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Course Objective

- To recognize the flavor of Islaamic Finance
- To recognize coherent and consistent system
- To learn logic of Islaamic Finance
- To acquire overall picture



Chapter 1: Introduction to Islaamic Finance

A. Overview

- a. Concept and Philosophy
- b. Principles of Islaamic Finance
- c. Different Modes
- d. Different Contracts

B. Objective

- a. To recognize the flavor of Islaamic Finance
- b. To recognize coherent and consistent system
- c. To learn logic of Islaamic Finance
- d. To acquire overall picture

C. Two Domains of Economy

- a. Transactions aimed at making Profit – For Profit Activity
- b. Transactions aimed at Charity, philanthropy – Non Profit Activity

D. Why Islaamic Economy?

- a. Economy should be balanced by having both kind of activities
- b. Having one side alone will make the system fail. Example: Communism on Non Profit activity and Capitalism on For Profit activity
- c. Islaamic Economy provides line of tradeoff between two activities and balances the system
- d. These two domains are like two wings of the bird
- e. Islaamic Economy is not a mix of Capitalism and Communism rather it is a different system based on brotherhood
- f. Brotherhood replaces individualism and Communism, so it harbours sympathy and cooperation
- g. Differences among the brotherhood allowed trade. Eg.: One brother is an Engineer and another is a Doctor. Trade requires Specialization

E. For Profit Domain

- a. Depends on Self Interest
- b. Most of the regulations are prohibition eg. Riba, Gharar

F. Non Profit Domain

- a. Depends on Altruism, Fairness, Enjoying of giving
- b. Most of the regulations are Obligation eg.: Zakah, nafaqat, Inheritance

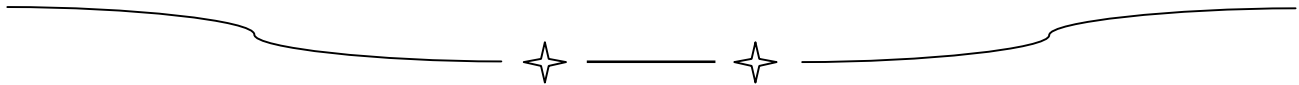


G. Why do we need two domains?

- a. To live happily
- b. To sustain happiness, we move from For profit to non-profit
- c. Study shows happiness declines once we obtain income enough for us

H. Zakah

- a. Donation/help/assistance from Rich to the poor or able to unable
- b. With extreme wealth concentration, market would fail
- c. We should treat poverty properly to keep the market healthy
- d. Hoarding is damaging to the economy. For ex, if everyone hoards then economy would collapse
- e. Zakah would work against hoarding

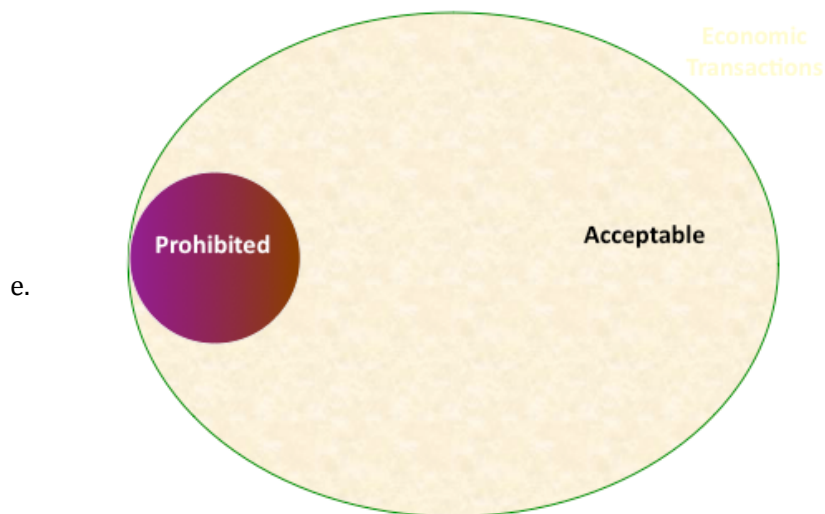




Chapter 2: Pillars of Prohibited dealings in For Profit Domain

A. Principles of Islamic Finance

- a. All general social transactions are acceptable from Sharee'ah perspective until there is some explicit prohibition
- b. If Scholars are split in an issue whether particular transaction is prohibited or not, then burden of proof is on one who claims it is prohibited
- c. Set of acceptable transactions are unbounded
- d. Set of prohibited transactions are restricted and limited



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B. Origins of Prohibited dealings

- a. Injustice: Riba
- b. Gharar: Ignorance

C. What is Ribaa?

- a. Any stipulated addition above and over the loan
- b. This additional something is called Riba
- c. **Example:**
 - i. If someone borrows \$100 and \$110 will be paid if he fails to pay on maturity
 - ii. Every year it is increase of \$10



- d. It includes Simple Interest like bank loans and Compound Interest (Riba on Riba)

D. Riba and Religions

- a. Concept of Riba prohibited by all religions like Hinduism, Judaism, Christianity, Confucianism
- b. It indicates principles of Islamic finance are universal and shared by followers of religions
- c. What is special about Sharee'ah is its detailed and specific step on where would riba exist and how to avoid it

E. What is wrong with Riba?

- a. Debt will grow faster than wealth
- b. Building up of wealth is much more demanding than building up of debt
- c. Building up of wealth requires something like Energy, hard work, creativity and so on

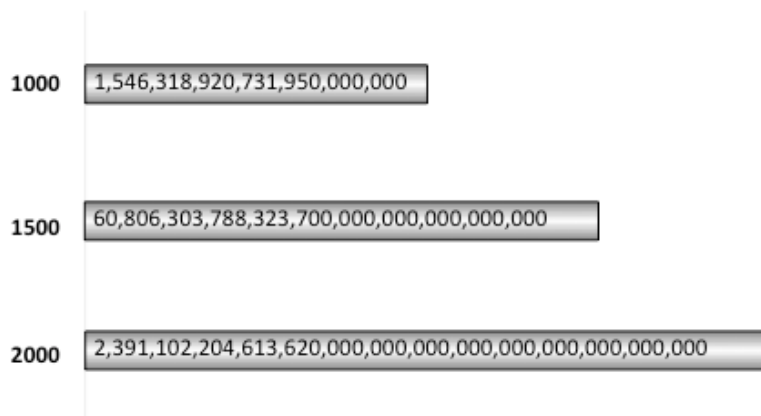
d. Example 1

- i. \$1 borrowed at 5% of interest in year 1 A.D
- ii. At year 1000, 1500, 2000 interest becomes unreadable number
- iii. It becomes impossible to pay

e. Example 2

- i. If 1 pence is borrowed at 4% in 1 A.D, then debt equals to weigh of the globe of Gold in the year 1750 and In 1990, it equals to 22,286 globes

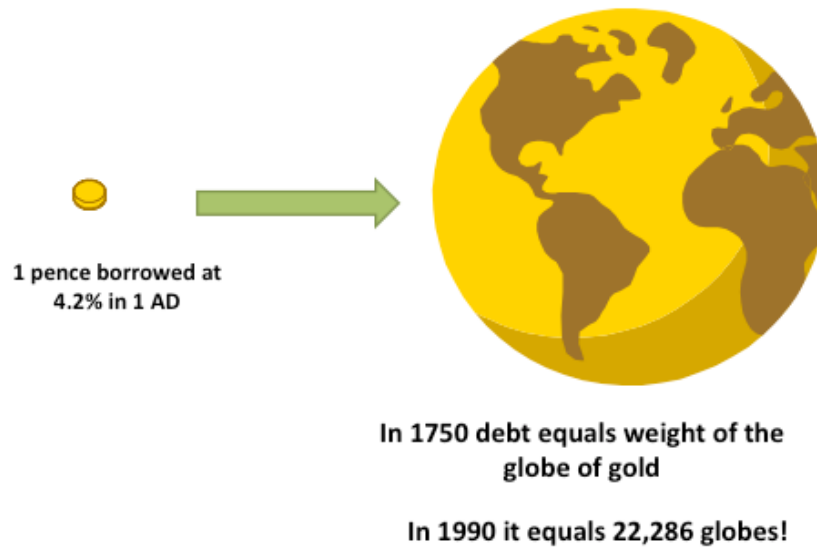
\$1 Borrowed at 5% in 1 AD



- f. It illustrates Compound interest is against laws of Physics to bare minimum
- g. Naturally, only thing that grows exponentially is disease and disorder which are sources of instability. Same goes with Riba. Riba is Cancer/disease in Economic system

h. It is not just theory - Practical Example

- i. Graph of Debt in US (in billion dollars)



F. Summary

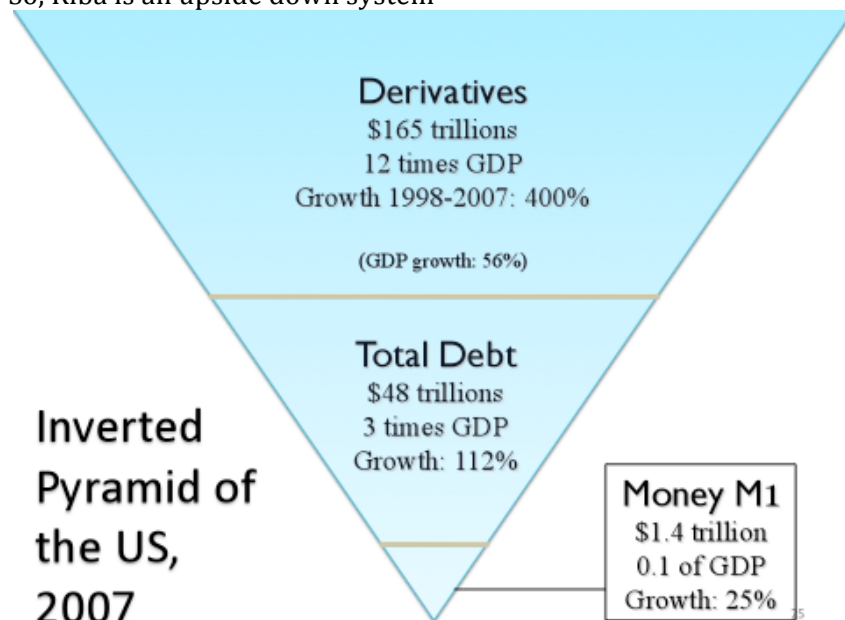
- a. Two pillars of prohibited dealings are Riba and gharar
- b. Riba is prohibited by all faiths
- c. Main problem with Riba is debt grows faster than wealth in multiples and multiples
- d. Dangerous aspect of Riba is it will collapse the whole Economic System



Chapter 3: Debt Pyramids

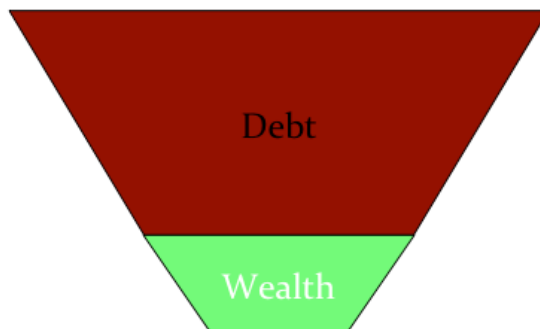
A. Inverted Debt Pyramid

- It is a pyramid where we have base of wealth upon which huge amount of Debt is standing
- So, Riba is an upside down system



- Inverted Debt Pyramid of US

Inverted Debt Pyramid





d. Africans are paying for their debt services twice as they spend on their Health care

B. Financial Instability

- a. Why do we need Finance?
 - i. Finance is means towards real economic needs
 - ii. We borrow to do some real transaction
- b. When debt grows beyond wealth, financial system collapse
- c. Root of the problem is Debt is not interlinked with real Economy. So, Inverted pyramid is not sustainable

C. Financial vs Real Sector

- a. Financial sector should serve the real sector like trade, Manufacturing, Production and so on
 - i. Once debt is delinked/decoupled from real transaction, we end up with financial sector growing up on its own. That's how Debt growing faster than wealth
- b. Finance sector should actually support Real sector. However, opposite is happening in present Economic System
- c. Hence, Economic System based on Interest is unstable
 - i. "Those who eat interest... Habbathum..." (Qur'aan)

D. Restrictions of Debt in Materialistic Economic System

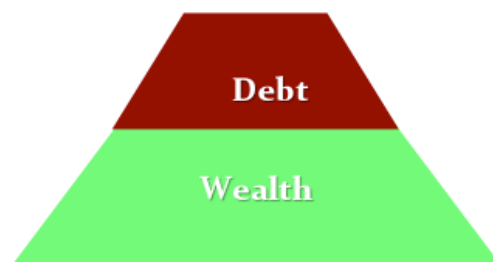
- a. All agree debt must be under control
- b. In Economic Theory, there are budget constraints which means you can borrow only with the capacity to pay
- c. Theory: Inter-temporal Budget Constraint:
 - i. The present value of debt go to zero
 - ii. Prevents Ponzi financing
- d. Reality: EU requirements:
 - i. Deficit < 3% of GDP
 - ii. Debt < 60% of GDP
 - iii. Deficit is debt for the current year
- e. Problem: Need to govern debt from the ground-up
 - i. These restrictions are adhoc. Why 3% and why not 5%? Why we have to wait until 60% and then say "Stop!" It will be too late and too difficult to start
 - ii. We need a mechanism to keep debt in control from the beginning

E. How Islamic Finance does?

- a. Islamic Finance integrates For Profit debt creation with Wealth Creation, so debt is always under control
- b. For-profit debt must be contractually embedded in real transactions
- c. Islamic modes of finance: Deferred sale; salam; leasing;
- d. In Islamic finance is it is only normal debt pyramid assuring stable economic system



Normal Debt Pyramid



F. Building Blocks:

- Trade is the building block of real economic activities
- Integrating credit with trade puts a cap on debt growth
- Debt is under control from the ground up
- For-profit debt is always coupled with wealth creation

G. Trade vs Loan

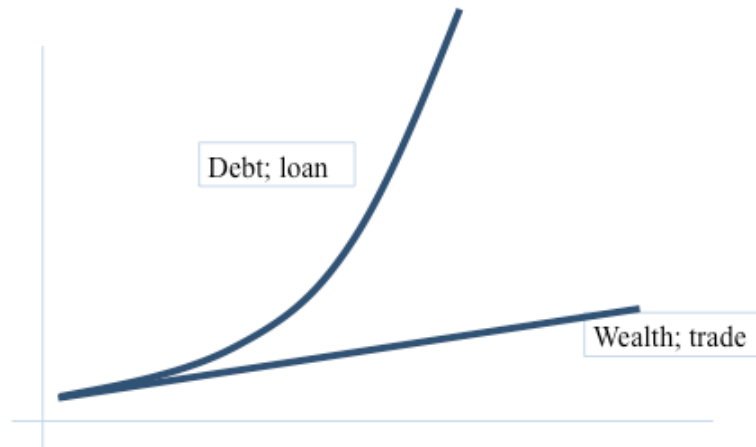
- Trade is the real transaction where each party able to gain something through Exchange
- Trade is building block of real sector
- Loan is building block of Financial sector

S.No	Trade	Loan	Remarks/Impact
1	Exchange different Items	Exchange Identical Items	In loan, it is exchange of items in terms of quality. There will be difference in Quantity if interest is introduced
2	Allows for Specialization	No Specialization	Eg. Umar is good in dress, then they specialize and produce more than their need. Hasan is good in electronics. Hasan and Umar exchange their wealth. They exchange their surpluses. Total output of economy will be much much greater than without specialization
3	Gains from Trade	No gains from Trade	
4	Multidimensional	Unidimensional	In Trade, Difference in quantity is compensated by difference in quality.



			In loan, if we add riba the difference in quantity is not compensated by difference in quality
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The First "Cell"



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Chapter 4: Time value

A. Fallacy of composition

- a. I can do something as long as I do it alone or few in the society are doing it. If everyone in the economy does it, composition will fail

b. Example

- a. Story of water well
 1. If there is water well in the city, city should be careful of how much they are consuming as limited water will be available
- b. Story of Tragedy of commons

c. Lending and Interest

- a. Person X takes loan for production but lends it to person Y. Later Person Y lends to person Z. If everyone does lending and relending, economy will collapse as no one will produce
- b. If individual hoards the money, it is okay. If everyone hoards the money, economy will collapse

C. How Islamic Finance circumvents?

- a. Hoarding is treated through Zakah
- b. Lending is controlled by prohibition of Riba

B. Time Value

- a. Time has value as long as economy which is producing
- b. Value of time is derived from real economy
- c. Time value is allowed as long as it is part of real transaction
- d. Separating time value from real value is illogical

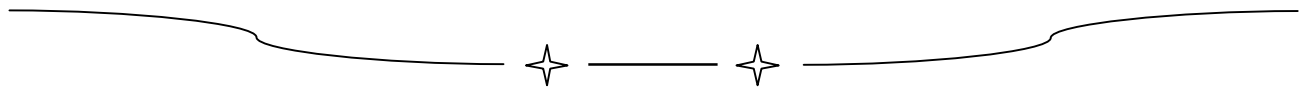
C. Riba and Time value

- a. If I give \$100 now, after 1 year, value of \$100 will be less than what is now, so you compensate me by additional \$5. This makes up for discounted future
- b. If such is the case, then borrower after maturity can say, that \$100 I took is less in value than \$100 in my pocket right now. So I will discount \$5 and will pay only \$95
- c. People discount the past more than the future
- d. It is impossible to satisfy both lender and borrower at time preference
- e. In Riba concept, time preference is always served for borrowed.
- f. Time preference on both the direction will cause damage. So fair solution is to paying on par
- g. Same refutation of Riba for money will work for things bought on credit as buyer would still value what he bought one year back as the present value



D. Trade and Time Value

- a. Trade allows both the party to win whereas in riba one party always wins
- b. If everybody keeps on lending, then debt explosion will happen
- c. It illustrates loan cannot be used for wealth creation
- d. That's why from Sharee'ah perspective, loan is non-profit instruction and not a profit transaction
- e. Finance "shall" be a means
- f. By integrating finance with trade, finance becomes "subordinate" of trade
- g. Islamic finance puts finance in its natural position





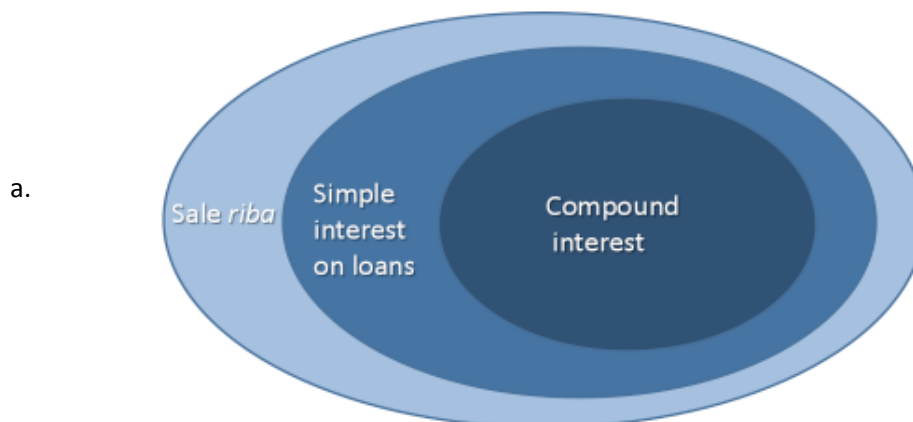
Chapter 5: Riba

A. Riba

- a. Any stipulated addition of a loan is Riba
- b. Riba for loan will apply to any kind of materials like Money, Gold, Silver.

B. Types of Riba

Types of Riba



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b. Three levels of Riba:

- i. Riba of debt (compound interest - Riba al jahiliyyah)
- ii. Riba of loans (simple interest - Riba al quroodh)
- iii. Riba of sale (riba al boyou').
 1. This includes riba al fadhl + riba al nasaa'.
 2. Riba al Naseeah
 - a. Riba of loans
 - b. To trade two items of the same group of the six items with one side spot and the other deferred.
 3. Riba al fadhl: trading an item of the six items with itself but with different quantities.

C. Sale Riba

- a. It applies when two items are not identical



- b. Applies to Specific type of commodities
 - i. Gold and Silver
 - ii. Stable food
- c. Refer the Table

d.

	Gold	Silver	Wheat	Barley	Dates	Salt
Gold	⌚ =	⌚	✓	✓	✓	✓
Silver	⌚	⌚ =	✓	✓	✓	✓
Wheat	✓	✓	⌚ =	⌚	⌚	⌚
Barley	✓	✓	⌚	⌚ =	⌚	⌚
Dates	✓	✓	⌚	⌚	⌚ =	⌚
Salt	✓	✓	⌚	⌚	⌚	⌚ =

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- e. **Legend**
 - i. = symbol denominates it should be equal
 - ii. Clock denominates it must be spot and immediate
- f. **Sample Interpretation**
 - i. We cannot exchange 24 carat gold for 18 carat gold though it is immediate
 - ii. For exchanging silver, it should be spot alone and not equal
 - iii. If we want silver now for gold in the future, then the element of loan is present as they are similar. Loan element would dominate Trade element.
- g. **Guiding Principles**
 - i. Anything by itself should be equal and spot
 - ii. Anything by other item should be spot alone
 - iii. Anything from one group to other group has not specific restrictions
 - iv. If the transaction is on spot, element of loan is removed and so the riba
 - v. Classification of items helps in where to draw the line

D. Illustration

- a. Suppose I have \$100 bill in my pocket. I say to Yusuf "Give me 100 coins each of 1 \$." So Yusuf says I am doing the service, so I will take \$2 service charge and give you \$98
 - i. On spot - Okay!
 - ii. Quantity - not equal - not okay!



- b. Other perspective: If I say to Yusuf, I will give \$100 currency after a week after receiving the Salary. Give me \$98 now as usual. Won't you call it as Riba?

E. Common property in all 6 items

a. Physical property

- i. Each of the item are homogeneous. If you take 1 gram of gold, one part will be identifiable with other parts. Fungible.

b. Economic property

- i. Necessary items for living

c. Why these two properties lead to Sale Riba?

- i. People would borrow and lend items of this kind as they are fungible.
ii. Less risk for borrower and lender
iii. People don't borrow anything except what is important to them

F. Two qualities that makes an item potentially borrowable

- a. Exchanging one item from one group (Gold and Silver) with other item from other group (Wheat, Barley, Dates, Salt) doesn't have specific restrictions applicable
b. Being Essential (duroori) and Fungible (Mithli) would make an item potential for borrowing and lending
c. Riba al Buva or Ribal al Fadhl is Sale Riba is in the gray area for us to fall into Riba. As it is in border, Sharee'ah given a clear guidelines.

G. If the duroori and Mithli are illaa for restriction of sale riba, Can we extend it to commodities outside this?

- a. Take for example things like Rice, Potato and so on
b. Most important commodity today is oil
c. Suppose we include oil in our table, within which group we should include the oil?
i. If we include it in Gold and silver group, then Forward transaction might be problem
ii. If we include it in Stable food group, it is not visible
iii. So no problem in including new group for oil. If we exchange oil for oil, then spot and equal applies. For exchanging with other group, there is no specific restrictions
d. More they are similar, stronger the restriction or lesser it is flexible
e. More they are different, lesser the restrictions or more it is flexible

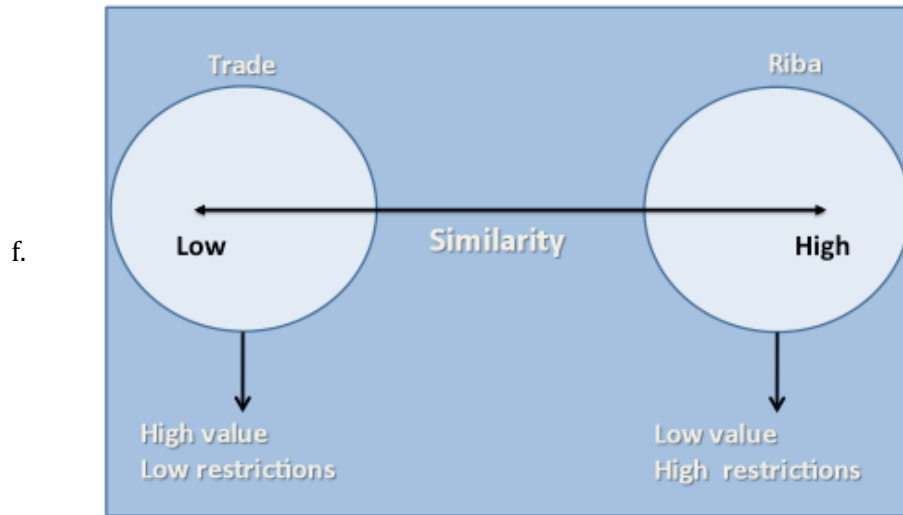
H. Why more they are similar, more there is restriction?

- a. Base is definition of trade
b. Objective of Sharee'ah is to create wealth so that people can live happily
c. More the two sides are similar, less the value is created
d. Similarity between to two sides will minimize gain from trade
e. Diversity, in general, is important for prosperity
f. Too much of one thing doesn't satisfy the need
g. So, Riba is not good for Economy

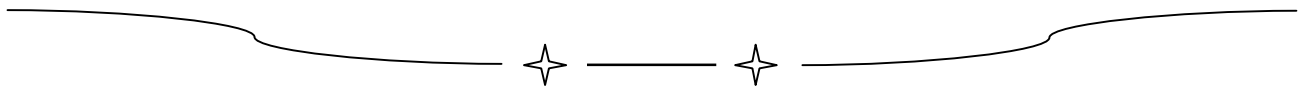


I. The Principle of Similarity

- a. Similarity negates gain from trade
- b. Variety allows mutual benefit
- c. Diversity is essential for prosperity
- d. Stronger similarity imposes stronger restrictions of exchange
- e. Riba: imbalanced exchange of similar items



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Chapter 6: Gharar

A. Definition:

- a. Gharar is risk with delusion
- b. It is not just pure risk
- c. At surface it good and appealing. At beneath, it is risky and dangerous (Thaahiruhum Mahboob wa baatinuhum makroor)

B. Levels of Gharar

- a. Degree of Risk
- b. Form/Structure of Risk

C. Degree of Risk

- a. Risk is probability of Loss
- b. Gharar is probability of Loss \geq Probability of gain
- c. Gharar applies when we have two possibilities. Most likely of the two possibility is most hated.
- d. Some Scholars said that Gharar applies when two possibilities of existence and non-existence is equally possible
- e. How to measure the probabilities?
 - i. It depends on decision/Judgment of people
- f. **Example:**
 - i. If we have Project 1 where likelihood is 70% possibility is loss and 30% of gain, then there is Gharar. In 30% chance of gain, several multiple of capital comes, then it involves delusion
 - ii. Lottery
 1. 1/10M can win the Prize
 2. Why people still put money into this? Reason is size of prize is too big
 3. Luck vs Skill
 - a. If person buys Lottery, he relies purely on Luck
 - b. In lottery, we cannot influence decisions which is strictly prohibited. So it means there cannot be any skill involved
- g. If you think it is 50/50 chance of profit and gain, then it is also Gharar. You should be confident of Success. Good Managers don't gamble
- h. We would take Risk when likelihood of Success is much more greater. It is reasonable risk.

D. Types of Risk



- a. Good Risk - Dominated by Success
- b. Bad Risk - Dominated by Failure
- c. Al Ibratul Ghaliba - It is based on dominance

E. Difference between Mysir (Gambling) and State Lottery

- a. Mysir is mainly for Social Objectives. Arabs would slaughter numerous camels. Whoever wins can take all the meat. However, person cannot take all, he will give it to needy and become generous
- b. Same goes to state lottery. Winner gives some part to needy and poor
- c. Ends does not justify the means. If we aspire a noble end, then we need noble means.
- d. Qur'aan is very objective. It says there is some benefit in Mysir but harm is more

F. Feasibility study

- a. It is very important as it helps us to choose the Business Project
- b. Required from Sharee'ah point of view

G. Structure of the Contract

- a. So far, we were looking at one side which is Decision maker. This is level 1 Gharar. Now we will get into gharar in structure of the contract
- b. Gharar is zero sum transaction with uncertain payoffs
- c. If one party gains (+1000), it will be expense of others (-1000). We end up zero which is zero sum transaction

H. Example of Gharar in Structure of Contract

- a. Gambling
- b. Sale of lost camel/car
 - i. If person lost the camel which has a part value of 1000 Dinar, he sells it at discounted prize of 100 Dinar as it is lost.
 - ii. If the buyer finds the camel in the corner, it means Seller lost 900
 - iii. Buyer gained 900. So zero sum pay off
 - iv. If the camel is not healthy, impaired, then it is loss for the buyer
- c. Commercial Insurance

I. Types of Transaction

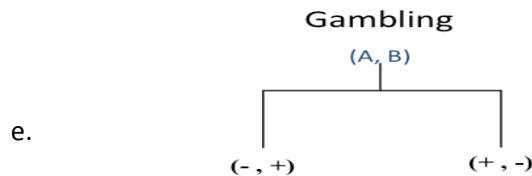
- a. Zero Sum
- b. Positive Sum
- c. Mixed



Zero Sum Transaction

A. Zero-Sum Transaction

- It is between two parties A and B
- Possibility 1: A would win (+) which means B (-) would lose
- Possibility 2: A would lose (-) which means B (+) would win
- It is impossible for two parties to win



B. How to know it is Zero Sum Transaction [ZSG]?

- If one party always says No, then it is ZSG
- Explanation:**
 - For example Gambling by tossing of coin. Person A chooses Head and person B chooses tails
 - If we ask A, Suppose you know in advance, outcome is going to be head, Would you play that gamble? He would not
 - If one party refuses to play, then it is ZST
- Steps:**
 - Start from a final outcome
 - If one party refuses to play, it is a zero-sum outcome
 - Repeat for other outcomes
 - If all outcomes are zero-sum, it is a ZSG

C. Why Zero Sum Transaction is not allowed in Sharee'ah?

- If one party wins (Ghaanim) at expense of other (Ghaarim), then he is not compensating from party B for whatever he has taken from Party A
- This is Aklul Maal bil Baatil. It is simply eating others wealth for nothing

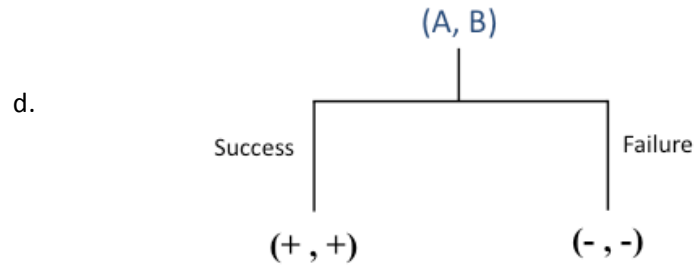
Positive Sum Deals

A. Positive Sum Deals

- Both the party wins together and both the party lose together. However, objective is to win.
- Interest of both the parties are aligned
- Example: Partnership Business (Musharakah)



Musharakah (partnership)



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Mixed deals

A. Mixed Deals

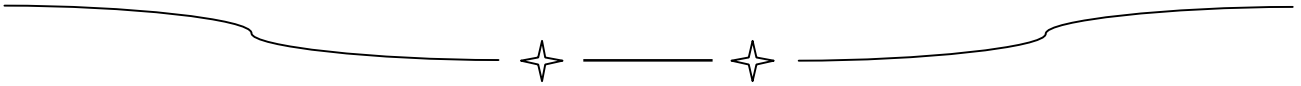
- a. It is neither ZST nor Positive Sum Deals. It is mixed deal
- b. If the zero-sum outcome is more likely, it is excessive gharar—not acceptable
- c. If it is less likely, it is minor gharar—acceptable
- d. They are in the middle between PSD and ZSG
- e. We have two parties where we have possibilities of
 - i. Win-win (+,+)
 - ii. Win-Loose (+.-)
- f. Most of the transactions in our lives are mixed

B. Side point:

- a. Some writers write "Life is a gamble" which is not true as it is not ZSG.
- b. In general, Life is actually of mixed deals

C. Activity - Try it now!

- a. Draw a tree to represent commercial insurance. How it will lead to Zero Sum Game
- b. Take example of car insurance, then two possibilities are
 - i. Accident
 - ii. No Accident
- c. Follow the steps mentioned earlier



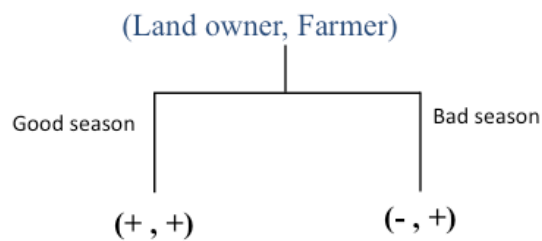


Chapter 7: Some forms of mixed deals

Example 1: Muzara'ah (Crop Sharing)

- A. **Muzara'ah (Crop Sharing)**
 - a. Parties involved are Person owning the land and Farmer
 - b. End of the day, they will share the crops
- B. **What kind of deal it is going to be?**
 - a. Based on structure of pay offs
- C. **Two possibilities**
 - a. Good season
 - b. Bad Season

Muzara'ah (crop-sharing)



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- D. **Good Season Scenario**
 - a. Usually in Muza'arah, Farmer bears the cost of plantation, irrigation. Take cost would be \$1000.
 - b. Value of crops - \$5000
 - c. Share for each party will be \$2500
 - d. For Farmer, \$2500 - \$1000 = \$1500
 - e. Both will be happy (win-win) - PSG



E. Bad Season Scenario

- a. Value of crops - \$1500
 - b. Share for each party will be \$750
 - c. For Farmer, $\$750 - \$1000 = - (\$250.00)$
 - d. For the Land owner, it will be + \$750
 - e. It is +, - (ZSG)
- e. **How to evaluate Mixed Deals?**
- a. ZSG are not allowed in Sharee'ah. PSG are allowed as long as both parties win-win or loose-loose together
 - b. We have to decide based on mutual outcome
 - c. **Probability:** If both parties are confident that Good season income is dominant than bad season income. It should be sufficiently above win-loose
 - d. **Magnitude** of gain in Win-win should be greater than gain in Win-Loose
 - i. In the above example, Land owner gets \$2500 in good season and gets just \$750 in bad season
 - e. **Mutual outcome = Win-Win outcome > Win-Loose outcome**
 - f. This is accepted transaction according to Sharee'ah
 - g. The Win-Loose in the above transaction is called Minor Gharar (Gharar li yarir)

Example 2: Ja'alah Transaction

A. Ja'alah Transaction

- a. If you achieve so and so target, you will get the bonus. If you don't, you will not get the bonus
- b. Example: Landowner hiring a agent to find water in his land. If the agent is successful, he will get the Money. If he doesn't, he will not get it

B. Possibilities

- a. Agent will find water in the area (+,+) Principal (Land owner) will get the water
- b. Agent unable to find the water. He would lose all the labors, and expenses he incurred in finding the water (-). It is possible for the Principal to gain something (+) like he himself continue exploration by digging another 20m and he finds the water. (Win-Loose)

C. Scholarly opinions on Ja'alah

- a. Not all the Scholars accept Ja'alah transaction
- b. Hanafi School call it as Gharar
- c. Malikis say Ja'alah is okay as long as Principal will not benefit from the unfinished work of the agent
- d. Hanbali and Shafi'ee call Ja'alah as accepted transaction irrespective Principal will benefit from unfinished work of agent or not
 - i. They allow it because Win-Win outcome is supposed to be dominant outcome in Likelihood and Magnitude
 - ii. It allows minor gharar



- e. In principle, no Scholar will allow Aklul Maal bil Baatil. Minor Gharar outcome is tolerated. It comes into picture in application and not in theory. That's where Scholarly differences arise. Similar to all scholars agree on Qawaid "Certainty is not removed by doubt" However, they differ in the way it is applied

Example 3: Sale of immature (unripe) Fruit

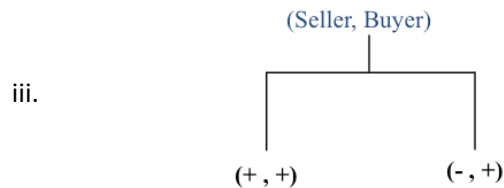
A. Sale of immature (unripe) Fruit

During the time of Prophet, Owners will sell the dates before maturity (i.e, when it is green) For the seller, it is to get cash in advance (Liquidity). For buyer, he will get at discounted price

B. Two possibilities

- i. Dates will not reach maturity at all, Spoiled. Buyer will be looser
- ii. Dates are better as Buyer expected.

Sale of Immature Fruit



C. Hadeeth regarding Sale of immature fruit

- i. Prophet ruled "Don't sell fruits until the maturity starts to appear"
- ii. Here Win-Lose is dominant in terms of parameters: Likelihood and Magnitude of gain
- iii. There is still some probability some of the fruits will not mature. This is minor Gharar
- iv. In this transaction, if opposite is true i.e., Win-Win is predominant, it is acceptable transaction
- v. That's why Prophet said "Don't sell fruits until the maturity starts to appear" He did not say "Don't sell fruits are matured completely" This indicates the room for minor Gharar



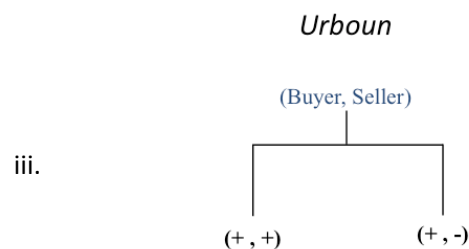
Example 4: Urboon

A. What is Urboon transaction?

- i. Loss of down payment/deposit when transaction is not completed
- ii. If person wants to buy the furniture but he is not sure that furniture will fit him. He makes down payment of 5% He would reserve the furniture for sometime until his family members or boss are okay with this. If they are happy, he will buy it. If they are not happy, he will not buy and ending up losing the down payment
- iii. It is the normal sale transaction with right to cancel

B. Two possibilities

- i. Complete the transaction (+, +)
- ii. Cancel of transaction (+, -)



C. Scholarly Opinions

- i. Hanafi, Maliki and Shafi'ee do not accept Urboon
 1. They justify why buyer losing his urboon without any reason. They call it as Aklul Mal bil baatil
- ii. Hanbali School and earlier scholars before four schools permit Urboon
 1. They say it is a normal sale transaction. Objective of any sale transaction is mutual gain. Then, this possibility is considered as minor Gharar

D. Principle regarding Gharar

- i. As long as mutual gain outcome is dominant outcome
- ii. Win-loose is minor in terms of likelihood and magnitude
- c. Objective of the transaction is Win-Win

E. Relation of types of Gharar



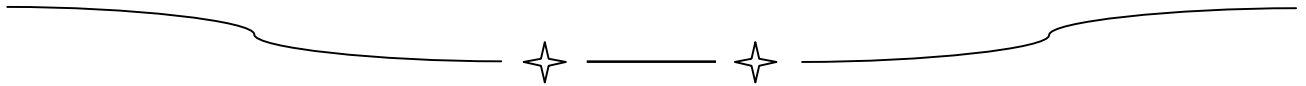
- a. Zero-sum games are always high risk
- b. High risk deals invite zero-sum games
- c. High-risk: speculation
- d. Zero-sum: gambling

F. Relationship between Ribaa and Gharar

a.

Ribaa	Gharar
Separates time value from the real transaction and Wealth creation	Separate Risk from Real transaction (eg. Gambling) and no wealth creation

- b. Time and Risk cannot be separated. They are two sides of same coin.
- c. If we are not allowed to separate Time from real transaction. Same applies to Risk as well. This implies prohibition of Ribaa means prohibition of Gharar





Chapter 8: Unacceptable Transactions

Forms of Unacceptable Transactions

- a. Profit without Liability
- b. Sale of what you do not have
- c. Two sales in one
- d. Sale and Loan

Profit without Liability

A. What is meant by Profit without liability?

- a. I would buy a good for \$100 and will sell it for \$110 retail to the customer. This is allowed
- b. If I purchased the good and I am not liable for it, then I cannot sell it for margin of 10

B. Examples:

- a. In other words, I purchase Laptop and it is not available today and I have to come tomorrow. 1 hr later flood hit the area and store was submerged. Owner of the store is responsible for the product and buyer is not liable during that period
- b. Someone came to me at 10 pm. I will pay you 100 more for the same laptop, Can I sell it for 1100? Within this period, I am not liable for the product. Then I cannot sell it for profit.
- c. Here Ribaa in general sense involved.

C. Why it is prohibited?

- a. It is money for money. In between, there is nothing
- b. Prophet prohibited the profit so we can sell it at the same price
- c. If someone asks for the same laptop, we can give non binding promise
- d. There are many international transactions in this way when Settlement period (Purchase date + 2 days to receive it) : T + 2 is not completed. Like selling of metals on a virtual market
- e. Here there is gap between settlement date and purchase date. Buyer is not liable for the products he bought during this period



Session 12

Monday, May 09, 2011
8:35 PM

Sale of what you don't have

- A. **What is Sale of what you don't have**
 - a. **You have means:** You own or You control
 - b. eg.: Walmart doesn't own most of their products in their shelves but are authorize people to sell it

- B. Seller must be confidently able to deliver the goods on time
- C. **Eg.: Airlines strategy of overbooking**
 - a. Jeddah to Kulalampur
 - b. Capacity: 300 seats
 - c. They will sell 310 seats
 - d. Here they are selling something that they don't own
 - e. If everyone turns up, they cannot deliver it.

- D. People sell Securities in International market this way. They side bids (Sale on purchase) the securities without even receiving the securities in hand
- E. Prohibiting this prevents both Riba and Gharar

Combining Two sales in One

- A. **What is meant by Combining Two sales in One?**
 - a. This is specific kind of combination where two sales are combined
 - b. When two contracts contradict each other, then we cannot combine it
 - c. If there is no inconsistency between two contracts, then we can freely combine it

- B. **Why "Two"?**
 - a. Inconsistency always arise between two things at a time

- C. **Three forms**

Forms	Example
Contradiction	Einah



Deceiving objects	Mudd ajwah
Tying Arrangements	Microsoft case

Einah

- a. Root word: Ayn - Money/Spot Gold/Spot Silver
- b. It is two-step contract to end up with a loan
- c. There are variety of forms of Einah

d. Bilateral Einah (Party 1: A | Party 2: B)

	A	B
Step 1	Mobile	\$100 deferred
Step 2	\$90 cash	Mobile
Net	\$90 cash	\$100 deferred

Step 1: A sells a mobile to B for \$100 to be paid one year from now (deferred)	B is the owner
Step 2: B sells the same phone to A at \$90	It is a separate step. Anyone can sell their property.
Step 3: If you combine two transactions, mobile will be cancelled out.	<p>\$90 cash for \$100 deferred</p> <p>It is money now for money later</p> <p>It is literally lending \$100 at \$10</p>

e.

Scholarly Opinions

- i. Shafi'ee School permits this transaction as we do not have solid proof for Step 2 transaction
- ii. Other Schools forbids because objective indicates their transaction is for Riba

Mudd 'Ajwa Transaction

A. What is Muddj Ajwa means?

- a. It is exchange of money for money plus a good
- b. Money = Money + Goods



B. Scenario 1

- a. If the money standing alone on one side of transaction is greater than combined money, then the transaction is okay
 - i. Good's value should compensate the difference
 - ii. Both should be on spot transaction
- b. If one is deferred, it becomes a sale and loan
 - i. Example: $\$100 = \$50 + \text{Pen (worth of \$50)}$

C. Scenario 2:

- a. If it is opposite i.e, Combined money is greater than separate Money, it is not allowed
- b. Example:
 - a. $\$100 < \$50 + \text{Pen (worth of \$60)}$
 - b. No rational person will do it. However they defer it to make this transaction happen
 - c. Buy this pen for \$10, you might win \$1000. This is lottery and it is not allowed. Objective of transaction is haram
- c. Ijma exists in prohibition
- d. Combining legitimate with illegitimate will make the transaction only illegitimate

D. Guiding Principles

- i. If separate Money > Combined money --> Acceptable
- ii. If separate Money <= Combined money --> unacceptable
 - 1. Good +100 =100 means Good =0 (ZST)

Tying Arrangement

A. What is tying arrangement?

- a. I will sell you this pen only if you buy from me notebook
- b. This is forcing the buyer to buy what he doesn't want. This is exploitation

B. Example: Microsoft Case against Netscape

- a. In Early 90's, Netscape was choice for the browser
- b. Netscape took greater share of the Internet Market
- c. Microsoft invested lot of money on their Internet Explorer
- d. They forced vendors like HP, DELL to have IE as default browser.
- e. If they don't sell IE, then Microsoft will not give their OS to them
- f. All the companies joint together sued Microsoft for this

Combining Sales and Loan

A. What is combining Sales and loan?

- a. Loan is simply to facilitate a trade. If I fail in trade, it will end up in Riba



- b. Trade is used as price for loan
- c. It is specific kind of combination which is forbidden

B. Guiding Principles:

- a. If the loan is objective, then the sale becomes an implicit interest to the lender
- b. If the trade is objective of the loan, then it is permissible

C. Example 1:

- a. Give me \$1000 as Loan. Ahmad says I will give loan provided you buy this Pen or sell your mobile
- b. Trade component here is simply interest

D. Example 2:

Someone offered job into new city. In order for him to move, he needs money to lease apartment and so on. Employee mandates in his contract that he should be given interest free loan for him to move - This is permissible

Trade part	Employment
Loan part	Means to facilitate trade

E. Example 3: Muza'rah and Loan

Like in Muzara'ah contract, If farmer conditions loan for him to start his farming, then it is acceptable as objective is Trade and not lending

F. Example 4: Loan to buy a car

- a. Some dealers would sell you a car for deferred price. Dealer would also give a loan. This is acceptable

Sale Part	\$15000 deferred 3 years
Loan	\$5000

- b. This would be problematic if loan is with interest and or anything charged extra from price of the car i.e., \$15000 > Car+5000

