the latter is also recognized by Islamic law. A time should be framed for such delivery in the contract and if the Islamic bank fails to deliver the asset on the date specified, then it cannot claim any rent from the farmer for that duration, and the agreed rent should also be reduced accordingly. The implements and equipments which are discussed above for farm financing are usually not too much expensive. So it is better that the Islamic bank should purchase the commodity by itself and thus will become the absolute owner of the asset, and will then lease the asset to the farmer.

The Islamic banks and other Islamic Financial Institutions can also provide transport facility to a farmer through transport financing. This can be done by two ways. First it is possible that the Islamic banks and other Islamic Financial institutions will acquire the required asset and will become its absolute owner. After this they will lease the asset to the farmer on rent. This is a normal lease transaction as like 'farm mechanization financing' which is discussed thoroughly in the previous pages. Secondly it is also possible that the Islamic banks or Islamic financial institutions and a farmer acquire the asset jointly and thus become the co-owner. Such ownership can be structured on the basis of Diminishing Musharakah. In this case there must be an agreement in which both the parties will agree on the point that how much portion of the price will be paid by the farmer and the Islamic bank. After acquiring the asset the Islamic bank will rent its share to the farmer. The latter will also promise that he will purchase share of the Islamic bank in the asset gradually until and unless he becomes its sole owner. By this way heavy price vehicles e.g. tractors, refrigeration vans, farm cooling tanks, motorcycles for milkmen, small pickups, mini trucks, chiller carriers etc can be acquired.<sup>363</sup>

After a thorough study of farm mechanization financing and transport financing, a conclusion is drawn, which may not be correct, that both these cannot help a poor farmer. The reason behind this is very clear. If the agricultural sector is studied then it reveals that for the majority of farmers, farming is not a business but a way to live. In other words it can be said that majority of them belong to the lower class. The question that always comes to the mind and at the same time irritate it that how a farmer who is unable to buy the basic needs for agriculture e.g. seeds, fertilizers, herbicides, weedicides, insecticides, manual sprays etc, then how he can lease or purchase expensive agricultural implements and equipments e.g. tractors, thrashers, mini trucks, vans, power tillers, rotavators, driggers, press machines for wheat

straw and dry fodder etc. it is seemed that all these sorts of financing are not structured for a poor farmer, although they are suitable for those farmers for whom agriculture is a business and not a way of life i.e. land lords. It is the primary duty of the Islamic banks and other Islamic financial institutions to help out the poor farmers by providing them their basic needs of agriculture both for crop and non crop activities. So those things which are consumable in nature, the Islamic bank must have to enter into the contract of Murabaha with the farmer. These commodities may consist of seeds, fertilizers, herbicides, weedicides, insecticides, manual sprays etc., while those basic needs of the farming sector which are in the shape of non-consumable commodities, the Islamic bank must have to use Ijarah for all those e.g. spade, shovel, fork, tube well, hand fork, hoe, rake, wheel barrow, watering can etc. For these things the Murabah and Salam modes of financing can also be very effective to be used.

It is a matter of fact that some of the Islamic banks and financial institutions draw their attention to help out the poor farmers in the crop and non-crop activities. For this purpose they buy heavy machineries and equipments, which are necessary for the agriculture sector, from the local market. By this they own a pool of machinery and equipments e.g. tractors, threshers. Power tillers, plough, cultivators, riggers, drills, rotavators, cotton pickers, potato planter, sugar cane planter, rice transplanter, self propelled reaper for harvesting wheat and rice crops etc. After having such assets, the Islamic bank leases these to a farmer on lease basis. For the easiness of a farmer, the Islamic banks usually lease these assets on the basis of hourly rentals. It is a fact that some of the local people, especially in the rural areas, also own such assets particularly tractors. They also give their tractors to farmers on the basis of hourly rentals. It is suggested for the Islamic banks to charge rents comparatively less than the rentals charged by the local people from the local farmers. It will be very helpful for the extension of their business

As said earlier that farmers usually belong to the poor class and because of this reason the Islamic bank must have to settle the rentals in such a way to get a reasonable profit from a farmer. It must have to act on the principle "the institution does not finance primarily the farmer to get profit but finance him for the purpose to facilitate him". So it must have to treat a farmer as a special customer by providing him special concession in rents and will not treat him as an ordinary customer.

## **6.7 Procedure for agricultural ijarah**

If a farmer and an institution, which may be Islamic bank or any other Islamic Financial Institution, want to enter into the contract of ijarah then they must have to follow a specific procedure. Each and every Islamic bank has its own procedure which a customer has to follow while dealing with that bank. But there is a general procedure discussed by the Accounting and Auditing organization For Islamic Financial Institutions (AAOIFI), which is acting as a guide line for the Islamic financial institutions. But that procedure is not simple in nature and cannot be understood by an illiterate farmer for

the determination of his rights and obligations .so it is not suitable for agricultural sector .it is because of this reason a simple procedure has to be followed as for as the agricultural sector is concerned. It will be very helpful for both the parties to get awareness about the minute details of the contract. Similarly if the procedure is simple then it will be in the benefit of the Islamic banks or Islamic Financial Institution and the farmer because it will decrease expenses of the contract, and, resultantly a farmer would pay less rent.

Before entering into the contract of Ijarah, the farmer and Islamic bank may enter into Master Ijarah. After the notice of offer and acceptance such memorandum will become an integral part of the contract. But it is not mandatory and the parties can enter into the contract directly without resorting to it. In the Master Ijarah Agreement, the farmer will undertake that he will take certain asset of lease from the Islamic bank upon arrival of such assets. He will submit an application that he is in need of certain asset lease. The institution will acquire the commodity and will transfer its usufructs to the farmer. The Islamic bank may purchase the commodity by itself or will appoint another person as its agent who will purchase the commodity on its behalf. It can also appoint the farmer (the applicant) as its agent. In the researcher's point of view the farmer is the best choice for agency. It is because that he knows better the quality of the asset that he requires. Secondly, if he buys the commodity himself then he will get awareness about its price which will help him in the settlement of rentals. But the Islamic bank must be careful while appointing the farmer as its agent. The reason is that some institutions misuse this provision. They hand over money to the farmer as debt on interest basis who himself buys the commodity from the local market. In such situation it is looking that contract is the contract of Ijarah but in real sense it is the contract of loan. For the purpose to remove such ambiguity, the institution must have to pay the payment directly to the seller and not to hand over the money to the farmer directly.

### **6.8 Securities in agricultural ijarah**

The Islamic bank and other Islamic Financial Institutions can ask a farmer to provide a sum of money to the institution as a security for the purpose to guarantee the farmer's commitment to accept the lease asset upon its arrival and also to fulfil his subsequent obligations. This is because that binding promise has financial implication. If the farmer retracts from his promise, then the financial institution will deduct the actual damage from such security. Such security can also be used when the farmer does not pay the rent for a particular time. This principle has been approved by the Shariah Board of Al-Barkha Bank in the shape of Fatwa. This security is called Hamesh Jeddeya.<sup>364</sup> While according to some scholar security and Hamesh Jeddeya are two different thing In this regard a well renowned scholar Mulana Ejaz Ahmad Samdani says

”it should be clarified here that Hamesh Jeddeya and Security Deposit are two different things. The role of Hamesh Jeddeya is limited to the execution of Ijarah.....While the security Deposit can be used to recover all actual losses up to the termination of Ijarah”<sup>365</sup>

But demanding security from a poor farmer is not satisfactory in nature because of some reasons.

- First, demanding security from a poor farmer has no logic. Actually these farmers resort to the Islamic bank because of lack of money in their empty pockets. The question arises that how such a poor individual can give money in advance as a security or Hamish-Jiddiyah to the institution.
- Secondly, promises are generally not binding in Shariah. Majority of scholars have the view that fulfilling a promise is a noble quality and it is advisable for a promisor to observe it, but it is neither mandatory nor enforceable through the court of law. This is the view of Imam Abu Hanifa, Imam Shafi, Imam Muhammad and some Maliki jurists.<sup>366</sup> The Maliki Jurists regard promises as binding in nature. This view is attributed to Ibn-Shabramah, a Maliki jurist.
- Thirdly, not only shariaha but also the conventional law does not attribute binding nature to a promise

The above description shows that majority of the Muslim jurists do not accept binding nature of a promise. The view which is attributed to Ibn-e-Shabramah has his personal view and cannot be preferred over the majority view. It is to be noted that when a particular concept of Shariah is applied to a particular situation (contract), then it must be applied in such a way to confirm all the requirements of Shariah along with the Intention of the law giver. It is not allowed to use a legal device (which is in this case the statement of Ibn-Shabramah) and subterfuge to circumvent the obstacles posed by the Islamic Commercial law. As said by the majority jurists, promises should not be made binding one because it is against the basic principles of Shariah. But a question may be raised by a conscious reader that if promises are declared unenforceable especially in the commercial transactions then it may seriously jeopardize commercial activities.

A jurisprudential solution of such problem can be sought out. It is not correct to say that promises are binding in nature because as said earlier that almost all the jurists have consensus that promises cannot be enforced through the court of law. But it can be said that the basic principle of Shariah is that promises are not binding in nature, however, for the public good (Istihsan) it can be made binding. Keeping in view the above discussion a farmer can be asked to pay some amount as a security. However, this security should not be in the form of cash, but it may be in the form of title documents of the property owned by the farmer. But if he has no property at all, then in such a case, a cash amount can be taken from him and that should be a very small amount less than the amount received by the Islamic banks and other Islamic financial institutions from other customers as a security for the purpose to insure their

commitment. The security which is given by a farmer, if in the shape of cash, can be held by the bank as a trust and cannot be used by it without permission from the farmer.<sup>367</sup> After getting permission, the institution will invest it on the basis of Mudharabah or Musharakha and in this case the profit will be shared between the farmer and bank according to the agreed ratio.<sup>368</sup>

## **6.9 Buy back transaction and agricultural ijarah**

It is reality that a farmer is always in need of money in the form of cash. He likes to buy seeds, fertilizers, machinery and other equipments according to his own wishes. For the purpose to achieve money in the form of cash, he cannot take loan on the interest basis, because it is strictly prohibited by Shariah. He sells an asset (tractor, tube well etc.) to the bank and subsequently takes the same asset from the bank on Ijarah basis. The Accounting and Auditing organization For Islamic Financial institutions allows it but with the condition that the subsequent contract of lease should not be stipulated in the contract of sale.<sup>369</sup> In such a situation the asset must come in the ownership of the bank. But this arrangement is not according to the basic principles and spirit of Islamic commercial law. Because it is clearly a buy back transaction which is strictly prohibited by Shariah. The philosophy of Ijarah clearly shows that in such contract the lessee gets the leased asset on lease because he is unable to buy it. So keeping in view the above arrangement, if the lessee owns the asset, then sells it to the Islamic bank and takes it back on Ijarah, reveals that he is only in need of money on interest bases (here rent will be considered as an interest). No logic is found that why a well renowned contemporary scholar Mufti Muhammad Taqi Usmani allows it although he himself says

“As mentioned earlier, leasing is not a mode of financing. However, the transaction may be used for financing, subject to certain condition. It is not sufficient for this purpose to substitute the name of 'interest' with the name of rent and replace the name of mortgage with the name of the leased asset”.<sup>370</sup>

So, it is not permissible for the Islamic banks and other Islamic Financial Institutions to purchase a commodity from the farmer and then lease it back to him on rent. It is also not permissible because Imam Al-Kasani says that even if there is a doubt of 'riba' in a contract, then it will be null and void.<sup>371</sup> But the question arises that how a farmer will get money in the form of cash to satisfy his basic needs. The answer to this question has been given in the chapter of qardh-i-Hasan. He can resort to the bank by the door of Qardh-i-Hasan to get money in the form of cash.

## **6.10 Urboon in agricultural ijarah**

The Islamic banks and other Islamic financial institutions can take urban (advance payment) from a farmer after the execution of the contract. This is treated an advance payment of the rentals. This rule has been given in the Accounting and Auditing Organization for Islamic Financial Institution (Shariah standard). It further says that if the farmer fails to execute the lease contract, then the bank can retain such amount.<sup>372</sup> But this rule is not satisfactory in nature. The reason is that urbun is a concept which is originally related to the contract of sale. Even the Jurists have contradiction over the same issue and some of them allow it while the others not. Even in the contract of sale there is no single opinion of the jurists regarding it. The question comes to the mind that how it can be applied to the contract of Ijarah. Secondly as mentioned earlier that farmers are poor people then how they can give money as an advance payment of the rents? It is true that some of the scholars have the view that lease is a contract of sale because there is exchange of two counter values. For example a well renowned Hanafi Jurist Imam Sarkhsi says "in the wider sense the term 'bay' includes Ijarah because it is the exchange of benefits arising from rented property for rent, or it is the exchange of wages for services rendered. Hiring is often referred to by Jurist as the sale of benefit arising periodically".<sup>373</sup> So, if the contract of Ijarah is considered as a contract of sale then consequently all rules and regulation of sale contract, which also includes the concept of urboun, will be applicable to it. But it is pertinent to mention that Imam Sarakhsi's statement has is not understood properly according to the context. He does not say that Ijarah is a sale but he says that in broad sense the word "buy" includes the term Ijarah. Similarly he describes the sale and Ijarah in two different chapters. If it is considered that Ijarah is a sale, there would be no need to discuss them separately in two different chapters. In short, it can be said that Ijarah and sale are two different concepts and hence advance payment cannot be given in the contract of Ijarah being a basic rule of the former. Thirdly, if the advance payment is taken from a farmer which will be considered a part of the rental, then it means that the Islamic bank has taken the rent from the farmer before he uses the leased asset. It is strictly prohibited by Shariah to charge the rent from the lessee before he uses the leased asset.<sup>374</sup>

## **6.11 Penalty clause in agricultural ijarah**

Some of the banks include a penalty clause in the contract of Ijarah with the farmer. This penalty is for the purpose to prevent the latter from the default of payment. This principle has been based by the Hadiths of the Holy Prophet (sm) and Qiyas (analogy). Hadiths of the Holy Prophet (sm) are "Procrastination by the default is injustice", and "Harm may neither be inflicted nor reciprocated". This last Hadith is also supported by the legal maxim "Harm must be eliminated". The Qiyas which is made a base for this principle is that delay in payment is seen to be analogous to ghasb (usurpation) and the usurper may, in the Shafi and Hanblali School of thought, be held liable to compensate the owner for his

loss. The 'Illah' or effective cause that is in common between 'ghasb' and 'mumathla' is "obstructing the use of property and exploiting it in a tyrannical way" The Fiqh Academy of the Organization of Islamic Conference, in its resolution 66(1992) authorized imposition of liquidated damages and penalty in 'Istisna' (manufacturing contract) on the basis of prior agreement between the contracting parties. This is when the parties agree and stipulate in their contract a sum that shall be payable in the event one party fails to discharge or delay his contractual obligation.<sup>375</sup>

The evidence quoted in support of this ruling is the Bukhari Hadith in which the Holy Prophet (sm) said "Muslims are bound by their stipulation unless it be a condition that renders a Haram into Halal or vice versa".<sup>376</sup> Similarly a statement of a well renown judge in the history of Islam Shuray Ibn Harith , " who ever imposes a condition upon himself voluntarily, he must abide by it"<sup>377</sup> Imam Abu Zahra has the same view. He says that due to the change of circumstances people may need to insert a condition on 'Twa'id' in contract to secure their economic interest in which case they are bound by their stipulation.<sup>378</sup> But all these arguments must be studied analytically. Penalty clause should not be inserted in the contract of Ijarah because it will open the gate for riba. The banks and other financial institutions may misuse this rule to a great extent. A well renowned Scholar Mufti Muhammed Taqi Usmani has the same view. He says

“Inserting of penalty is not valid in the contract of lease according to well established principles of Islamic law. The reason is that the rent after it becomes due is a debt payable by the lessee and a monetary charge on it is tantamount to riba. However, a stipulation can be put in the contract of lease that if the lessee fails to pay rent after the time specified in the contract (late payment) then he has to pay a certain amount for charitable purpose. This may provide a deterrent to late payment even though it does not compensate the lessor for his opportunity cost over the period of default”.<sup>379</sup>

In short words it can be said that the Islamic banks and other Islamic Financial institution should not insert penalty clause in the contract of lease with farmer.

## **6.12 The law of options in agricultural ijarah**

Another issue, which is very important in the contract of lease, is that of law of option and stipulation. It is to be noted that the concept of options and stipulation is executed in the contract of sale. But it is also equally applicable to the contract of lease, because the word "bay", in broad sense, according to Imam Sarakhsi, also includes lease.<sup>380</sup> So the Islamic banks or financial institutions and a farmer can insert law of option and stipulation in the contract of lease. This law of option will be effective, according to the majority view, for three days. So a farmer can hire an object from the Islamic bank and other

Islamic financial institutions on the basis of option of defect (Khiyar-al-Ayb). If he finds any defect in the leased asset, then he can dissolve the contract. Similarly both the parties to the contract or their agent have the right to stipulate the option of viewing (Khiyar-al-Ruyah) which would entitle them to dissolve their contract after seeing the leased object if they have not seen it at the time of contract.

The implementation of the law of option is necessary to be applied in the agriculture sector particularly in the contract of lease. The reason is that it will be in the benefit of farmers, although the insertion of such law will not be beneficial for the Islamic banks and Islamic financial institutions. Because of this reason they are reluctant to stipulate the option of viewing or defect in the contract.

### **6.13 Application of different kinds of ijaraha to the agricultural sector**

There are two kinds of Ijarah practiced by the modern banks (conventional banks) e.g. finance lease and operating lease. The first one is not according to the basic principles of Shariah because in this case the risk is borne by the lessee, while in Shariah risk of damage and obsolescence is exclusively borne by the lessor. Similarly in this lease, the lessee cannot cancel the contract even if he finds the item unuseful during the term. While Islamic law of option recognizes the option of defect to be inserted in the contract of lease. Keeping these drawbacks in the mind, a farmer cannot conclude the contract of finance lease with bank (conventional bank). But as far as the operating lease is concerned, there is nothing objectionable from the Shariah's perspective, and hence a farmer can conclude such contract with the bank.<sup>381</sup>

As far as the Islamic banks are concerned, there are two types of Ijarah e.g. Ijarah Muntahiya Bittamleek and direct leasing. Both are according to the rules and regulations of Shariah. But as far as the agricultural sector is concerned, a more inclination should be given to the direct leasing. There are so many reasons for this inclination.

- The first one is that in Ijarah Muntahiya Bittamleek there is complexity because it is nearly a mixture of two contracts i.e. sale and Ijarah. The first one is in the shape of a unilateral promise in the beginning and turns to a contract at the end, while the latter is in the shape of a regular contract from the very beginning. Because of this complexity it is extremely a difficult job for an illiterate farmer to understand such contract and its complexity.
- Secondly this contract is not a desirable from the perspective of Shariah because it is similar in feature to the finance lease which is discussed in the above lines.
- Thirdly, in this kind of lease the object is eventually acquired by the lessee. Because of this reason, the lessee has to pay the rentals equal to the price of the leased asset along with profit. It means that a farmer has to pay more. A question arises that a person who is unable to purchase basic needs of agricultural sector e.g. seeds, herbicides, insecticides, weedicides etc, how he can

purchase a tractor or a thresher etc. But it does not mean that such kind of lease is unuseful at all. It is a very beneficial for a middle class of farmers who have comparatively owns a large portion of land as compared to the farmers of the lower class.

On the other hand, direct leasing should be preferred for agricultural finance. It is because of some genuine reasons.

- Firstly, this contract is very simple in nature and does not create any sort of ambiguity in the mind of an illiterate farmer.
- Secondly, there is no objection on this kind of lease from the Shariah's perspective. In other words it can be said that it is a purely Islamic mode of financing.
- Thirdly, this kind of lease is very suitable for a poor and indigent farmer who is unable even to buy for himself the basic tools for agriculture.

So, in the researcher's point of view, which may not be correct to a great extent, the Islamic banks and other Islamic financial institutions should use the direct leasing for the agricultural sector which is a normal form of lease and completely according to rules and regulations of Islamic commercial law. But when the direct leasing is not possible for one or another reason, they can resort to the Ijarah al Muntahiya-Bil-Tamleek. As far as the conventional banks are concerned, if they are willing to help out a poor farmer by the way of an Islamic lease, they can do this by the way of operating lease and not by the way of finance lease because the previous is according to rules of Shariah.

Ijarah contract is not concluded forever and comes to an end after a particular time which is mentioned in the contract. According to the majority of schools except the Hanafi School of Thought, allow the revocation of Ijarah when the leased asset loses its utility and benefit. They argue that the basic purpose of Ijarah is to enable the lessee to enjoy the usufructs of the leased object, and until and unless this purpose is existing, the contract cannot be revoked.<sup>382</sup> Unlike the Hanafi school of thought, the majority of schools have the view that Ijarah contract cannot be revoked on the ground of any personal disability of the lessor or lessee.<sup>383</sup> Similarly they have the view that Ijarah remains intact even after the death of one of the contracting parties but their legal heirs would consequently step into the shoes of their deceased. While the Hanafi school of thought have a different view in this connection.

As far as the agricultural sector is concerned, the Ijarah contract must be for a specific period which is mentioned in the contract. But there must be flexibility in such specification in the sense that if there is necessity of extension beyond the due date. It is because that in agriculture sector no body knows about the exact date of harvest with certainty.<sup>384</sup>

It is known that "Ijarah" is a term of Islamic Fiqh which is used for two different situations. In the first place it means to employ the services of a person on wages given to him as a consideration for his hired services. In the second place it means to transfer the usufructs of a particular property to another

person in exchange for a rent claimed from him. Both these kinds of Ijarah are thoroughly discussed in the literature of Islamic Jurisprudence and each one of them has its own set of rules. The Islamic banks are generally using the second type of Ijarah which is the transfer of usufructs of a particular asset against a specific rental.<sup>385</sup> The Islamic banks and other Islamic financial institution do not use Ijarah in its full fledged scenario, but only use a part of it which is the transfer of usufructs of a particular asset. They do this because of high potentiality of profit involved in it. On the other hand, they do not pay any attention to the second portion of Ijarah which is the employment of services of a person. But the Ijarah of personal services (Ijarat-al-Ashkhas) has also a great potential for profit if it is used by the Islamic banks and other Islamic financial institutions in its real spirit.

## Notes

- <sup>1</sup> Draft Guideline for Livestock Financing, A Guideline issued by the state Bank of Pakistan, p.1
- <sup>2</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Series Number 280, January. 1982, p.17
- <sup>3</sup> See for details [www.pakistan.com](http://www.pakistan.com);agricultural sector in Pakistan
- <sup>4</sup> See for details [www.pakistan.com](http://www.pakistan.com);agricultural sector in Pakistan
- <sup>5</sup> Waiter Schaefer – Kehnert and Jhon D.Von Piodike “Agricultural credit policy in developing countries”, World Bank Re Print Series Number 280, p-4.
- <sup>6</sup> See for details International Farm Management-Farming At The Edge.p.1
- <sup>7</sup> Waiter Schaefer – Kehnert and Jhon D.Von Piodike “Agricultural credit policy in developing countries”, World Bank Re Print Series Number 280, p-4.
- <sup>8</sup> See Imam Ibni Rushd Al Qurtabi,Bedayat-al- Mujtahid Wa Nehayat-al- Muqtasid,Kitab-al-Sharika,vol.2;Imam Kasani, Badai al-Sanai, vol.6 and etc
- <sup>9</sup> See Muhammad Taqi Usmani,An Introduction to Islamic Financial System,editon August 2008,Maktaba Maariful Quran Karachi,p.10
- <sup>10</sup> Draft Guideline for Livestock Financing, A Guideline issued by the state Bank of Pakistan, p.1
- <sup>11</sup> Dr. Muhammad A.Gulaid, Financing Agriculture through Islamic modes and Instruments Practical Scenario and Applicability, Research Paper-No.34, p-44.
- <sup>12</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.5
- <sup>13</sup> See for details Livestock from Wikipedia, the free encyclopedia.
- <sup>14</sup> See Draft Guidelines for Livestock Financing, issued by Agricultural Credit Department of The State Bank of Pakistan, p-1.
- <sup>15</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.6
- <sup>16</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.6
- <sup>17</sup> See for details website of Zarai Traqiati Bank
- <sup>18</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.5
- <sup>19</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.4
- <sup>20</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.4
- <sup>21</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.4
- <sup>22</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.5
- <sup>23</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.6
- <sup>24</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.6
- <sup>25</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan,page no.5
- World Bank (1975) Agricultural Credit Sector Policy Paper, World Bank, Washington, D.C.
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- <sup>31</sup> Finance Scheme for Small Farmers, Guideline presented by the Agriculture Credit Department of State Bank of Pakistan, p. no12
- <sup>32</sup> Finance Scheme For Small Farmers, Guideline presented by the Agriculture Credit Department of State Bank of Pakistan, p. no12
- <sup>33</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Series Number 280, January. 1982,p.17
- <sup>34</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Series Number 280, January. 1982,p.17
- <sup>35</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Series Number 280, January. 1982,p.17
- <sup>36</sup> Gonzales, Vega, C-1977"Interest Rate Restrictions and Income Distributions," American Journal of Agriculture Economics, Volume-59, No. ,pp.972-976
- <sup>37</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Series Number 285, January. 1982, p .18
- <sup>38</sup> See for details Stock Hausen, J-Von (1973) "Supervised Credit In Entwick Lungsländern Unter besonder Berncksichtigung Von Sudamerika"["Supervised Credit" In Developing Countries With Special Reference to South America], Agrarwirtschaft [Agrarian Ecomomy] Volume N. 22.No.9, pp.309-316
- <sup>39</sup> Agricultural Credit Constraints And Borrowing Behaviour Of Farmers, an article presented by co-authors Waqar Akram, Zakir Hussain, M-H-Sial and Ijaz Hussain, page.8
- <sup>40</sup> See for details web page of Zarai Taraqaiti Bank Limited
- <sup>42</sup> See for details web page of Zarai Taraqaiti Bank Limited
- <sup>43</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Series Number 285, January. 1982, p.7
- <sup>44</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Sense No. 280, (11982), p-8
- <sup>45</sup> "Financing Scheme for Small Farmer" A guideline issued by the State Bank of Pakistan, p-12.
- <sup>46</sup> Financing Agricultural through Islamic Modes and Instruments Practical Scenarios and Applicability by Dr. Mahmoud. A; Gulaid, Research Division Islamic Development Bank Jeddah, Saudi Arabia, Research Paper No. 34, p-44.
- <sup>47</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Sense No. 280, (11982), p-8.
- <sup>48</sup> Donald, G. (1976) Credit for small farmers in developing countries, Westview Press, Boulder, Colorado.
- <sup>49</sup> Agricultural Credit Policy in Developing Countries, World Bank Reprint Sense No. 280, (11982), p-8
- <sup>50</sup> Taslim Sjah, Lean Russel, Douald Cameron, "Acceptance And Repayment of Agricultural Credit in Lombok Indonesia – Farmers perspective" School of NRSU, university of Queensland, Galton Campus, Australia, Faculty of Agriculture University of Mataram, Indonesia,p.3
- <sup>51</sup> Taslim Sjah, Lean Russel, Douald Cameron, "Acceptance And Repayment of Agricultural Credit in Lombok Indonesia – Farmers perspective" School of NRSU, university of Queensland, Galton Campus, Australia, Faculty of Agriculture University of Mataram, Indonesia,p.3
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- <sup>54</sup> See for details web page of Zarai Taraqaiti Bank Limited
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- <sup>56</sup> "Acceptance and Repayment of agricultural credit in Lombok Indonesia – Farmers perspectives" An article written by Tashim Sjah, Lean Russel and Donald Cameron, School of NRSU, university of Queensland, Gatton Campus, Australia, Faculty of Agriculture, University of Mertaran, Indonesia.
- <sup>57</sup> Quran 2433
- <sup>58</sup> Quran 23
- <sup>59</sup> Mushtaq Ahmed, Business Ethics in Islam,a PhD desertation
- <sup>60</sup> See Wahba al –Zuhali, al-Fiqh al-islami wa adillahtuho, Iran, Nashr ihsan, third edition, 2006, vol.5, p.3786
- <sup>61</sup> See Bukhari, English version, translated by by M. Muhsin Khan,chapter.41,Hadith.572
- <sup>62</sup> Muhammad al shwkani,Nayl –al-Awtar,Dar Ehia -al -Tourath -al –Arabi,first edition,2001,vol5p.259.
- <sup>63</sup> See Wahba al –Zuhali, al-Fiqh al-islami -wa -adillahtuho, Iran, Nashr ihsan, third edition, 2006, vol.5, p.3787.
- <sup>64</sup> See Al-Imam-Alkasani, Badia-al-Sanai fi Tarteeb-al-Sharai, Daru-al-Fikr, Beroot Labnan, First edition, Kitab-al-Qard, vol.7, p.581.
- <sup>65</sup> Ibn Qudamaha, al-sharh al-Kabir, Beroot Daru-al-Fikr, vol.4, p.313.

- <sup>66</sup> See Muhammad Taqi Usmani, An Introduction to Islamic Financial System, editon August 2008, Maktaba Maariful Quran Karachi, p.10
- <sup>67</sup> See Imam –al-Shawkani, Nay-al-Awtar, Kitab-al-Qard, first edition 2001, published by Dar Ehia Al-Tourath Al-Arabi, p.260.
- <sup>68</sup> See Al-Imam-Alkasani, Badia-al-Sanai fi Tarteeb-al-Sharai, Kitab-al-Qard, vol.7, p.581.
- <sup>69</sup> See Imam –al-Shawkani, Nay-al-Awtar, Kitab-al-Qard, p.261.
- <sup>70</sup> See Wahba al –Zuhali, al-Fiqh al-islami -wa -adillahtuho, vol.5, p.3793.
- <sup>71</sup> See Al-Imam-Alkasani, Badia-al-Sanai fi Tarteeb-al-Sharai, Kitab-al-Qard, vol.7, p.582; See also Imam –al-Shawkani, Nay-al-Awtar, Kitab-al-Qard, p.262.
- <sup>72</sup> See Al-Imam-Alkasani, Badia-al-Sanai fi Tarteeb-al-Sharai, Kitab-al-Qard, vol.7, p.583.
- <sup>73</sup> Akhtar, A.R. (1988), The Law and Practice of Interest-Free Banking (With Banking).
- <sup>74</sup> See Financing Scheme for Small Farmers, issued by Agricultural Credit Department of The State Bank of Pakistan, p.4.
- <sup>75</sup> Guidelines on Islamic Finance for Agriculture ,issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan, p.4
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- <sup>77</sup> See Al-Imam-Alkasani, Badia-al-Sanai fi Tarteeb-al-Sharai, Kitab-al-Qard, vol.6, p.212
- <sup>78</sup> See Dr.Mulana Ejaz Ahmad Samdani, Islamic Banking, A Realistic And Balanced Analysis, Idara-e-Islamiat Karach –Lahore, 2007 edition, p.55.
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- <sup>81</sup> Mufti Muhammad Taqi Usmani, An Introduction to Islamic financial system, p.119.
- <sup>82</sup> Mufti Muhammad Taqi Usmani, An Introduction to Islamic financial system, p.118.
- <sup>83</sup> See Imam –al-Shawkani, Nay-al-Awtar, Kitab-al-Qard, p.261.
- <sup>84</sup> Quran, 3824.
- <sup>85</sup> Ibn Qudamah, al-Sharh al-Kabir, Beiut Dar-al-Fikr, vol.3, p.348.
- <sup>86</sup> Ibn Abidin, Raddul al-Muhtar, vol.3, p-364
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- <sup>98</sup> Dr. Saad-Al-Hasan, Article on Musharakha Financing Model.
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- <sup>102</sup> Siddiqi, M.N., Partnership and project sharing in Islamic law, the Islamic foundation, Leicester, 1985, p-22-23.
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- <sup>118</sup> Tanawi, Ashraf Ali, Imdadul-Fatawa.
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- <sup>120</sup> Ali Abdullah Ali is professor of Economics, college of Business Studies, Sudan University of Science and Technology.
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- <sup>129</sup> See Ali ibni Abu Bakar ibni Abdul Jalil al –Farghani al-Marghinani al-Rushdani Burhan al-Din, Kitab al-Hidayah sharh Bidayat al-Mubtadi, Cairo, 1368/1948. vol.4, p.54.
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- <sup>131</sup> Majallah al-Ahkam al- Adliyah, section.1431.
- <sup>132</sup> Dr. Mahmood A. Gulaid, Financing Agriculture through Islamic Modes and Instrument Practical Scenarios and Applicability, Islamic Research And Training Institute Islamic Development Bank Jeddah, Saudi Arabia, Research Paper-No.34, p.45.
- <sup>133</sup> See Imam Kasani, Badai al-Sanai, vol.6, p.264.
- <sup>134</sup> Ibn Umar is reported to have said that the Holy Prohet (sm) made a Muamala (agreement) with the people of Khayber for part of the yield of fruit and crops (This tardition isn reported in the Sahih Compilation; see also Al-Shawkani, Nayl-al-Awtar, Vol.5, p.310.
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- <sup>138</sup> See Imam Kasani, Badai al-Sanai, vol.6, p.280.
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- <sup>259</sup> See Dr Muhammad Tahir Mansuri, Islamic law of contracts and business transctions, p. 204.
- <sup>260</sup> See Imran Ahsan Khan Nyazee, outline of Islamic Jurisprudence, p. 276.
- <sup>261</sup> See Al-sharaksi, Al-Mabsoot, vol.12.p.131.
- <sup>262</sup> See Wahba-al-Zuhaili, Al-Fiqhu-al-islami –Wa-Adilatohu, vol.5.p.3613.
- <sup>263</sup> See Imam Ibni Rushd Al Qurtabi, Bedayat-al- Mujtahid Wa Nehayat-al- Muqtasid, Kitab-al-Salam, vol.2, p.358.
- <sup>264</sup> See Ashraf Ali Tanvi, imdad-ul-Fatawa, vol.3, p.211
- <sup>265</sup> See Wahba-al-Zuhaili, Al-Fiqhu-al-Islami –Wa-Adilatohu, vol.5.p.3611.
- <sup>266</sup> See Imam Ibni Rushd Al Qurtabi, Bedayat-al- Mujtahid Wa Nehayat-al- Muqtasid, Kitab-al-Salam, vol.2, p.357.

- <sup>267</sup> See Ashraf Ali Thanwi, *Imdad -al -Fatawa*, vol.3.
- <sup>268</sup> See Imam Shawkani, *Nayl-al-Awtar*, vol.5, p.173.
- <sup>269</sup> See Al-sharaksi, *Al-Mabsoot*, vol.14, p.6.
- <sup>270</sup> See Imam Ibni Rushd Al Qurtabi, *Bedayat-al- Mujtahid Wa Nehayat-al- Muqtasid*, *Kitab-al-Salam*, vol.2, p.360.
- <sup>271</sup> See Guidelines on Islamic Finance for Agriculture, issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan, p.1.
- <sup>272</sup> See Report of the State Bank of Pakistan on Rural Finance, 2002.
- <sup>273</sup> See Dr.Ahmad Kaleem (The writer is an associate professor at Lahore School of Economics), *Agri Overview, Outlook for Islamic Financing of Agriculture*.
- <sup>274</sup> See Guidelines on Islamic Finance for Agriculture, issued by the Agricultural Credit Department Islamic Banking Department State Bank of Pakistan, p.1.
- <sup>275</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.10, English Version,Rule.2/1/1*, p.153.
- <sup>276</sup> See Wahba-al-Zuhaili, *Al-Fiqhu-al-Islami –Wa-Adilatohu*, vol.5, p.3605.
- <sup>277</sup> See Imam Shawkani, *Nayl-al-Awtar*, *Abwab-al-Riba*, vol.5, p.173.
- <sup>278</sup> See Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.187.
- <sup>279</sup> See Imam Ibni Rushd Al Qurtabi, *Bedayat-al- Mujtahid Wa Nehayat-al- Muqtasid*, *Kitab-al-Salam*, vol.2, p.355.
- <sup>280</sup> See for a detailed discussion Wahba-al-Zuhaili, *Al-Fiqhu-al-Islami –Wa-Adilatohu*, vol.5, p.3611.
- <sup>281</sup> See Al-sharaksi, *Al-Mabsoot*, vol.14, p.6.
- <sup>282</sup> See Al-sharaksi, *Al-Mabsoot*, vol.12, p.131.
- <sup>283</sup> See Muhammad Tariq Usmani, *An introduction to Islamic Finance*, P.193.
- <sup>284</sup> See Al-Rajhi Banking Investment Corporation, *Collection of Shariah Fatawas, Resolution No.41*.
- <sup>285</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.10, English Version,Rule.6/3*, p.167.
- <sup>286</sup> See Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.194.
- <sup>287</sup> It is pertinent to mention that this idea has been described generally for salam by Mulana Taqi Usmani, however it can be extended to the concept of Parallel Salam.
- <sup>288</sup> See Imam Kasani, *Badai al-Sanai*, vol.6, p.94.
- <sup>289</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.10, English Version,Rule.6/2*, p.167.
- <sup>290</sup> pertinent to mention that this idea has been described generally for Salam by Mulana Taqi Usmani; however it can be extended to the concept of Parallel Salam.
- <sup>291</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.10, English Version,Rule.5/7*, p.168.
- <sup>292</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.10, English Version,Rule.3/3*, p.165.
- <sup>293</sup> Dr. Muhammad Tahir Mansori, *Islamic Law of Contracts and Business Transactions*, p.x.
- <sup>294</sup> See Ibni-Abidin, *Rad-al-Mukhtar*, vol.4, p.221.
- <sup>295</sup> See Imam Kasani, *Badai al-Sanai*, *Kitab-al-Bouy*, vol.5, p.213.
- <sup>296</sup> See Wahba-al-Zuhaili, *Al-Fiqhu-al-Islami –Wa-Adilatohu*, vol.5, p.3643.
- <sup>297</sup> See Muhammad Taqi Usmani, *An Introduction to Islamic Financial System*, p.195.
- <sup>298</sup> See *Istisna Contract in Islamic Fiqh*, Publication Series of Tadamon Islamic Bank, Shaban.1412, February.1992, Issued by the Fatawa and Research Department, p.30.
- <sup>299</sup> See Imam Kasani, *Badai al-Sanai*, *Kitab-al-Bouy*, vol.5, p.311.
- <sup>300</sup> See Al-sharaksi, *Al-Mabsoot*, *Kitab-al-Bouy*, vol.12, p.139.
- <sup>301</sup> See Al-sharaksi, *Al-Mabsoot*, *Kitab-al-Bouy*, vol.12, p.139.
- <sup>302</sup> See Dr.Muhammad A.Gulaid, *Financing Agriculture Through Islamic Modes And Instrument Practical Scenario And Applicability*, p.44.
- <sup>303</sup> See Dr.Muhammad A.Gulaid, *Financing Agriculture Through Islamic Modes And Instrument Practical Scenario And Applicability*, p.54.
- <sup>304</sup> “Guidelines on Islamic Finance for Agriculture” is a draft issued by the Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan.
- <sup>305</sup> See *Istisna Contract in Islamic Fiqh*, Publication Series of Tadamon Islamic Bank, Shaban.1412, February.1992, Issued by the Fatawa and Research Department, p.17.
- <sup>306</sup> See Imam Kasani, *Badai al-Sanai*, *Kitab-al-Istisna*, vol.5, p.4.

- <sup>307</sup> See Guidelines on Islamic Agricultural Finance, issued by Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan, p.5.
- <sup>308</sup> See Guidelines on Islamic Agricultural Finance, issued by Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan, p.6.
- <sup>309</sup> See Guidelines on Islamic Agricultural Finance, issued by Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan, p.5.
- <sup>310</sup> See Guidelines on Islamic Agricultural Finance, issued by Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan, p.7.
- <sup>311</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, Shariah Standard.11, English Version, Rule.7/4, p.187.
- <sup>312</sup> See Ezzendine Mohd. Khoja, Head of Financial Investment Department, Instrument of Islamic Investment, Dallah-al-Baraka Group.
- <sup>313</sup> See Guidelines on Islamic Agricultural Finance, issued by Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan, p.5.
- <sup>314</sup> See Shariah's opinion on Istisna Contract and Salam, Compiled and Classified by Dr. Ahmed Moheddin Ahmad, Reviewed by Dr. Abdul Star Abu Ghddah, Al-Barka Banking Group Department of Research and Development.
- <sup>315</sup> See Accounting and Auditing Organization for Islamic Financial Institutions, Shariah Standard.11, English Version, p.194.
- <sup>316</sup> See Dr. Muhammd Tahir Mansori, Islamic Law of Contract and Business Transaction, p.392.
- <sup>317</sup> See Imam Kasani, Badai al-Sanai, Kitab-al-Istisna, vol.5, p.4.
- <sup>318</sup> See definition of Parallel Istisna Contract, Accounting and Auditing Organization for Islamic Financial Institutions, Shariah Standard.11, English Version, p.195.
- <sup>319</sup> See Wahba-al-Zuhaili, Al-Fiqhu-al-Islami –Wa-Adilatohu, vol.5.p.3644; Istisna Contract in Islamic Fiqh, Publication Series of Tadamon Islamic Bank, Shaban.1412, February.1992, Issued by the Fatawa and Research Department, p.17.
- <sup>320</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, Shariah Standard.11, English Version, Rule.7/1, p.186.
- <sup>321</sup> See Imam Kasani, Badai al-Sanai, Kitab-al-Istisna, vol.5, p.4
- <sup>322</sup> See Wahbah-al-Zuhaili, Al-Fiqh-al-Islami Wa Adilatoho, vol-5, p.4058.
- <sup>323</sup> See Abdullah ibni Qudama-al-Muqadisi, Al-Kapi, Kitab-al-Ijarah, vol.2, p.300.
- <sup>324</sup> See Imam Kasani, Badai al-Sanai, Kitab-al-Istisna, vol.4, p.256.
- <sup>325</sup> See Al-sharaksi, Al-Mabsoot, Kitab-al-Bouy, vol.15.p.67.
- <sup>326</sup> See Wahba-al-Zuhaili, Al-Fiqhu-al-Islami –Wa-Adilatohu, vol.5.p.3803.
- <sup>327</sup> See Muhammad Taqi Usmani, An Introduction to Islamic Financial System, p.p.157-158.
- <sup>328</sup> See Imran Ahsan Khan Nyazee, Outlines of Islamic Jurisprudence, p.284
- <sup>329</sup> See Dr. Muhammad A. Gulaid, Financing Agriculture Through Islamic Modes And Instrument Practical Scenario And Applicability, p.48.
- <sup>330</sup> See Al-sharaksi, Al-Mabsoot, Kitab-al-Bouy, vol.15.p.75.
- <sup>331</sup> See Imam Kasani, Badai al-Sanai, Kitab-al-Istisna, vol.4, p.255.
- <sup>332</sup> See Imam Kasani, Badai al-Sanai, Kitab-al-Istisna, vol.4, p.255.
- <sup>333</sup> Quran, 656
- <sup>334</sup> Quran, 2826
- <sup>335</sup> See Al-sharaksi, Al-Mabsoot, Kitab-al-Ijaraat, vol.15.p.75.
- <sup>336</sup> See Imam Shawkani, Nayl-al-Awtar, Kitab-al-Ijaraat, vol.5, p.173
- <sup>337</sup> See Imam Ibni Rushd Al Qurtabi, Bedayat-al- Mujtahid Wa Nehayat-al- Muqtasid, Kitab-al-Ijaraat, vol.2, p.387.
- <sup>338</sup> See Abdullah ibni Qudama-al-Muqadisi, Al-Kapi, Kitab-al-Ijarah, vol.2, p.301.
- <sup>339</sup> See Imam Kasani, Badai al-Sanai, Kitab-al-Ijarah, vol.4, p.257-258.
- <sup>340</sup> See Wahba-al-Zuhaili, Al-Fiqhu-al-Islami –Wa-Adilatohu, vol.5.p.3869.
- <sup>341</sup> See Imam Kasani, Badai al-Sanai, Kitab-al-Ijarah, vol.4, p.308.
- <sup>342</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, Shariah Standard.9, English Version, Rule.5/1/5, p.142.
- <sup>343</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, Shariah Standard.9, English Version, Rule.5/1/6, p.142.
- <sup>344</sup> See Muhammad Taqi Usmani, An Introduction to Islamic Financial System, p.160.
- <sup>345</sup> See Abdullah ibni Qudama-al-Muqadisi, Al-Kapi, Kitab-al-Ijarah, vol.2, pp.308-309.
- <sup>346</sup> See Imam Ibni Rushd Al Qurtabi, Bedayat-al- Mujtahid Wa Nehayat-al- Muqtasid, Kitab-al-Ijaraat, vol.2, p.401.

- <sup>347</sup> See Imam Kasani, *Badai al-Sanai, Kitab-al-Ijarah*, vol.4, p.285.
- <sup>348</sup> See Imran Ahsan Khan Nyazee, *Outlines of Islamic Jurisprudence*, p.286.
- <sup>349</sup> See Abdullah ibni Qudama-al-Muqadisi, *Al-Kafi, Kitab-al-Ijarah*, vol.2, p.302.
- <sup>350</sup> See Al-sharaksi, *Al-Mabsoot, Kitab-al-Ijaraat*, vol.15.p.81.
- <sup>351</sup> See Imam Kasani, *Badai al-Sanai, Kitab-al-Ijarah*, vol.4, p.295.
- <sup>352</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.9, English Version,Rule.7/2/2,p.145*.
- <sup>353</sup> See Imam Ibni Rushd Al Qurtabi, *Bedayat-al- Mujtahid Wa Nehayat-al- Muqtasid, Kitab-al-Ijaraat*, vol.2, p.407.
- <sup>354</sup> See Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.163.
- <sup>355</sup> See Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.164.
- <sup>356</sup> See Dr.Mulana Ejaz Ahmad Samdani, *Leasing Process In Islamic Banking System,Darul-Ishaat Karachi-Pakistan,2008.p.25*.
- <sup>357</sup> See Dr.Mulana Ejaz Ahmad Samdani, *Leasing Process in Islamic Banking System*, p.16.
- <sup>358</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.9, English Version,Rule.8/1,p.146*.
- <sup>359</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.9, English Version,Rule.5/2/3,p.143*.
- <sup>360</sup> See Dr.Mulana Ejaz Ahmad Samdani, *Leasing Process in Islamic Banking System*, p.16.
- <sup>361</sup> See Guidelines on Islamic Agricultural Finance, issued by Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan, p.10.
- <sup>362</sup> See Guidelines on Islamic Agricultural Finance, issued by Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan, p.5.
- <sup>363</sup> See Guidelines on Islamic Agricultural Finance, issued by Agricultural Credit Department Islamic Banking Department of State Bank of Pakistan, p.5.
- <sup>364</sup> It is pertinent to mention that Accounting and Auditing Organization for Islamic Financial Institution treats Hamesh Jeddeya as a security deposited by the customer.for example see for details *Shariah Standard.9, English Version,Rule.2/3,p.146*.
- <sup>365</sup> See Dr.Mulana Ejaz Ahmad Samdani, *Leasing Process in Islamic Banking System*, p.16.
- <sup>366</sup> See for further details Malik, *Fathul-ola*, vol.1, p.254.
- <sup>367</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.9, English Version,Rule.2/3,p.139*.
- <sup>368</sup> See Dr.Mulana Ejaz Ahmad Samdani, *Leasing Process in Islamic Banking System*, p.41.
- <sup>369</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.9, English Version,Rule.3/2,p.140*.
- <sup>370</sup> See Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p.164.
- <sup>371</sup> See Imam Kasani, *Badai al-Sanai, Kitab-al-Buoy*, vol.5, p.258.
- <sup>372</sup> See Accounting And Auditing Organization For Islamic Financial Institutions, *Shariah Standard.9, English Version,Rule.4/1/4,p.141*.
- <sup>373</sup> See Al-sharaksi, *Al-Mabsoot*, vol.14.p.119.
- <sup>374</sup> See Muhammad Taqi Usmani, *An Introduction to Islamic Finance, Ijarah*, p.165.
- <sup>375</sup> See *Majmu' -al-Fiqh li Rabitha al-Aslam. Qararat Majma' Al Fiqh al-Islami 1975*
- <sup>376</sup> Ibn Maja has reported this tradition,2/783,printed by Mustafa al-Babi al-Halabl,Calro,1372H/1952 A.D
- <sup>377</sup> See Al-Bukhari, *kitab al-Shurut (book of conditions)*
- <sup>378</sup> See Mustafa al-Zarqa, *al-Madkhal-Fiqhi-al-Amm, Al-Fiqh-ul-Islam- Fi -Thawbih- al-Jadid, Damascus; Dar-al-Fikr, 1968,III,386*.
- <sup>379</sup> Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, pp. 171-172.
- <sup>380</sup> See Al-sharaksi, *Al-Mabsoot*, vol.13.p.109.
- <sup>381</sup> The idea has been taken from the books "Islamic Law of Contracts and Business Transaction" written by my respected teacher Dr. Muhammad Tahir Mansoori, pp237-238.
- <sup>382</sup> See Imam Kasani, *Badai al-Sanai*, vol.4,p.287.
- <sup>383</sup> See Imam Kasani, *Badai al-Sanai*, vol.4,p.289.
- <sup>384</sup> See for details Accounting and Auditing Organization for Islamic Financial Institutions, *Shariah Standard.9, English Version,Rule.7/2/6,p.145*.
- <sup>385</sup> See Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, pp.157-158.

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