

An Analytical Study of the Shariah Foundations of the Contemporary Islamic Banking in the Light of the Teachings of the Holy Prophet Muhammad ﷺ

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Abstract

This paper describes in detail the Islamic principles of investment and partnership and then takes a closer look at the current banking practices in vogue in Inslamic Banking system of Pakistan. Islam is a complete code of life which sets high moral values in all the social aspects of human life including economics. The Science of economics has attained a pivotal role in the modern era. All economic activities are directly or indirectly controlled by the existing banking systems which work on the principle of interest. Although the contemporary Islamic banking system has gradually evolved and it is claimed that it works according to Islamic sharia; however, it is still a question whether this system works according to the true spirit and principles of Islam. The present study uses the descriptive analysis technique to give a detailed account of the conventional and Islamic banking and related current practices of banking in Pakistan. The paper gives an overview of bank, its types, and a little history if banking system. It also exhibits how “Interest/Riba” has been condemned in the Holy Quran and Sunnah. Then, the paper addresses some of the criticism raged against the principles of investment being used in Islamic banking. The paper suggests how an alternate to the existing interest based banking system may be introduced in the light of the recommendations put forth by the Council of Islamic Ideology. The contemporary Islamic banking thrives on its investment mostly made in Musharakah, Mudarabah, Murabaha, Ijara, As Salam, and Istisna’a. Very often, on having a close look into the tools and procedures of Islamic banking, we come to the conclusion that the existing

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Islamic banking system is not working according to the true spirit of Islam. Instead, it has muddled the concepts of permissible and impermissible things and practices contrary to the principles of Islamic Jurisprudence. Our Holy Prophet Muhammad ﷺ was also a successful trader but “MUSHARKAH” and “MUDARABAH” were always done on the basic principles of profit and loss. Our Holy Prophet ﷺ has strictly prohibited interest and declared it an open war against Allah and His Prophet ﷺ. But instead of all these facts, it is has been found that our contemporary Islamic Banking system has camouflaged the Islamic Shariah and still works on net profit gain and not on profit and loss principle. Under these circumstances, it is the need of the hour and a challenge to Islamic finance scholars and the experts of economics to rethink, contemplate, and make reforms to evolve a new mechanism regarding the contemporary Islamic Banking in the light of Islamic Shariah.

Keywords: Science of economics, Islamic finance, interest-free banking, Principles of Islamic banking, Mudarabah, Musharakah, Ijara, Salam.

1. Preamble:

Islam is the last and complete revealed religion which encompasses all the walks of life. It has its own specific methods and practical values. It has its own laws and Shariah. The universal message of Islam addresses all the people of mankind *يَا أَيُّهَا الَّذِينَ آمَنُوا ادْخُلُوا فِي السِّلْمِ كَافَّةً*

Translation: “O ye who believe! Enter into Islam whole-heartedly”¹

Economics is also a department of Islamic system of life which is very important. As is the backbone to a human body so is economics to a country’s financial well-being and progress. Banks, undoubtedly, are rendering great services in the modern world. Bank operations are interest based and interest is declared as a war against Allah and His messenger Prophet Muhammad ﷺ. Although Islamic banking has become operational, but we cannot say for sure if these Islamic banks have opted fully the principles of Islamic Sharia in true letter and spirit or not. It is necessary for an Islamic bank that it must operate on the Islamic principles of Shariah in its administrative affairs. It must follow the guiding principles given to us by the last Prophet Muhammad ﷺ. Moreover, it should abstain from interest and forbidden things. In the present age, a major

part of investments in Islamic banking is made in Musharakah, Mudaraba, Murabaha, Ijara, As Salam and Baye Istisna'a. However, the contemporary Islamic Banking is principally based on a decided profit instead of profit and loss. In contemporary environment, it is incumbent that the foundations of Islamic banking should be revamped in the light of Islamic jurisprudence.

1.1 Meanings of the Word "Bank"- Literal and Implied

In fact, the word "Bank" is derived from Latin origin "Banco" which means Joint Stock Fund".² In simple words, bank means "an institution that accumulates the savings of public and gives the money to businessmen and industrialists."³

A famous Arab economics scholar Dr. AbdurRehman Usri defines Islamic bank as follows:

"An Islamic bank means an institution that follows Islamic Shariah principles in all its activities and its administrative affairs. It aims at the accomplishment of Shariah's purposes and must arrange for the financial and consumption needs."⁴

Dr Rafique Younus writes about banking:

"This is a trading institution which takes money deposits from the people and provides the same as loans to businessmen, industrialists, and other desirous people. Conventional banks receive greater interest on these loans and pay relatively far lesser interest to their clients on their deposits. The difference of the interest on these loans and deposits is the profit of these banks."⁵

So the contemporary experts define Islamic banking as:

لمصرف الإسلامي هو: مؤسسة مالية مصرفية تزاوّل أعمالها وفق أحكام الشريعة الإسلامية

Translation: "The Islamic Bank is a financial banking institution that operates in accordance with the Islamic laws."⁶

"Therefore, an Islamic bank means a banking financial institution that will carry out its affairs according to Shariah." An interest based bank receives the money from people as trust or loan, and then forwards a large portion of it as the interest based loans and distributes a portion of the interest accrued from these loans to its account holders.

1.2 Historical Perspective:

In ancient times, people used to deposit their gold to the goldsmiths as trust

deposits “amanat” and the goldsmiths would issue its receipts. Gradually, the business started based on the receipts only. People would not come to collect their gold back. Therefore, the goldsmiths started lending gold. When they noticed that people only used to do transactions with the help of those receipts, they used to issue only receipts to the people seeking loans instead of giving gold. Later, this assumed the shape of a bank and the banks started getting established and were given the shape of a regular institution.⁷

1.3 Establishment of Bank and Its Types:

Basically, bank is also a type of a “joint stock company”. It is formed just like a company. A bank makes the people habitual of submitting their trust deposits “amanat” which, according to the jurisprudence, is a type of loan. These are called “Amanat” in Urdu, “Wadaaey” in Arabic, and “deposits” in English. Deposits have many types.

- **Current Account:** This type of account is called “Alhisaab al Bahari” in Arabic and “Madrawan” in Urdu. No interest is offered on the deposits in this account. Money deposited in this account can be withdrawn any time in any amount without any restrictions.
- **Saving Account:** This type of account is called “Hisab ut Taufeer” in Arabic and “Bachat Khata” in Urdu. There are certain restrictions on withdrawal of money on this account and the banks offer interest for this account.
- **Fixed Deposit:** This type of account is called “Wada I Saabah” in Arabic. The deposits in this account cannot be withdrawn for certain period of time. Banks offer certain determined amount of interest against the deposits in this account according to the time period of deposits. The rate of interest is larger for longer time period of deposits.⁸

1.3.1 Types of Banks:

There are different types of banks. Some banks operate in a specific sector and some operate in general. Common types of banks are listed below:

1. Agriculture Bank that offers loan to agriculture sector.
2. Industrial bank that offers industrial loans.
3. Development bank that offers loans for the developmental activities in different sectors.

4. Cooperative bank which is established on the principle of mutual cooperation. It is limited to its members only. It maintains the accounts of only its members and offers loans to them.
5. Investment Bank has limited operations as they maintain accounts only for a fixed time period.
6. Commercial banks that are called “Al bank al Tijari” in Arabic.

1.4 Contemporary Islamic Banking and Its Foundations in Shariah:

In fact, "banking" is an important term of the modern times. As there existed no such term in initial days of Islam, so no explanation of Sharia existed on it. And since it is related to the daily affairs of life, no specific debates and judgments were made to it even in the later jurisprudence periods in history.

But the concept of banking was conceived 1400 years ago in the name of Baitalmal “The House of Money”. During the reign of the Holy Prophet ﷺ and his companions, there existed a similar institution called Baitalmal which had features like some of the services of the modern day banks.⁹

The Central Financial Institution, just like Musharakah, Mudarabah, and Baitalmal which are the forerunners of the central banks of today, was known as Baitalmal. This used to be the property of a country and provided almost all services like the banks of today.¹⁰

The loans were provided without any interest for various necessities and the additional amount was considered as the interest. All of these will be detailed further in the article.

1.5 A Historical Perspective:

Before and during the early days of Islam until the verses on interest were revealed, trade loans and interest were known to have existed. The famous tribe of Taif “SaqaiF” would take commercial loans and pay back with interest. Banu SaqaiF owed to pay a huge interest to Hazrat Abbas which the Holy Prophet Muhammad ﷺ asked to forgive.¹¹

Hazrat Ibn Abbas and Hazrat Usman had given a commercial loan to a businessman. When he was asked to pay the interest, the Prophet Muhammad ﷺ forbade them to take interest in the view of the impermissibility of interest.¹²

In another narrated tradition, Hazrat Abbas and Hazrat Khalid bin Walid had a business partnership and had a transaction with the famous tribe of Banu Saqaif from Taif. And they had a huge amount of money due by the tribe.¹³

1.5.1 An Alternative for the Interest-based Banking System:

Before discussing an alternative system of interest-based banking system, some basics need to be considered:

- Looking for an alternative to the present interest-based banking should not mean that the existing bank should continue to follow the same methods as it would be of no use to opt for an alternative system.
- Alternative means adopting a different method for a bank's operations in the current trading scenarios, which are in accordance with the law and principles of the Islamic Shariah.
- In one respect, the service of the prevailing banking is commendable for the way it has created the use of the individual savings in industry and trade. If these savings were to remain unused in their holders' own possession, these could not have benefited in the promotion of industry and trade. And obviously, the useless accumulation of wealth is neither logical nor useful according to Shariah.
- The way the bank has set out to engage these savings in industry and trade is interest-based loans.
- Fourthly, it is always difficult to replace a system that is deep rooted and has been in place for centuries. It is not correct to declare the new alternate system unviable only because of these difficulties when the change of system is necessary. Therefore, instead of stop looking for a new system, the solution to the impending challenges should be sought for.

1.6 Islamic Method of Financing:

Islamic methods of providing capital are discussed here. There can be many ways of Islamic financing in the light of Shariah. That is, the economic principles that the Messenger of Allah Hazrat Muhammad ﷺ has also adopted such as the Musharaka, Mudarabah, Murabaha and so on had no element of curse like the interest. The term 'contemporary Islamic banking' actually came up as an alternative to the traditional bank. The opposite of both is "interest".

Just as the real business of the interest-based banks is to lend at interest, the real business of Islamic banks is Murabaha, Ijara, Musharakah, and Mudarabah. Below is the analysis of the Islamic foundations that the concept of Islamic bank is made up of in the light of the teachings of the Prophet Muhammad ﷺ.¹⁴

1.6.1 Partnership

The principle of participation in Islamic economics is of great importance. The experts of Islamic jurisprudence have given different definitions of the term “Musharakah” which are almost the same. One of these definitions is as follows:

” الا اجتماع في استحقاق او تصرف ”¹⁵

‘Getting together (of two or more people) for the privilege of the right to the ownership or the right to use of something’

It is mentioned in Badaaye us Sanaye:

الشركة في الاصل نو عان شركة الامسلاك و شركة العقود و شركة الامسلاك نوعان و يثبت¹⁶

Partnership (“Shirkah” in Arabic) means mutual ownership or having parts in something. Whereas, partnership deed or agreement is a document wherein the conditions of the partnership are written and in this case it is used in the meanings of a masculine entity.¹⁷

Different scholars have defined Musharakah in different ways that are almost similar in meaning. One of these is

” الا اجتماع في استحقاق او تصرف ”¹⁶

‘Getting together (of two or more people) for the privilege of the right to the ownership or the right to use of something’...

Mujallatul Ahkam al Adliyah defines “Musharakah” in these words: “mixing and cooperating of more than one person for something is called partnership”.¹⁹

Almuajjam ul Kabir defines partnership as ‘Asshirkah in the meaning of company, partnering, association; whereas, Shirkah means to take part, to get included, to associate’²⁰

1.6.2 Status of Partnership in Shariah:

The Holy Quran says:

فَإِنْ كَانُوا أَكْثَرَ مِنْ ذَلِكَ فَهُمْ شُرَكَاءُ فِي الثَّلَاثِ

"If the heirs of the dead [the brother and sister of the dead] are more than two, they are participating in the third part of the inheritance."²¹

On another point in the Holy Quran, it is mentioned:

وَإِنَّ كَثِيرًا مِّنَ الْخُلَطَاءِ لَيَبْغِي بَعْضُهُمْ عَلَىٰ بَعْضٍ إِلَّا الَّذِينَ آمَنُوا وَعَمِلُوا الصَّالِحَاتِ

"Many intermixers wrong one another; except those who believe, and do good works"²²

The Holy Prophet Muhammad ﷺ also assumed the principle of Musharakah and also liked it. According to a hadith in Saheh Bukhari:

قَالَ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ: "إِنَّ الْأَشْعَرِيِّينَ إِذَا أَرْمَلُوا فِي الْعُرُوِّ أَوْ قَلَّ طَعَامُ عِيَالِهِمْ بِالْمَدِينَةِ جَمَعُوا مَا كَانَ عِنْدَهُمْ فِي ثَوْبٍ وَاحِدٍ، ثُمَّ اقْتَسَمُوهُ بَيْنَهُمْ فِي إِنَاءٍ وَاحِدٍ بِالسَّوِيَّةِ، فَهُمْ مِنِّي وَأَنَا مِنْهُمْ"²³

"Abu Musa (peace and blessings of Allah be upon him) said: "The people of The Tribe of Asher, when the ration used to reduce either at the occasion of jihad or with their families in Madina, they would gather in a cloth whatever they had. Then they would divide all that evenly with the help of a vessel. So they are mine, and I am theirs."

1.6.3 Types of Partnership:

It has two types: joint ownership and a partnership effected by a mutual contract

All the types and the details of the partnership are the same with almost minor differences according to the books of jurisprudence.

1.7 Diminishing Musharakah in Islamic Banking:

The discussion given above is meant to project the fact that diminishing musharakah is a new form of partnership. It is not mentioned in the books of Islamic Jurisprudence but the contemporary Islamic Banking has its foundations in this concept.

"Diminishing Musharakah is a form of partnership in which one partner promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him."²⁴

Islamic banks use Diminishing Musharkah generally in the financing of solid assets. Sometimes, it is also used for financing a business. According to the

standards of Shariah, Diminishing Musharakah is considered as Shirkat-e-Annan type of Mutual Contract partnership; whereas, it seems from their operating procedures that Islamic banks consider it as a form of joint ownership:

"There is no set of principles about Musharakah (partnership) in Islam, but there are certain rules which have the scope of different forms and methods. Every new form of musharakah is acceptable in the eyes of the Sharia unless the Quran and the Sunnah and the Consensus are against the People. Therefore, it is not necessary to adopt the name with its traditional form."²⁶

1.7.1 Concept of Musharakah According to the scholars of Islamic Jurisprudence:

According to the interpretations of Imam Malik and Imam Shaafiyye, for the Musharakah to be valid, it is necessary that every partner will get profit proportionate to his/her investment. Therefore, if A invests 40% of the total investment, he will get 40% of the total profit. Every such agreement will be valid that makes A eligible for more or less than 40% in the profit. Contrary to this, according to Imam Maalik, ratio of the profit can be different from the ratio of the investments provided that it is agreed upon by the partners according to their free will. Therefore, it is quite possible that a partner may get 60% or 70% profit with investment of 40% and vice versa.²⁷

Musharakah is an Arabic word that means partnership. Scholars have defined Musharakah in different ways that are almost similar. One of these defines Musharakah as 'Getting together (of two or more people) for the privilege of the right to the ownership or the right to use of something'.²⁸

So, Musharakah means a situation where two or more people join hands to buy something, or get its ownership without any agreement, or two or more people start a business together and share the business profit.

1.8 Objection Posed on Deminishing Musharkah:

The following objections to the business done by the Islamic banks are raised by various academic circles, the employees of Islamic banks, and the economists:

- There is no doubt that an Islamic bank collects rent from Zayed when he gets home ready and Zayed starts living in it. But when the house is still under construction and the bank provides money to Zayed for the construction of this house, the bank starts the calculation of the rent from the day it has given Zayed the first portion of the money. It should be noted that the bank usually does not give Zayed the full amount of money in a single payment for construction of the house, but in the form of periodic installments rather.
- An Islamic Bank determines the rent for the house at the interest rate of the conventional interest-based banks. Mufti Dr. Abdul Wahid writes that similarly, insurance or Takaful (Islamic insurance) is required in home financing which is not permissible. According to the words of a tradition, Hazrat Anas narrates:

"The prices of goods soared very high during the time of the Messenger of Allah, and the Prophet (peace and blessings of Allah be upon him) and some of the companions requested to the Prophet that he may set the prices means the market rate for them. The Holy Prophet said: "Allah is the one who increases the prices. He is the one who tightens the sustenance; He is the Munificent, and the Provider. I would like to meet my Lord in a state that none of you (the buyer and the shopkeeper) would be the one who demands revenge for any wrong from me which has happened in his blood or wealth."²⁹

It is learnt from this hadith that even the government does not hold the right to set the market rate, as is said by Allah Almighty in the Holy Quran:

"Except for that, there is a trade with mutual consent".³⁰

But when a market rate is fixed by the free will of the people, then opposition to it creates many social and economic problems. So, Hazrat Umar once ordered Hazrat Hatib to leave from the market when he sold against the market rate.

1.9 Mudarabah:

"Mudarabah" is a special form of partnership in which one partner provides money to invest in the business. The investment is made by the first person, called "Rabb-ul-Maal", while the responsibility of managing the business and operations lies with the other party called "Mudarib".³¹

Fataawa Aalamgiri defines Mudarabah as follows:

“According to Shariah, sharing profit on partnership with investment by one party and action by the other is called Mudarabhat.”³²

Mudarabhat has two types:

1. Mudarabhat Mutallaqah one in which there is no limit of the time, place, the particular type of trade, or the fixed commodity customer.
2. Mudarabhat Muqayyeda one in which there is one or more limits like place, time, or type of trade.³³

1.9.1 Status of Mudarabah in Shariah:

Before the Pronouncement of Nubuwwah, the Holy Prophet ﷺ himself performed trade with Hazrat Khadija tul Kubra based on Mudarabah. Many of the companions of the Holy Prophet ﷺ also had business ventures based on Mudarabah.

Here are some sayings of the Holy Prophet ﷺ related to Mudarabah:

1. In Sunnan Ibn e Maaja, Hazrat Suhaib narrates that Hazrat Muhammad ﷺ said, “There are three things that are blessed: selling borrowings for a fixed period of time; to give money to someone on the basis of Mudarabah; mixing of wheat with barley for domestic need-not to sell (not permissible to do so).”³⁴
2. In Behiqi, it is narrated about Hazrat Abbas who is an uncle of Muhammad ﷺ, “When he gave someone the goods for trade, he used to pose the conditions that he could not take the goods to the sea and would not take it to any valley, nor would he buy the animal from it. If he did that, he would be responsible for the loss. When this situation was presented to Prophet Muhammad ﷺ, he granted permission for such a conditional trade.”³⁵

1.10 Principles of Mudarabah:

1. Mudarabah has two parties; one who provides money for trade and is called “Rabbul Maal” and second who performs trade or business and is called “Mudarib”.

Rabbul Maal means the investor cannot take part in the business or management of trade; however, it is his/her basic right to be taken in confidence about business policies, to know details of business calculations, and to look after the business so that the Mudarib (the entrepreneur) may not commit any dishonesty or negligence. All the religious scholars agree to this right. As both the investors as well as the entrepreneur are partners in a business, the investor must be given the right to supervise the business and to ensure that the entrepreneur must do his part of the agreement honestly. When seen from a logical point of view, it does not seem fair that a person who has invested money in a certain business should be kept aside of the business transactions and procedures.

On an occasion, Imam Malik was asked a question that a man gave the other a wealth on the mudarabat he worked hard which resulted in his profit. Now, if the investor wants to get his share from the profit in the absence of an investor, is it right? He answered this way, “Unless the Lord of money (Rabbul Maal) is present on the spot, the Mudarib (entrepreneur) does not have the right to receive his share from profits.”³⁶

In the contemporary Islamic Banks, except for the current account, all the accounts are opened on the basis of Mudarabah in which the client or the investor is the “Rabbul Maal” whereas the bank is “Mudarib”. However, Islamic banks do not follow the aforementioned spirit of Mudarabah. Instead a disclaimer appears on the account opening form: “Any amount specified by the bank as profit or loss will be final and all customers will be bound by it. No user will have the right to question the basis for determining such profits or loss.”³⁷

Imposing such a limitation on the clients by Islamic Banks is a negation of the basic rights of the investor “Rabbul maal” and is against the principles of justice. It is because of this undue condition that the profit of Islamic Banks is soaring higher and higher; whereas, the profits rates of their investors are the same. Some of the Islamic Banks in Pakistan has achieved 106 percent profit increase in a fiscal year. Sorry state of affairs is that the profit rate for the depositors has not been increasing. There had been hardly around one percent increase in

the profit which is really unfair. This amply proves that the Islamic banks in Pakistan are perpetrators of dishonest practices and the form of Mudarabah practiced by them is not the real Islamic Mudarabah in its essence.

2. A second principle that makes the Mudarabah valid is that both parties involved in Mudarabah should determine the percentage of the profit at the start of the business agreement. It means that they should determine whether they would distribute the profit at 50- 50 ratio, 40-60 percent ratio or at some other agreed determined ratio. This is because in Mudarabah, the profit is pre-determined and the Mudarabah will stand invalid if profit is unknown.

A renowned book “Muaabir ul Shariah” contains the principles and rules, determined by the scholars of Islamic Banking, narrates:

يشترط في الربح أن تكون كيفية توزيعه معلومة علمًا نافيًا للجهالة ومانعًا للمنازعة

Translation: “There is a condition in profit that its distribution is known in a way that it is obviously known without a possibility of any ambiguity.”³⁸

In contemporary Islamic banks, at the time of account opening the ratio of profit distribution is not clearly determined rather it is declared after the starting of Mudarabah. Islamic banks rather have the following statement in the account opening form:

“The bank will share the rate of profit from the gross income gained from the business with the depositor at the beginning of each month or period. The bank's share may change from time to time and will also be announced with calculators within the first week of the relevant month or period.”³⁹

This proved that the rate of distribution of profits is not known when starting the Mudarabah with the Islamic banks, but later, and the bank can change it whenever it wants, which invalidates Mudarabah.

3. Investors in Mudarabha cannot ask for a guarantee that they will be paid certain profit in any case, whether the venture accrues profit or loss, because such guaranteed profit is considered interest and will be invalid.

Rather, he can take guarantee from the Mudarib that Mudarib will pay his duty in full integrity and honesty and do business according to the terms that have been fixed between the parties. If there is any damage caused by violation of the terms set out in the agreement or by negligence, he will be redressed for it. This is also mentioned in Muaabir ul Shariah:

Translation: “The investor or ‘Rabbul Maal’ may take sufficient and reasonable guarantees from the Mudarib, but the condition is that the Rabbul Maal will enforce these guarantees only if the negligence or the violation of the conditions of the ruling by Mudarib is proved.”⁴⁰

4. In the jurisprudence, there is also a rule in the debate of the Mudarabha that only trade can be done from capital on the basis of money, except trade, it cannot be used for any purpose other than trade. Imam Novavi says:

“عقد القراض يقتضى تصرف العامل في المال بالبيع والشراء، فإذا قارضه على أن يشتري به نخلا يمسك رقابها ويطلب ثمارها لم يجز لأنه قيد تصرفه الكامل بالبيع والشراء، ولأن القراض مختص بما يكون النماء فيه نتيجة البيع والشراء وهو في النخل نتيجة عن غير بيع وشراء فيبطل أن يكون قراضاً ولا يكون مساقاة، لأنه عاقده على جهالة بها قبل وجود ملكها، وهكذا لو قارضه على شراء دواب أو مواشى يحبس رقابها ويطلب نتائجها لم يجز لما ذكرنا

“The need of the “Aqd e Mudarabah,” means the speculative contract, is that the entrepreneur “Mudarib” should use the money in buying and selling only. Therefore, if he buys palm trees from this money and gets fruit from them to earn profit, it will not be a valid Mudarabah because according to condition, investment can be used only in buying and selling. Secondly, as the Mudarabha is limited to the cases where the increase in money is due to the sale and purchase (trade); whereas, in the case of palms dates, this increase is not as a result of buying and selling, so its Mudarabha stands false and invalid. It can neither be a case of the “Musaqaat” (agricultural contract), because in this case it will come to force on the trees under consideration even before the dates come in possession. Similarly, if the Mudarib buys animals or cattle that are to stay under his custody, and he gets their produce as well, then it will not be permissible. The reason is what has been mentioned above, i.e. the profit was not achieved as a result of buying and selling.”⁴¹

Imam Abul Qasim Abdul Karim Raafiee writes:

"لو قارضه على أن يشتري الحنطة فيطبخها ويختبرها والطعام ليطبخه ويبيع والريح بينهما فهو فاسد أن الطبخ والخبر ونحوهما أعمال مضبوطة يمكن الاستئجار عليها وما يمكن الاستئجار عليه فليسغني عن الفرائض إنما القراض لما لا يجوز الاستئجار عليه وهو التجارة التي لا ينضبط قدرها

Translation: "the money invested in Mudarbha can be used only for trade and is not valid for investing in other profitable ventures because Mudarabha is done where Ijarah "leasing" is not possible and that is trade. The Mudarabha is not needed where Ijarah is possible."⁴²

According to the Hanafi jurisprudence scholars, the money of Mudarabha can be invested in trade and related activities only, therefore, the famous book from Hanafi jurisprudence, "Hidayah" says:

فينتظم العقد صنوف التجارة وما هو من صنيع التجار

Translation: "Mudarabha contract is limited to only sales and purchase activities; whereas, this thing (amounting to another particular issue) is not the job of traders".⁴³

At another place, the author writes in explanation of another issue:

"According to Imam Muhammad ﷺ and Imam Abu Hanifa, this is not permissible because this is not included in trade and Mudarabha contract means to make someone representative in trade activity".⁴⁴

He writes further, "If this is not trade, this is not included in the category of Mudarabha either."

1.11 Contemporary Islamic Banking and Murabaha:

Murabaha is a specific type of trade. It is one type of financing methods introduced by the contemporary Islamic banks. It has gained a great recognition among the Islamic banking clients.

1.11.1 Meanings of Murabaha:

Etymologically, the word Murabaha is derived from "Rabah" meaning profit. This will connote "to do something that determines profit".

This is the same definition given by the many seminary books on Islamic Juisprudence with a little change of words including Hidayah, Albadaaye fis Sanaaye, Almughni, Rauza tu Talibin.⁴⁵

This means purchasing something, spending some more money on it and then based on the cost and expenses, selling it on profit is called Murabaha.⁴⁶

It is mentioned in “Durr ul Mukhtar”,

*بيع ماملکه بماقام عليه ويفضل*⁴⁷

هو البيع بمثل الثمن الأول مع زيادة ربح وصورة المرابحة كما ذكر المالكية هي أن يعرف صاحب السلعة بكم اشتراها ويأخذ منه ربحاً إما على الجملة مثل أن يقول اشتريتها بعشرة وتربحني ديناراً أو دينارين وإما على التفصيل وهو أن يقول تربحني درهما لكل دينار أو نحوه أى إما بمقدار مقطوع محدود وإما بنسبة عشرية. وتعريفها عند الحنفية نقل ما ملكه بالعقد الأول وبالثمن الأول مع زيادة ربح. وعند الشافعية والحنابلة هي البيع بمثل رأس المال أو بما قام على البائع وربح درهم لكل عشرة ونحو ذلك بشرط علم العاقدین برأس المال

Translation: “It means that trade in which a profit amount is also charged in addition to its initial price. And Maalkiyah has given an example of Murabaha that the seller must explain how much the article cost him and charge some profit to the buyer in addition to its cost price. To put in other words, he may say that I have purchased this article for 10 dinars and will sell it to you for one or two extra dinars or may determine a profit in detail for example to say to the purchaser that I will charge one dirham for each dinar of its actual price. It means that he can either determine his profit on a limited scale or explain in terms of tenths. According to Ahnaf school of thought the trade of Murabaha means the selling a thing at a price more than its cost price at which he earlier purchased it a result of agreement of sale. According to Shafayee and Hanbali schools of thought, trade of Murabaha means a trade in which seller gains profit in addition to the actual purchase price and other expenses for example one dirham against each 10 dirhams with a condition that the seller and the purchaser both know the actual price.”⁴⁸

It is written in AlMuajjam ul Waseet:

هو بيع براس المال مع زيادة معلومة

Translation: “To sell something at a determined profit on the actual cost is called trade of Murabaha.”⁴⁹

A commonly known trade and Murabaha trade is different in that it is not necessary to inform the purchaser of the actual cost and the profit in a common trade; whereas, in Murabaha it is conditional to inform the purchaser of actual cost of the thing.

1.11.2 Argument for the Murabaha Trade:

Allah Almighty says in the Holy Quran:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

Translation: “Allah has permitted trade and prohibited interest.”⁵⁰

Therefore, any affair that comes under trade is permissible and Murabaha is also a type of trade. The scholars have mentioned it that

الا صل في المعاملات الحل

That means “the basis of affairs of a trade is that it is permissible except for those things that are declared “Haram” impermissible by the Sharia.”⁵¹

1.11.3 The Use of Murabaha in Islamic Banking:

Basically, Murabaha is a deed of sales and purchase not a method of financing. However, with some conditions, this can be used as a method of financing in the contemporary Islamic Banking. This is presented below in brief.

2. Methodology:

The kind of transactions made in the Islamic bank in the name of Murabaha is not just a marabah, but many other affairs also come in practice to complete the Murabaha. Therefore, the whole process is called 'Murabaha'. A practical implementation of Murabaha is that a person bought the thing instead of giving him money to buy that thing; whereas, an interest-based loan will fulfill that requirement of the person in the conventional banking.⁵²

Allama Yousuf Qarzaavi, a famous Islamic religious scholar, is a strong proponent of Islamic Banking and is the Chairman of Sharia Boards of Qatar Islamic bank and Faisal Islamic bank says:

*أن المرابحة هي قريية من التمويل الربوي” مشيرا إلى أنه للأسف أصبحت المصرفية الإسلامية سجينة للمرابحة
وأصبحت في المائة من عملياتها في المرابحة – بحسب تقديراته*

Translation: “Murabaha is very close to interest based financing and it is very disappointing that the Islamic banks of the day have become the prisoners of Murabaha. According to my guess in all the activities of Islamic banks, the ratio of Murabaha is 95%.”⁵³

2.1 Baay e Salam / Sale on Advance payment:

To purchase something on credit after giving payment is called “Baay e Salam” means sale on advance payment.⁵⁴

In this type of trade, the seller receives the money in advance from the buyer and hands over the commodity over to the purchaser after buying in the future. This type is called “Salam”.⁵⁵

This type of trade is mentioned as a proof in the Holy Quran also:

يا ايهاالذين آمنوا اذا تدابرتم بدين الى اجل مسمى فاكتبوه

“O ye who believe! When ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing”.⁵⁶

Many cases of Salam have been reported during the days of the Holy Prophet ﷺ. The Messenger of Allah ﷺ allowed the Salam with specific conditions. Its main objective was to meet the needs of small scale farmers who had to meet the expenses of their wife and children until their crop was produced and was ready. After the interest was banned, they were not allowed to borrow a loan on interest; they were allowed to sell their agricultural produce in advance.⁵⁷

It is reported in Sahih Bukhari:

”قدمه النبي المدينة وهم يسلفون بالتمر السنيتين والثلاث فقال من اسلف في شئى ففي كيل معلوم ووزن معلوم الى اجل معلوم

“The Prophet ﷺ came to Medina and the people used to pay in advance the price of dates to be delivered within two or three years. He said (to them), “Whoever pays in advance the price of a thing to be delivered later should pay it for a specified measure at specified weight for a specified period.”⁵⁸

In the books of the famous jurisprudence scholars, As Salam is found with addition of some conditions. Some of them have mentioned seven conditions and some have reported lesser.

2.2 Trading on Advance Payment (As Salam Trade) with the Person who does not possess the saleable commodity:

حَدَّثَنَا مُوسَى بْنُ إِسْمَاعِيلَ، حَدَّثَنَا عَبْدُ الْوَاحِدِ، حَدَّثَنَا الشَّيْبَانِيُّ، حَدَّثَنَا مُحَمَّدُ بْنُ أَبِي الْمَجَالِدِ، قَالَ: بَعَثَنِي عَبْدُ اللَّهِ بْنُ شَدَادٍ، وَأَبُو بَرْدَةَ، إِلَى عَبْدِ اللَّهِ بْنِ أَبِي أَوْفَى رَضِيَ اللَّهُ عَنْهُ، فَقَالَا: سَلَّهُ، هَلْ كَانَ أَصْحَابُ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ فِي عَهْدِ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ يُسَلِّفُونَ فِي الْحِنْطَةِ؟ قَالَ عَبْدُ اللَّهِ: ”كُنَّا نُسَلِّفُ نَبِيْطَ أَهْلِ الشَّامِ فِي الْحِنْطَةِ، وَالشَّعِيرِ،

وَالزَّرْبِيتِ، فِي كَثِيرٍ مَعْلُومٍ إِلَى أَجَلٍ مَعْلُومٍ"، قُلْتُ: إِلَى مَنْ كَانَ أَصْلُهُ عِنْدَهُ، قَالَ: مَا كُنَّا نَسْأَلُهُمْ عَنْ ذَلِكَ، ثُمَّ بَعَثَانِي إِلَى عَبْدِ الرَّحْمَنِ بْنِ أَبِزَى، فَسَأَلْتُهُ، فَقَالَ: كَانَ أَصْحَابُ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ يُسَلِّفُونَ عَلَى عَهْدِ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ، وَلَمْ نَسْأَلُهُمْ أَلَهُمْ حَرْتُ أَمْ لَا. حَدَّثَنَا إِسْحَاقُ، حَدَّثَنَا خَالِدُ بْنُ عَبْدِ اللَّهِ، عَنْ الشَّيْبَانِيِّ، عَنْ مُحَمَّدِ بْنِ أَبِي مُجَالِبٍ، وَقَالَ: فَسَلَفُهُمْ فِي الْحِنْطَةِ، وَالشَّعِيرِ، وَقَالَ عَبْدُ اللَّهِ بْنُ الْوَلِيدِ، عَنْ سَفْيَانَ، حَدَّثَنَا الشَّيْبَانِيُّ، وَقَالَ وَالزَّرْبِيتِ، حَدَّثَنَا قُتَيْبَةُ حَدَّثَنَا جَرِيرٌ، عَنْ الشَّيْبَانِيِّ، وَقَالَ: فِي الْحِنْطَةِ، وَالشَّعِيرِ، وَالزَّرْبِيبِ

“Narrated Muhammad ﷺ bin Al-Mujalid: `Abdullah bin Shaddad and Abu Burda sent me to `Abdullah bin Abi `Aufa and told me to ask `Abdullah whether the people in the lifetime of the Prophet used to pay in advance for wheat (to be delivered later). `Abdullah replied, "We used to pay in advance to the peasants of Sham for wheat, barley and olive oil of a known specified measure to be delivered in a specified period." I asked (him), "Was the price paid (in advance) to those who had the things to be delivered later?" `Abdullah bin `Aufa replied, "We did not use to ask them about that." Then they sent me to `Abdur Rahman bin Abza and I asked him. He replied, "The companions of the Prophet used to practice Salam in the lifetime of the Prophet; and we did not use to ask them whether they had standing crops or not."⁵⁹

In Al-Mughni, it is explained as follows: Full payment of price is mandatory in the Salam. However, Imam Malik's religion explains that the seller can give concession to the buyer for two or three days. This concession should not be a regular part of the agreement.⁶⁰

2.3 Conditions of as Salam:

1. In order for the Salam to be valid, it is important that the buyer pays the full price of the whole at the time of the trade agreement. It is necessary because if the buyer does not pay the price fully at the time of agreement, it will be equivalent to the trade of a given thing in exchange for the thing, which the Messenger of Allah has clearly forbidden. In addition, the basic wisdom of the validity of the Salam is to fulfill the urgent need of the seller. If the price is not paid fully, the primary purpose of the transaction will be lost.⁶¹
2. The trade of As Salam cannot be made for a determined thing or a determined field.
3. The standard and the nature of the thing being traded under the trade of As Salam must be determined.

2.4 Baye Istisna'a/ Istisna'a Sale:

Baye Istisna'a is also a type of As Salam trade. The purpose which is achieved through As Salam trade is fulfilled through Istisna'a trade in case of the industrial loans. However, the obligation of following the Sharia principles is not as strict in Istisna'a sale as it is in As Salam trade.

According to the famous Arabic dictionary, "Taaj ul Uroos", the meaning of Istisna'a is as follows:

صنع المثلث صنعاً وصنعاً بالفتح والضم أى عمله⁶³

"...it means to ask for making of a certain thing."

Allama Shami explains the meanings of Istisna'a in these words:

هو لغة طلب الصنعة أى ان يطلب من الصانع العمل⁶⁴

According to dictionary, Istisna'a means "to seek a job" and according to Sharia, it means to ask some specific thing in some specific way from someone.⁶⁵

In other words, Istisna'a means to have products prepared on demand.

"Istisna'a is the other type of trade in which a deal is done before the product is made. Istisna'a means ordering a manufacturer to make a certain item for the customer. If the manufacturer accepts the responsibility of preparing the item for the buyer by spending on the raw material himself, the trade agreement will come into existence. However, for the Istisna'a sale to be valid, it is necessary that the price should be fixed with the consent of both the parties and the necessary attributes of the desired thing that is in place should be fixed."⁶⁶

2.4.1 Difference between Istisna'a and an Ordinary Trade:

The main difference between an ordinary trade and the trade of Istisna'a is that although in Istisna'a sale and purchase is also made but it is essentially different from an ordinary trade in that the basic term of trade determined by Sharia is that

لا تبع ما ليس عندك¹

"Do not sell what what you do not possess".

2.4.2 Arguments in the Favour:

Some scholars take the plea in favour of Istisna'a from the following verse from the Holy Quran:

فَهَلْ نَجْعَلُ لَكَ خَرْجًا عَلَىٰ نَفْسِنَا وَنَبْنِيَهُمْ سِدًّا⁶⁸

Build for us a barrier between us and them, and we will pay you a tribute.

Ibn e Abbas has explained the word “Kharaja” in the above mentioned verse as a great reward. In this verse the Holy Quran has guided on this type of agreement as the right and valid. According to a Hadith, the Holy Prophet Muhammad ﷺ asked an Ansari woman, “ask your carpenter son to make for me a seat of wood clogs so that when I address the people, I should sit on this seat.” So the woman ordered her son to prepare the wooden seat.⁶⁹

When Istisna'a is seen from the trade perspective, it means that it is not permissible to get a thing prepared on order because the seller is selling a thing which is not yet in his possession rather does not exist at the time of the trade agreement. However, Sharia creates ease for the people, so Allah says in the Holy Quran:

يُرِيدُ اللَّهُ بِكُمُ الْيُسْرَ وَلَا يُرِيدُ بِكُمُ الْعُسْرَ

God will make it easy for you, and He will not make it difficult for you⁷⁰

‘And (Allah Almighty has) not introduced any burden on you regarding religion.’

2.5 Lease Purchase Scheme (Ijarah)

According to this scheme of business, a client approaches an Islamic bank with the intention to purchase a car or machinery but does not have the desired money. The bank makes that person its agent and purchases that article. For example, a client wants to purchase a certain car. The bank makes him its agent and authorizes him to make the purchase for the bank. Afterwards, the bank offers that person the same car on rent for a predetermined limited time. After that time lapses, the same person purchases the same car from the bank for a nominal price.

2.5.1 Objections Raised on Ijarah:

The following objections are generally raised against this type of business done by the bank:

- If the bank is accepted as a buyer, then its purchase is still artificial because the bank purchased the vehicle to sell it on zayed's demand. And we are forbidden from buying and selling of this kind. Hazrat Hakeen bin Hazaam says:

Translation: "O Messenger of Allaah ﷺ! A man comes to me, he wants to buy from me something that I do not have, so shall I buy for him from the market (i.e. buy and sell it from the market)? He ﷺ replied: "Do not sell what you do not possess."⁷² Imam Ibn ul Arabi has declared this hadith as valid. Imam Novavi (died 676 hijra), Imam Ibn e Qaddama (died 682 hijra), Imam bin Daqiq Ale'id (died 702 hijra) have also declared this hadith as valid. Imam Ibn al Qayyam, Imam Ibn e Hajar (died 852 hijra) have declared it safe (mehfooz). Imam Ibn al Malaqan (died 804 hijra) has declared it as valid, and Allama Albaani (died 1332 hijra) has declared this hadith as (valid as conditioned by Shaikhain) saheeh ala shartush Shaikhain.

Here it was the case that the man was going to the market and purchasing himself, but he was purchasing for doing a trade with someone else that the Companion of the Messenger ﷺ had forbidden. On the contrary, no employee from the Islamic Bank goes to the market and instead provides money only because he has to do one more trade with Zaid ahead, that is, to make a future transaction, he is doing another artificial purchase, and it is prohibited and invalid.

- A person expressed his desire to rent a vehicle from the bank, the bank booked the vehicle and if it takes 4 months to get the vehicle, the bank charges a reasonable "opportunity cost" of 4 months from its customer and the form of receipt is that the bank will charge this opportunity cost of these 4 months in rent and increases the rent. So after booking, if the vehicle is delivered late, the bank will increase its rent accordingly. That is, in order to determine the rent of the vehicle, the bank also takes into account the time period between the booking and delivery of the vehicle which becomes necessary to acquire a new vehicle. The bank starts its calculation of rent from the day it invests its money for booking.⁸¹

The bank buys the vehicle and becomes its owner. Therefore, he is bound to bear the expenses for the ownership of the vehicle. The bank bears the vehicle related expenses but also charges its customer the same expenses in the rent. For example, a bank fixes rent of the vehicle at 30,000 per month, but it charges 60,000 car rentals for the first month so that the costs it has to bear in getting the ownership of the vehicle may be charged to its customer. So in one month the car rent is 60,000, and in the second month it is 30,000. The question here arises that what a rent type this is which fluctuates so much in a limited interval of merely one month.

Mufti Dr. Abdul Wahid writes: "The Car Ijara Scheme issued by Meezan Bank contains an interim assessment of the rent that it includes the first month's rent, registration, and the transportation costs. The amount of rent for the remaining months also includes the insurance (or tafal) money."⁸²

- When a bank buys a vehicle and gives it to a person on Ijara, he has to get the vehicle insured which is invalid to all scholars. The Islamic banks generally respond to this objection that the State Bank of Pakistan (SOB) does not allow them to do car financing until they get the vehicle insured. So, they are forced to get the vehicle insurance. The answer to this objection is that why the Islamic Bank adopts a means of trade that it has to do an invalid job. Islamic banks have now resolved the problem of insurance that an Islamic insurance has been introduced in the name of Takaful. It is a camouflage to name this takaful as the true Islamic insurance.⁸³ Researchers at Islamic banks take the argument from a quote from Ibn Dinar bin Maliki (died 212Ah) to justify this fine. According to a fatwa agreed upon by the Ulema-e-Ahnaf: "The knowledgeable scholars are expected that by accepting the mentioned mood and stand of Imam Maalik, they will declare as invalid the justification of the financial penalty imposed on investment made through interest based excuses of Murabaha and Ijara by the banks."⁸⁴

Maulana Mufti Hafiz Zulfiqar has given a research based comprehensive response to the sayings of Imam Ibn e Dinar Maalki.⁸⁵ This is not being copied here due to its length.

2.6 Suggestions Put Forth by the Council of Islamic Ideology:

The Council of Islamic Ideology submitted proposals to establish an interest free economy. These included the proposal of P.T.C which concluded that as already reported, a company has to issue bonds to provide capital. The bonds are so called interest based. The Council offered an alternative that the company should issue documents of Mudarabaha with the name of “participation term certificates”. These would be the Mudarabaha certificates issued for a fixed period of time.

The Council of Islamic Ideology also proposed a new kind of agreement called (shirkat e munaqisa) “the participatory ownership” for house financing. According to this, the house will be purchased and built with the common capital of the financing institution and the house-aspirant. The two will have "participatory ownership" in the house in proportion to their contributed capital.

3. Conclusion:

To sum up, it can be said that although the importance of the banking system for economic progress cannot be denied in the modern times, but the basis on which the system is running is not valid according to the teachings of Islam. Islam has given solution to every problem based on its flexibility in every period in history. In the present world, most of the economic problems are caused by the unfair, unjust and unequitable economic system. Traditional banking system has played as a tool in shaping the present problematic economic system of the world. It is not a wonder that the ethical and equitable distribution of wealth and resources are promised by Islamic Sharia only. As an alternate to the conventional interest based banking system, some Islamic scholars have laid the foundation of an Islamic banking system based on the principles of partnership and Mudarabat and has tried to terminate the interest-based system. The contemporary Islamic banking offers six basic types of products including Musharakah, Mudarabah, Murabaha, Ijara, As Salam, and Istisna'a. If used honestly in their true spirit, these Islamic banking products can bring in a revolution in the global industrial and social development. Some cases of Malaysian Islamic banks and financial institutions⁸⁶ which are working on the

basis of interest free banking can be guideline for Pakistan as well. For a successful experiment in Pakistan, the State Bank of Pakistan which is regulator of banking system has to step forward and transform the banking system as suggested by Quaid-e-Azam Muhammad Ali Jinnah who, at the inauguration of SBP in 1948, declared that the banking system in Pakistan would be Islamic. Now, it is the foremost responsibility of the government and SBP to avoid the curse of interest and to make the Islamic principles a source of economic development that Islam has encouraged. The main objective of this article was to analyze the Pakistani Islamic banking system with reference to the Islamic concepts and teachings on investment and commerce and to indicate the things that are against the spirit of Islam. Suggestions have also been put forward in this regard.

4. Recommendations:

The first and the foremost recommendation for establishing a dependable Islamic banking system is that sincere efforts should be made to end the war with Allah and His Messenger Muhammad ﷺ and eliminate the banking system entirely which is based on interest “Riba” in true letter and spirit instead of merely trying to end the use of the word “interest”.

1. The government should implement economic rules and laws that would not only benefit the ordinary Muslims but also follow the rules and practices of the religion.
2. The deposited capital of the banks should be considered as a charity loan “Qarz e Hasna” and it must be invested in actual business by the banks instead of merely offering it as interest based loans to clients.
3. Interest “Riba” must be abolished immediately and the debtors who owe interest should be spared of the interest money and only the original debt money should be taken back.
4. All the Islamic countries should take the banks into national ownership and compensation should be paid in installments to the owners of the banks.
5. Bank business should be run as a partnership of labour and the people must share both profits as well as loss.

6. Institutions must be created on the basis of Mudarabah principle to establish interest-free banking.
7. The bank should be formed on the principle of the joint stock companies. Joint investment should be made on the basis of participation or Mudarbat. Those who provide capital should be named as the shareholder who must be at least two in number. In principle, no number can be fixed; however, a minimum and optimum number can be determined. The shareholder may be bound to buy a few shares. Each shareholder should be the owner of the bank according to the position of his/her assets.
8. The government should give loans through banks to people without interest and issue credentials for it. A copy of this document may be saved in the government registry with the date of return clearly mentioned. Such certificate should not cost the person³. Akhuwat Trust⁸⁵ operating in Pakistan is a practical and an interesting contemporary case study in using interest free micro loans to alleviate poverty in the country by strengthening housing and business sectors.

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