

## *Mudarabah* in Non-Trade Operations<sup>(\*)</sup>

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ABSTRACT. The author introduces *mudarabah* as being permitted against the rules of analogy which required fixed wages for the working party. This exception was made only in favour of trading activities and cannot be extended to industry, agriculture services, etc. In applying *mudarabah* in all kinds of business, contemporary Islamic banks are going beyond the standard fiqh, the author concludes .

### I

*Mudarabah* is one of the techniques which a large number of Islamic banks have adopted for financing their customer's business requirements. In most cases the scope of the application of *Mudarabah* has not been defined. Banks like the Islamic Bank of Jordan and Faisal Islamic Bank of Sudan have introduced the concept of *Mudarabah* Certificates as an instrument to finance fixed investment and working capital requirements. The concept of *Mudarabah* Certificate is also to be found in Pakistan for financing short-term and medium-term requirements of different sectors of the economy. Banks like Dubai Islamic Bank propose to finance commerce, industry, real estate, etc., on the basis of *Mudarabah*. Among all these countries Iran seems to be the only one to confine the scope of *Mudarabah* to trading operations excluding private sector imports. In fact law relating to *Mudarabah* is suggestive of a simple mode of trade viz, purchase and sale. Unlike *shirka* there are no kinds of *Mudarabah* to cover any other economic activity than simple business, nor are there any precedents to suggest for it a wider scope of operation. Part I of this study is intended to give a fuller treatment to this approach while Part II tries to examine the doubts and objections that may and do challenge the validity of this approach.

There apparently seem to be two sets of reasons, legal and practical, for disallowing *Mudarabah* in non-trade operations.

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### **Legal Reasons**

(a) *Mudarabah* is a relationship between capital and labour in which the former utilizes the services and skill of the latter in return for a share in expected profits. Thus it is essentially a contract of hire/wage. But according to the basic rules of the *Shari'ah* based on the Prophet's saying, a contract of hire/wage should precisely lay down the amount of hire/wage to be paid to the worker<sup>(1)</sup> failing which the contract will become voidable and therefore the worker will have to be paid standard wage (*ajr mithl*). In a contract of *Mudarabah*, on the other hand, the condition of precise fixation of wage to the worker does not exist. Thus the analogy of the law of wage demands that *Mudarabah* should be held unlawful. But the holy Prophet, in supersession of this rule, exempted this contract from the purview of the law of hire. According to majority of jurists a thing established contrary to legal analogy (*Qiyas*) cannot be used as an analogy for other things.<sup>(2)</sup> *Mudarabah* was legalized on the ground of social and economic necessity. But because the permissibility of *Mudarabah* super ceded a basic rule and defied analogy it had to suffer a legal limitation. In order to find out the nature of limitation we may take the example of another similar contract. Such other contract is *bay salam* or advance payment for deferred delivery of goods (which the seller, or grower does not possess) where the permissibility of the contract defies analogy. Here also the rule is that goods not in possession of the seller cannot be sold. And here also the holy Prophet legalized it as an exceptional case. As a result this had to suffer a legal limitation viz, the original seller is allowed to sell the commodity before the good comes into his possession; but the purchaser is not allowed to contract the resale of this good unless he possesses it.<sup>(3)</sup> Thus the contract of *bay Islam* has been restricted in its scope to a single transaction.

The question now arises as to the nature of limitation placed on *Mudarabah*. While all jurists have not categorically pointed out this limitation, the scope of their discussion clearly alludes to the fact that the contract is applicable to simple mode of trade (purchase and sale). The *Shafi'i* and the *Maliki* (as well as the *Jafari*) view seems to be more rigid than the *Hanafi* and *Hanbali* view. The *Shafi'i* jurist *Al-Ramali* for example opines that:

"The job of the worker is trading which is earning profit through purchase and sale but not through grinding or cooking because the worker of the latter job is termed as craftsman, not trader" ,<sup>(4)</sup> Another jurist *Al-Rafi'i* observes as follows: "Trading is making money through purchase and sale but not through handicraft or manufacturing".<sup>(5)</sup>

Applying this principle to different jobs, the same jurist explains as under:

"A person advances money to another one on the basis of *Mudarabah* and advises him to buy date trees, animals or property to get the produce of trees or look after the animals or collect rent of the property on the condition of 50/50 distribution of profit. The contract of *Mudarabah* will be voidable because it is not earning profit through trade. Trade (on the other hand), means transacting purchase and resale while (in the examples cited above) the profit is not accruing through transaction (of purchase and sale) but through a non-financial operation (which is caretaking or collection of fruits or rent)<sup>(6)</sup>,"

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\* Parentheses added

Al-Jaziri sums up the Shafi'i position as follows:

"A *Mudarabah* business should consist of trading only which means purchase and resale".<sup>(7)</sup>

It may be pointed out here that exactly the same view has been taken by Jafari school of law. Even the Iranian law of interest-free banking confines this mode only to trade,<sup>(8)</sup>

The *Maliki* approach is summed up in *Muwatta'* under the title "what condition is lawful in *Oirad'* (*Mudarabah*), and is reproduced as follows:

"A person advances his money to another person on the basis of *Mudarabah* with the condition that this money will be utilized in purchase of trees or animals and that these trees or animals will be retained for getting fruits or offspring. (Imam Malik says) it is not permissible and does not conform to the Muslim norm (*Sunnah*) which is to be followed in *Mudarabah* (and which lays down) that these goods should be purchased for resale like any other merchandise"<sup>(9)</sup>

Explaining the above opinion (by Imam Malik) Al-Zarqani observes that the job of the working party is trading, not watering plants and rearing animals..., the worker should earn profit only through the sale of animals etc.<sup>(10)</sup>

While direct evidence of the *Hanbali* jurists is not available to us, their discussion the non-trade activities of the worker reveals that they also support this restricted scope of the *Mudarabah* business. In his discussion on a worker's responsibilities in event of theft or usurpation of *Mudarabah* goods the famous *Hanbali* jurist *Ibn Qudama* discusses the question of the worker's responsibility to litigate against the thief or usurper. The basic theme of discussion on this issue revolves around the question if the act of litigation and claim comes in purview of trading activity or not. *Ibn Qudama* points out that there are two opinions on this question:

1) It is the duty of the worker to claim the *Mudarabah* goods.

2) It is not his duty to do so because the worker under a *Mudarabah* contract has actually contracted for trading which does not consist of litigation<sup>(11)</sup> As regards *Ibn Qudama's* own opinion he votes in favour of the former view with the following reservation:

(It is the duty of the worker to claim the lost goods because) it is obligatory on him to protect *Mudarabah* goods which in this case is impossible to do without litigation and claim. If he fails to do so he will have to indemnify the owner because he holds the goods (the *Mudarabah* property). The owner of the goods is unaware of the goods because the worker is often on his (business) travel and also because the owner himself is (some times) out of the city. Anyhow, if the owner is not unaware (of the goods or about its loss) the worker will not be bound to claim or litigate for it nor would he be required to indemnify the owner.<sup>(\*) (12)</sup>

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\* Parentheses added

In the above passage the proviso that "if the owner is not unaware ..." suggests that Ibn Qudama treats the lodgement of legal claim to goods as something which is out side the purview of trading. This is the main point emphasized by Ibn Qudama. Both opinions, however, restrict the concept of trade to purchase and sale or the acts which are necessary to conduct these operations.

Among the Hanafi jurists AI-Kasant's observation that *Mudarabah* does not take place unless purchase and sale are made<sup>(13)</sup> also implies the same concept although other Hanafi jurists have not given any hint at this aspect of the question. The discussion on the application of *Mudarabah*, however, suggests that their concept of *Mudarabah* did not go beyond trading.

A doubt may be expressed that the reason why the early jurists included in their discussion on *Mudarabah* only a simple trading operation reflected the institutional base of the period in which they compiled the law. The early medieval society could not conceive of a joint venture in spheres other than trade. But the doubt cannot be supported on historical grounds. Even in the Middle Ages agriculture, handicraft and transport were the most commonly practised professions in all regions of the Muslim world. These very medieval jurists have given full consideration to non-trading operations in the case of *Shirka* by classifying it into four different categories including partnership in arts or craftsmanship (*Shirka bi'l amal*) while no such classification has been provided in the case of *Mudarabah*. Even if the argument is accepted in the case of the jurists prominent during the second to seventh century of Hijra in which Imam Malik, Imam Shafi'i, Imam Ahmad, Imam Muhammad, Imam Yusuf, Qazi Khan, Kasani, Marghinani were the distinguished exponents of Islamic law, the jurists like Ibn Nujaym, Haskafi and Ibn Abidin who emerged in 11th, 12th and 13th century respectively also did not take into account the non-trading operations of *Mudarabah* which covered agriculture, transport, construction, handicraft etc. All these jurists have discussed the examples of *Shirka* (Partnership) in windmill, canal, boating, bath house, agricultural farm, livestock, poultry, sericulture, hunting, engraving, watering, tailoring<sup>(14)</sup> etc. but not of *Mudarabah* in any case of these activities. This fact leads us to conclude that according to all these jurists *Mudarabah* Was not applicable to any of these activities.

(b) Another legal reason is that the contract of *Mudarabah* has been legalized on the ground of a pressing economic necessity of the society. In all those cases where some unlawful thing is legalized merely on the ground of necessity the permissibility continues till such time only as that necessity persists. As soon as normally permissible modes of fulfilling the necessity are available temporary legality is waived off.<sup>(15)</sup> Thus no contract for which regular devices are available can be made on the basis of *Mudarabah*. Practically it is not always possible for the owner of surplus fund to employ a skilled person on regular wages to efficiently conduct trade on his behalf. The best way and the most profitable way of employing these funds is the condition of sharing with the worker in expected profit. Thus if *Mudarabah* business takes the form of an activity which can be performed and is usually performed on payment of fixed wages the contract will have to be converted into a wage contract (*Ijara*). The jurists have given us many examples of such a situation. For example, if a person offers an amount of money to another person with the condition that the worker should purchase

wheat, grind it, and cook it for sale, it would be avoidable contract.<sup>(16)</sup> Similarly, if he passes on a bundle of yarn to weave it into cloth for sale the contract will be voidable. The reason as laid down by jurists is that the permissibility of *Mudarabah* is contingent upon an inevitable necessity while the acts of grinding, cooking and weaving are easily and efficiently discharged on the basis of fixed wage, therefore these operations will be made on the basis of the contract of wage but not the contract of *Mudarabah*.<sup>(17)</sup> It will be practiced only when relaxation of the basic rule has become necessary. This is what the Shafi'i and Maliki jurists have clearly made out.

However, viewed in the context of present day trading it can be argued that the Shafi'i, the Maliki and the Jafari approach hopelessly narrows down the scope of *Mudarabah* to rather crude and primitive trading operations. This limitation confines the *Mudarabah* technique to retailers or hawkers, dealing purely in the purchase and sale of finished goods. This approach if rigidly applied will exclude modern trading operations in which presale processing and after sale service is also involved. It is here that the opinion expressed by Hanafi and Hanbali jurists finds its justification. Their approach is flexible enough to cover almost all the activities taking place the trading centre. Discussing complex examples of *Mudarabah*, the Hanafi jurists have therefore, defined trading operation to include all those things in *Mudarabah* which are conventionally treated to be trading.<sup>(18)</sup> While according to other Schools, abona fide trader of electronics, for example, will not be allowed to import accessories to assemble them locally for sale and earn higher profits, he may do so according to Hanafi jurists. In case the trader himself is technically qualified to assemble these electronic units, he will be supposed to be discharging his duty as a worker. In case, however, he cannot assemble them, he may employ technicians to look after the work in accordance with the provisions of the *Mudarabah* contract. It is because of this basis of "convention" that the Hanafi opinion has deviated from Shafi'i, Maliki, and Jafari opinion. Thus according to Imam Malik, a worker who purchases leather with *Mudarabah* funds to cut and stitch it into shoes, socks and mealspread will be entitled to standard wages (not a share in profits) because the contract of *Mudarabah* in this respect will be voidable<sup>(19)</sup>; but according to Hanafi jurists the contract will be valid because a trader is conventionally supposed to do so.<sup>(20)</sup> The Hanbali jurist Ibn Qudama's approach seems to be very practical in judging the validity of such conditions of the contract. According to him it is the duty of the worker perform all those acts which a trader is conventionally supposed to perform. In case he hires anybody for these acts he will have to pay the wages from his own pocket. The example in case of cloth trade is spreading and rolling of cloth, presenting it to the purchaser, bargaining a price, accepting the sale of cloth, collecting price from the purchaser, scrutinizing the coins, covering the packet, tying it up and keeping it back into the box etc. These are the services for which alone the working partner becomes entitled to a share in profit. Anyway the worker is allowed to employ someone on hire for all those jobs which conventionally the trader is not supposed to do himself; (the amount of hire so paid by the trader will be chargeable to the *Mudarabah* account).<sup>(21)</sup>

It follows, therefore, that if complex trading (but not manufacturing, services, transport, or contraction) is intended to be financed through *Mudarabah*, the answer lies in the adoption of Hanafi/Hanbali approach. And as long as such complex trading exists in the market and can benefit the trade there is no reason why this approach should not be

adopted. Most of the present day trading including trading in electronics, vehicles and electrical goods with the condition of fixing/installation and after sale service through electrician/plumber/mechanic etc. and a score of other similar trading operations should come in the purview of trading activity. The points to be noted here are that:

(a) the related services involved in these activities are rendered by the worker himself or got done by him on payment;

(b) non-trading job forms a minor part of the overall business activity, so that the character of the activity remains trading; and

(c) money involved in carrying out such services forms a very small portion of *Mudarabah* capital as against the setting up of an industry or sponsoring a hotel, construction or transport company in which trading involves only a small segment of the whole business.

### ***Practical Reasons***

Practical reasons that discourage the functioning of *Mudarabah* in non-trading operations emanate from the following facts:

1. In a contract of *Mudarabah* the entire capital is to be supplied by the owner. Thus all the expenses that are needed to run the business, excluding the subsistence of the worker, are to be borne by the financier. In case *Mudarabah* is applied to industry the owner will have to finance everything right from the expenses of promotion of industry down to the purchase of land, machinery, construction, installation, maintenance, wages, raw material, etc., etc. The worker would be supposed to put in only his skill and organizational ability to ensure that commodity is manufactured for marketing.

The last point made out above is the most important factor that makes *Mudarabah* in non-trade operations difficult to apply. An investor in short gestation projects would hardly find himself agreeable to spend on everything, to bear the entire risk of loss but pass on a portion of profit to the managing agent in addition to regular expenditure on his transport, health, trade tours, entertainment etc. which conventionally, is borne by the firm. On the other hand, in the case of long gestation projects or risky projects it will not be acceptable to any worker to devote his time and energy without a sure promise of a return within a reasonable time. In case he is ensured a subsistence during such period, this will weaken his incentive to maximize the profits of the business. More over, the promise for a subsistence would mean a sure return for the worker without a similar assurance for the owner and this would make the contract unlawful under the Islamic law.

2. In ordinary trading capital is used not only for purchasing merchandise for resale but also for meeting expenses incurred in connection with trading operations i.e., expenses on transport of goods from the producer's or original seller's god own to the workers god own or shop, purchase of packing material, payment of toll tax, excise duty, insurance premium etc., etc. Thus all these payments will be debited to *Mudarabah* account and incurred from the owner's capital. The working partner would

not be supposed to discharge any of these functions himself or pay for them from his own pocket. In this respect some jurists have gone to the extent that *Mudarah* funds will be debited to all those illegal gratifications which the worker is compelled to pay to different public agencies in consideration of security and maintenance of trade goods.<sup>(22)</sup> Anyway he will not be reimbursed for payments made for the work which he is supposed to do himself as a worker. The following examples given by jurists are adduced for further elaboration:

(a) A worker has a right to purchase a mule (for transport) out of *Mudarah* funds.<sup>(23)</sup>

(b) A worker shall not pay (from his pocket) for weighing<sup>(\*)</sup> and for protection of *Mudarah* property. These jobs can be got done on wage payment which will be made from *Mudarah* capital.<sup>(24)</sup>

(c) In case entire *Mudarah* capital has been spent on purchase of merchandise and the worker needs additional funds for improving or refining merchandise he is not supposed to borrow (without the express permission of the owner of capital). Thus if the worker spends the entire fund on the purchase of cloth and spends additional funds by way of wages for transport, washing, or rolling/wrapping it will be treated to be done by him ex-gratia as if he has done it himself. Anyway this washing will mean simple washing by him with plain water. In case this washing is done with starch it would mean coloring the cloth or if he gets it colored in red, he will be come a *sharik* (business partner) of the owner to the extent of *addition in the value of cloth* due to coloring but *not to the extent of expenditure* actually made on this account.<sup>(25)</sup>

(d) It is the duty of the worker to perform every job that the traders conventionally perform. If he employs somebody else for it he will be required to pay from his own account. The example is spreading of the piece of cloth (for sale), rolling it back, presenting it to the buyer, bargaining the price, contracting the sale, collecting the price, scrutinizing the coins, packing the cloth, and restoring the same to its place, because it is by virtue of these jobs that he is entitled to a share (in profit). Anyhow he has a right to employ a person for a job which he is not conventionally supposed to perform.<sup>(26)</sup> The expenses incurred in this (latter) account will be debited to *Mudarah* account.

Applying this approach to industry, agriculture, transport, services etc. the *Mudarib* will be the managing agent of the enterprise and would not be supposed to spend a single penny from his personal resources towards running the business. This condition dismisses the feasibility of *Mudarah* in non-trading operations and it would not be acceptable to the present day banks, investment organizations and *Mudarah* companies. No financier would agree to finance the purchase of land, machinery, raw material and the payment of wages, and hire, maintenance charges, fees, duties and taxes and all liabilities of the business, on the condition of profit-sharing with the managing agent who is not liable to any claims and losses of the business. Even if some financier is agreeable to this condition the Shariah would not allow it as the alternative of employing a managing agent on fixed remuneration is available. In this connection the following opinions of some jurists will be of relevance to the point.

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\* In early days weighing of heavy loads was done on payment by the purchaser

Trading on the basis of *Mudarabah* is itself subject to some conditions: Firstly this trading should comprise purchase and sale but not manufacture and handicrafts, The example is the contract of *Mudarabah* with a weaver requiring him to purchase cotton, weave it into cloth to sell it out. Or, another example is the contract of *Mudarabah* with a cook requiring him to purchase wheat, grind it and cook it in the form of bread to sell it out. *Mudarabah* would not be lawful in any such case because these are defined jobs for which it is possible to employ somebody on the basis of fixed remuneration but not on the basis of *Mudarabah*, and because the legality of this contract is contingent upon a necessity where it is not possible to employ anybody on wages.<sup>(27)</sup>

On the basis of the example of cooking Al-Rafi'i opines as follows:

... the contract is voidable. The rationale of this disapproval by our colleagues is that cooking is a precisely determinable job which can be performed on the basis of fixed wages; and if any job can be performed on the basis of fixed wages the contract of *Mudarabah* for such job will not be permissible.<sup>(28)</sup> The same situation can be visualized in the case of manufacture, transport, construction and services etc.<sup>(\*)</sup>

3. Banks and *Mudarabah* companies may have to contract *Mudarabah* with a newly sponsoring business or a running business. The latter is the most prevalent situation. The question is what will be the position of profit sharing in case the financier's funds have been indistinguishably combined with the working party's funds. This situation has been discussed by the *fuqaha* under the title of "combining of *Mudarabah* property" (*Khalt mal al-Mudarabah*). It is generally held in this connection that firstly, the worker does not enjoy an implicit right to combine his own goods with the *Mudarabah* goods. In the case the financing partner permits him to combine his own property with *Mudarabah* property the return accruing on his share of property will not be shared by the financier; it will be wholly for the worker.<sup>(29)</sup> As against this, profit accruing on *Mudarabah* property will be shared by both according to agreement. Logically, similar treatment will be made in the case of loss incurred on the worker's fund. It has been pointed out above that the Hanafi definition of trading is broad in the sense that they include in it all those jobs which are conventionally treated to be a trading operation. But the condition of precise fixation of the owner's monetary contribution has largely narrowed down the scope of *Mudarabah*. Another argument that disqualifies *Mudarabah* in such cases emerges from the conclusions made from examples of construction as produced by Al-Sarakhsi:

### **Example - 1**

A person offers a piece of land to another for construction of a house according to a given specification, on the basis of 50-50 division of the house.

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\* It will be found that in agriculture and gardening the condition of the payment of fixed wages for fixed nature of work may often become unprofitable for the landowner because it often involves unusual and extraordinary care in operations like sowing, weeding and protecting and harvesting etc. It is because of meeting this necessity that the Prophet has allowed the contracts resembling *Mudarabah* which are termed as *Muzaraa* and *Musaqat*. These contracts entitle the worker to a proportionate share in the produce and oblige him to work honestly and efficiently to maximize production and thus his own share.



Al-Sarakhsi's opinion: The contract is voidable because the worker has used his own tools of construction for which hire (has not been fixed and therefore it) has become uncertain. (A contract of *Mudarabah* involving ambiguity in the value of inputs is voidable). As a result the entire construction will belong to the owner of land while the worker would be paid standard wage for his labour.<sup>(30)</sup>

### **Example - 2**

A person offers a piece of land to another person for construction of a township to put it on rent on the condition of 50-50 in revenue.

Al-Sarakhsi's opinion: The worker would be entitled to take away the whole of rent because the owner of land did not supply a construction plan. The township belongs to the worker. The owner on the other hand will be paid the rent of land which belongs to him.

The difference between the two examples is that in the former case the commodity is known but a part of input is contributed by the worker in addition to his own labour. Had the use of this input (tools and implements) been evaluated in terms of hire and debited to *Mudarabah* account the contract, according to Al-Sarakhsi would have become lawful. In the latter example the commodity to be traded has not been specified by the owner which has made the contract voidable.<sup>(31)</sup> A voidable contract of *Mudarabah* is treated to be a contract of wage/rent.

### **Example - 3**

A person offers his house to another person for sale of barley in the house on 50-50 basis.

Al-Sarakhsi's opinion: Entire profit will belong to the worker because the contract is voidable on two grounds:

(a) The rent of the premises as an input in *Mudarabah* is not fixed. In other words, the owner's contribution is not precisely determined.

(b) the worker has earned money with his own commodity (barley) and thus he is to be treated as a trader on his own account. Thus the owner of the premises will receive rent for his premises while the worker will take away the whole profit.<sup>(32)</sup>

A few more examples discussed mainly by Hanafi jurists would prove how impracticable it is for the financier to allow combining his property with the worker's contribution. For example

(a) *Mudarabah* property is cloth. In case the worker gets it dyed with his own funds (and it adds to the value of cloth) he will be entitled to the entire value added to this property.

Illustration: The cost of a white sheet of cloth	= 5 dirham
The sale price of a white sheet of cloth	= 7 dirham
Profit	= 2 dirham
Divisible @ 50-50 which mean each gets	= 1 dirham

But suppose the sale price of dyed cloth is 8 dirhams which is one dirham higher than the sale price of white cloth. This addition of one dirham profit will wholly go to the worker because he has spent his own money (of course, subject to the financier's approval) for it and because the entire profit of his share of investment will belong to him and will not be shared by the financier.<sup>(33)</sup> This will be over and above his share in *Mudarabah* profit.

(b) It is not permissible for the worker to borrow for *Mudarabah* not even for the improvement of *Mudarabah* property (If he does so for the sake of ordinary operations of trading it will be his goodwill gesture). For example, if a worker spends the entire *Mudarabah* funds in the purchase of cloth sheets; then he borrows money for transport, washing and rolling these sheets, all these acts will be treated to have been done from his own sources gratuitously, provided washing is done with plain water. But if this washing is done with starch or colour it will make him a *sharik* of the owner to the extent this washing has added to the value of the cloth.<sup>(34)</sup> Anyhow if he has *Mudarabah* funds with him all such expenses will be met from these funds.<sup>(35)</sup> This is so because the contract of *Mudarabah* is not supposed to confer on him the right to borrow for *Mudarabah*. And in case he violates his authority he will be responsible for it. The interesting thing is that in the event of an express right of the worker to borrow, the amount borrowed will not be wholly the responsibility of the financier: it will be equally shared by both parties.<sup>(36)</sup>

(4) Another point that makes a non-trading *Mudarabah* unpracticable is that the worker is not supposed to use *Mudarabah* funds for his personal needs. He may be financed for his business journey<sup>(\*)</sup> but not otherwise.<sup>(37)</sup> This fact makes it unacceptable to a large number of the present day entrepreneurs. He will receive his share only when the profits accrue and are distributed. In a large number of non-trade operations like industry, agriculture, transport, services etc. the gestation period of, say, setting up an industry, or reclamation of land or raising a garden or laying the infrastructure of transport may be too long to attract the worker to devote his time and energy simply in the hope of sharing a profit which may or may not accrue. He would prefer to offer himself for employment rather than contracting *Mudarabah* because, for him, a bird in hand would be better than two in the bush.

### The Possible Rationale

The approach of the *fuqaha'* elaborated above apparently lacks reason and logic. But as already hinted above, this approach seems to take cognizance of the economic instinct of man. It seems to be very much in the interest of the owner of investible funds to use the services of a skilled entrepreneur to make an earning by setting up an industry or organizing transport service or a hotel. A problem would arise, however, in case he wants to disinvest his funds or the business itself shows signs of failure. In the former case the entrepreneur who is thriving on a good industrial unit/ hotel would try his best to manage the industry/hotel in such a way that disinvestment for the owner

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\* According to some Malikites expenses incurred even in connection with business travel can be met from *Mudarabah* funds only when *Mudarabah* capital is abundant otherwise not (Al-zarqani 3, 355) Even in the case of business journey some jurists do not allow him the expenses which he has to normally defray while in his own house

becomes a problem. On the other hand, in case the entrepreneur whose reward is contingent upon profit sees bleak prospects of return for himself on a job to which he has been devoting himself for months or years, he is prone to become less reliable and more unpredictable. This attitude may eliminate all the hopes of salvaging the owner's investment. In trading, a large portion of the investment is merchandise which, under this situation, maybe disposed of on cost or at a little less than cost, by the same or another worker or even by the owner himself. But in the case of manufacturing or service etc. a very small portion of investment is merchandise. Disassociation of the working partner from this business would mean irreparable damage to business and a ruin to the investor.

It should also be noted that in modern manufacturing, services, leasing, construction and hire-purchase, the goodwill of a firm is highly counted. A dejected manager may, rather than trying to rescue and rehabilitate a sick firm, hurry up in liquidating it. This attitude may seal the fate of the firm in the stock exchange market if it is a listed firm. On the other hand, failure of a trading unit, as pointed out above, does not affect the prices of merchandise in the commodity market. The worker can dispose of the whole stock at a reduced price, and thus save a substantial portion of capital. It may possibly be this rationale that the shari'ah has permitted *Mudarah* only in trading but not in other sectors of business. It is *shirka* or business partnership which remains the undisputed mode of joint venture for every sector where it can practically be adopted.

## II

The exposition of the scope of *Mudarah* made in the above lines is not in tune with the generally prevailing concept in the contemporary Muslim world. It offends the accepted theory that *Mudarah* and *Shirka* are the most practical substitute of interest for financial operations of banks. Some of the contemporary scholars have gone so far as to suggest *Mudarah* alone as a substitute for financing on the basis of interest (q.v. Al-Shaykh Baqar al-Sadr: *al-Bank al-la-rabawi fil Islam*).

Notions and traditions once deeply rooted are not easily dislodged from the mind. A voice of dissent provokes the adherents to defend their notions with the help of all the available arguments in good faith and with pious intentions. This part of the paper is devoted to examine the doubts that may and do challenge the validity of the above approach.

(1).

(a) The first and the foremost point that needs to be reemphasized is the standard of validity of the technique of *Mudarah*. The technique that was practiced in trade before Islam flouted the general law of hire that the Prophet laid down. And yet the Prophet, in spite of his knowledge about it, did not discard it; he even mentioned, without any dislike, the practice resembling this technique that he himself practiced before his prophetic mission. This fact implied that the technique was tacitly approved (*taqrir*) by him by way of relaxation, *rukhsa*, in the law of hire. According to the majority of jurists the rule is that an act which has been legalized in the Qur'an or in the Sunnah by way of relaxation in general rule is not amenable to provide a ground for further analogy on this basis. There is no doubt that some jurists mainly of the Shafi'i

school do not accept this rule in theory. But practically they do not seem to relax it at least in the case of *Mudarabah*. Al-Ramali's also Al-Rafi's views have been adduced in the above lines. Ghazzali, a very celebrated exponent of Shafi'i law, categorically observes: "Qirad is (applicable) in trade but not in manufacturing and crafts". (Al-Wajiz: 2:220). It is meaningful that in a large number of cases they believe in expanding the scope of *khilaf qiyas* as against other jurists mainly the Hanafites. The Prophet is reported to have allowed ablution with *nabidh* of dates. According to Hanafites this relaxation is confined to *nabidh* of dates and cannot be extended to that of barley etc. But the Shafi'i jurists do not confine this restriction to *nabidh* of dates. Eating or drinking during fasting in forgetfulness does not annul fasting because the act of forgetfulness has been exempted by the Prophet in the case of fasting. But this relaxation, according to Hanafites, cannot be extended to eating under duress. Shafiites believe in extending this relaxation. Similarly forgetfulness will not be condoned if a person begins to talk during prayers, which act spoils the prayers. But the Shafiites condone this flaw too, by extending the scope of forgetfulness during fasting.

In spite of their liberalism in extending the scope of *khilaf qiyas* in opposition to Hanafites, the Shafiites are not inclined to treat *Mudarabah* too in the same way. As a matter of fact it is difficult to judge as to which of the two schools of jurists is more rigid in confining *Mudarabah* to trade only.

The jurists give the same treatment to *bay'salam*. Had *salam* sale been used as a basis for further analogy the Shafi'i *fuqaha'* would have allowed further *salam* transactions by the purchaser before he takes over the commodity. This means that before the Shafi'i jurists the meaning of making this *asl* for drawing a parallel is somewhat different from what is generally claimed.

(b) The question as to the basis of legality of *Muzara'a* and *Musaqat* is to be decided on the point that it is *nass* that has legalized these practices but not analogy on *Mudarabah*.

(2) *Mudarabah* not only defies the general law of hire but also violates the Hadith: "Profit goes with liability" (*al-kharaj bil daman*) and "..... (no) profits without liability" (*.... la ribh ma la yudman*) which forms the basis of a legal maxim "profits are concomitant to risk" (*al-ghunm bi lghurum*) (Majalla, article 87). And the violation of the Hadith and the maxim occurs in case the working partner is made entitled to profits without having to bear the risk.

(3) Part I of this paper also presents Hanbali and Maliki approach to the problem. While Ibn Qudama's concept of trading has been defined in the above line, any more details on the subject can hardly be adduced from his excellent work *al-Mughni* because he has, at places, jumbled up *Mudarabah* and *Shirka* and also *Mudarabah* and *Shirka abdan*. Ibn Taymiyya's opinion to line up *Mudarabah* with *Shirka* also does not solve the problem because the main point that he wants to make out is not defining the scope of *Mudarabah* but to contend, unlike most other jurists, that nothing is *khilaf qiyas* in the Shari'ah. This contention was more comprehensively and forcefully advocated by his disciple Ibn Qayyim who devoted a couple of volumes to make out the case. There is no doubt that in Islam it is the quality that counts but not the quantity. But

a rare voice of dissent cannot be allowed to override the largely accepted opinion of the 'Ullama'. Treating Shirka and *Mudarabah* as parallels is a point that can hardly be convincing. The essence of Shirka is agency; the essence of *Mudarabah* is trust (*amana*). A voidable shirka becomes a contract of trust; a voidable *Mudarabah* turns into a contract of wage. Among the rights and duties what is implicit in Shirka needs to be explicit in *Mudarabah*. Combination of property (*khalt mal*) or uniformity of trade is necessary in Shirka; no such condition exists in *Mudarabah* which is a union of two uncombinable elements.

(4) The great Hanafi jurist al-Sarakhsi may also be quoted to prove that farming may also be done on the basis of *Mudarabah*. But a careful study of his *al-Mabsut* will reveal that he is as rigid in adhering to the Hanafi view as any other jurist. His including farming under the contract of *Mudarabah* is not because *Mudarabah* is amenable to everything but because farming, according to a saying of the Prophet, is classified as trade. As a result this point also makes no valid argument. It would be interesting to quote al-Sarakhsi's opinion:

"If a person advances money to another person on the basis of *Mudarabah* and leaves it to the discretion of *mudarib* with or without the provision of acting freely; and the *mudarib* uses some of this money in taking on lease a plot of uncultivated land and in purchasing foodgrain to grow it on this land, it is lawful as a trading practice because this is also done by traders for earning profits; a point which the Prophet has referred to in his saying: "*al-zari yatajir rabbah*" (a cultivator trades with his Lord)" (*Al-Mabsut*, 22: 72-73).

Al-Sarakhsi's opinion quoted above further confirms the point that *Mudarabah* is practicable in trade. And if farming is also done on this basis it is not because farming per se is allowed but because the Prophet has classified it as an act of trading. It however remains to be examined if metaphorical expression can be made a point of application of *qiyas* over literal sense of the root (*asl*).

(5) Comparison of *Mudarabah* is also made with legality and extension of a similar practice of *bay'salam*. But this ignores the point that in the case of *Mudarabah* what the Prophet did not disapprove was a technique of trade partnership which was named by the jurists as *Qirad* and *Mudarabah*. On the other hand what the Prophet positively approved in the case of *bay'salaf* (*idha aslaftum ...* Hadith), generally named as *bay'salam*, was a contract and he himself qualified it with certain conditions. As a result the validity of the former case was confined to the technique of trading while the latter case was confined to the conditions of the contract. Thus every thing could be traded on the condition of *bay'salam* within a single transaction. But a contract of resale of such an article without taking possession of the same could not be lawful. On the other hand no such limitation is imposed on *Mudarabah*. A worker may reinvest on the basis of sub-*Mudarabah*. Thus the difference between the two lies in the fact that *bay'salam* is confined to a contract and not relaxable to contract within contract but expandable to any trade or business; *Mudarabah* is confined to its technique (trade and commerce) but expandable to contract within a contract.

(6) Another misunderstanding that prevails in this respect is a loose definition of trade. It may be argued that any act in which profit accrues should be termed as trade. As a result, manufacturing, transport, construction etc. that are being carried out as a business are to be treated as trade and therefore amenable to *Mudarabah* technique. There is no doubt that all businesses are carried out with the object of earning profit. But in cases other than rentals and wages it is trade-purchase and sale-that ultimately earns profit. Manufacturing alone does not earn anything; it claims investments. It is the sale of manufactured goods that earns profit. Construction requires investment. Sale of premises earns profit. Craftsmanship requires labour and material. It is the sale of handicraft that earns. But in all such cases the major activity (*asl*) is non-trading operation; trade is only a secondary though ultimate activity (*tabi*) In *Mudarabah* trade should be the major activity (*asl*); other acts as the jurists have laid down, should be secondary (*tawabi'* and *daruriyyat*) to trade.

Another point that dispels this misunderstanding is that all activities that result in earning profit are not necessarily amenable to partnership. You can earn profit by selling out the proceeds of *mubah al asl*<sup>(38)</sup> (free goods) but you cannot contract partnership in exploiting it. You may sell your commodity to earn profit but you can not use this as capital for *Shirka* or *Mudarabah*. You may sell copyright or goodwill but you cannot contribute it as *Mudarabah* or *Shirka* capital. You may sell out your financial instruments but you cannot do *Mudarabah* with it and so on.

As a matter of fact the misunderstanding is caused by an etymological confusion. The word trade in English is also used to indicate any employment or business carried on as a means of livelihood including the general and literal sense of *tijara* which means purchase and sale. What *Mudarabah* covers is *tijara* (trade and commerce) as different from *sana'a*, *hirfa*, *ijara*, *zira'a*, *khidma*, etc. etc.

(7) An equally forceful argument may be based on the misinterpreted maxim that the essence of all the conditions and contracts is legality (*al-asl fil shurut' wal 'uqud al-ibaha*).

The first rejoinder to this maxim is an equally extreme maxim "All the conditions that are not to be found in the Book of Allah are void" (*Kullu shart laysa fi kitab Allah fa huwa batil*). Secondly the fact is that both are misused. The correct version of the former maxim is: "The essence of all the commodities is *ibaha*" (*al-asl fi kulli shay' al-ibaha*). There is a world of difference between the essential legality of all the commodities and the permissibility of all contracts and conditions. The maxim could be extended to cover conditions and contracts had the words been *kullu fi'l* (all actions) if not *kullu 'aqd* or *shart*.

(8) It may also be argued that early jurists while illustrating the different situations of *Mudarabah* did not include non-trading activities because of the prevalence of sole proprietorship in other economic activities. This is also not tenable because of the prevalence of *shirka bi'l abdan* which called for partnership of artisans. The activities like construction, fishing, hotel keeping, animal husbandry, hiring of animals, dying of cloth, carpentry etc. etc., though carried on a modest scale often required the services of more than one person. Some of the activities like construction, animal husbandry, iron

casting, and hotel keeping etc. could not be carried on by a single person. But in all such cases the rule was that a business that could be performed by hired labour cannot be allowed on the basis of *Mudarah*. This is what the jurists have laid down because of limited scope of *Mudarah*.

The second objection to this argument is that the jurists while illustrating the different situations of combinations in non-trading operations did discuss it and recommend it under *Shirka* were combination of larger amount of capital and resources was involved than could be contributed by a single *rabbul mal* in *Mudarah*. Thus there is no point in arguing that the early jurists conceived of only sole proprietorship in non-trading activities.

(9) This also should not be ignored that in case where the Shafi'i jurists have differed with Hanafites in restricting the scope of *khilaf qiyas*, the examples are generally those of *ibadat* which are largely supra-rational. In the case of transactions (*mu'amalat*), however, they are not very liberal. They do not extend the scope of *bay' salam* to more than a single transaction; not of *bay' araya* to more than five *wasqs* nor of *musaqat* to other than in date and grape and, similarly, of *Mudarah* to anything else than trade and commerce.

(10) There is no doubt that many jurists, while discussing the details of *muzara'a*, *musaqat* and *Mudarah*, have tried to analogize the conditions of one to another. This is the case of drawing a parallel of one over the other and the use of *qiyas* in its general sense but not its technical meaning. This is so because all the three techniques have one common factor: relaxation in the law of *ijra*. As a result the jurists are justified in examining the conditions of one to another. This is the case of drawing a parallel of one over the other and the use of *qiyas* in its general sense but not its technical meaning. This is so because all the three techniques have one common factor: relaxation in the law of *ijara*. As a result the jurists are justified in examining the conditions of one contract in the light of the conditions of the other. And because the validity of *Mudarah*, contrary to *musaqat* and *muzara'a*, enjoys *ijma'* in most of its conditions, this is generally made the criterion of judgment. Thus it is not the one which has formed the basis of legality of the other two contracts; all the three are legalized on three different grounds and have different standards of validity. In *Mudarah* the differences in details are the least; in *Musaqat* the differences are many, but upon the main conditions of *Muzara'a* none of the four schools agrees with the other three.

(11) The practical grounds that have made the *Mudarah* difficult to apply freely may be challenged on the basis of the working partner's willingness to accept even the most unfavorable conditions. But the question would arise if it is a sensible proposition to cite somebody's willingness to sail in troubled waters. Will it not ease out drowning rather than facilitate swimming. This theoretical claim would lose all its weight if one examines the asset allocation model of Islamic banks in the world, let alone in Pakistan where the entire system is claimed to have been reshaped. The reason why investments on the basis of *Mudarah* fail to claim a significant portion of total investments lies in the practical difficulties that our bankers have to encounter. It is *Murabaha* (Pakistani Mark-up) that seems to have claimed a position much superior to *Mudarah*, and even *Musharakah*.

(12) The study (Part I) adduces a number of quotations from *fiqh* literature which deal with claim of the worker for lost goods, the distinction between personal account of the worker and *Mudarabah* account, and the acts that a worker may or may not do under the contract. The object of all these instances is to elucidate the scope of the application of *Mudarabah* according to the jurists and to define a trading operation. Moreover, it also suggests an expansion in the scope of trade, not *Mudarabah*, as accommodated by Hanafi jurists, in opposition to the rigid concept of Shafi'i, Maliki and Jafari jurists. Under this proposal all the acts that a present day trader is supposed to perform are to be treated as an act of trading whether or not the early *fuqaha'* have approved it. Thus adding some more instances in the list, a trader in paper may be supposed to prepare for sale letter pads, envelopes, exercise books etc. as his own job as *Mudarib*. Similarly a dealer in film rolls may be supposed to repack big rolls into smaller ones for retail or may turn bulk packings of any article into small packings or vice versa for increasing sale or enhancing the rate of profit in his trade. In the same way assembling accessories of household appliances, their installation and arranging for after sale service may all be termed as trade. Purchase of long cloth and converting it into bed covers, sheets and curtains with *Mudarib's* own hand and in his own account, before sale should also be treated as trade. This should be so because, as Ibn Qudama aptly puts it up: "a trader is conventionally supposed to perform it". How far can this scope be expanded is indicated at the end of the discussion on legal reasons in Part I.

(13) Part I of the paper claims that legally the scope of *Mudarabah* is confined to trade. *Shirka* has no such legal constraint but practically it also has its limitations. This is discernible from statements of asset allocation of Islamic banks. That is why these banks had to resort to other modes of financing which have claimed a substantial part of their assets. The Council of Islamic Ideology in Pakistan, rather than proposing *Shirka* and *Mudarabah* has proposed the basic and broader technique of profit and loss-sharing in addition to *Murabaha*, hire purchase, leasing, rent-sharing and service charge. The central bank of the country, inspired by this approach, has proposed the techniques of *Shirka*, *Mudarabah*, Mark-up (*murabaha*), hire-purchase, leasing, rent-sharing, development charge, equity participation, Participation Term Certificates, *Mudarabah* Certificates, Commission, Mark-down, Term Financing Certificates, and buy-back (*bay' bi'l wafa'*) to provide finance to all the sectors and activities. This was so because *Shirka* and *Mudarabah* could not look after all the productive activities. And this should have been so because of legal constraint in the case of *Mudarabah* and practical limitations in the case of *Shirka*. But for the last three techniques there apparently seems to be nothing in the *Shariah* to disallow these techniques if properly implemented. *Shirka* and *Mudarabah* are not sacrosanct nor are they end-all of financial or business relationship. Pressing upon *Mudarabah* technique in the face of a large number of lawful alternatives, by unjustifiably extending its scope is unnecessary.

(14) In spite of the obvious redundancy of pressing upon and extended scope of *Mudarabah*, there can be, as is usual these days in respect of all intriguing issues, an insistence on the need for exercising *ijtihad*. On this particular issue, it may be proposed that just like combining of *mal* with *mal*, work with work, and goodwill with goodwill there should also be a cross-combination of *mal* with goodwill and work with goodwill as is the case in *Mudarabah* which allows cross-combination of work with *mal*. This is in fact the moot point of the whole issue. But a full treatment of the subject would take



us much outside the scope of this subject in discussing the necessity, qualifications and conditions of doing *ijtihād*. In brief it may be pointed out that combination of work with work and goodwill with goodwill are not the unanimously agreed forms of business partnership and they cannot, therefore, form a valid basis of doing *ijtihād* for their cross-combination. Moreover, when we use analogy to find out the legal position of some act it has its own restrictions. *Qiyas* reveals a law; it does not originate it. It is *muzhir al-hukm* and *muthbit al-hukm*.

### Notes

1. **Ahmad B. Hanbal al-Shaybani:** *Al-Fath al-Rabbani (Musnad)* compiled by Ahmad Abd al-Rahman al-Banna, Vol. **15**, Cairo, 1371 A.H. page 122.
2. *Majalla Ahkam al-'Adliyya*. Urdu tr., Article 15.
3. Passim.
4. **Al-Ramali, Shamsuddin:** *Nihayat Al-Muhtaj 'ala Sharh Al-Minhaj*, Cairo, 1938, Vol. **5**, p.221; Al Jaziri, Abd al-Rahman: *Kitab al-Fiqh*, Urdu tr. Manzoor Ahsan Abbasi, Vol. **II**, Pub. Auqaf Department, Lahore, 1973, p.833.
5. **Al-Rafi'i, Abd-al-Karim B. Muhammad:** *Fath al Aziz* Vol. **12**, Cairo, 1352 A.H., pp. 12-13.
6. **Al-Rafi'i**, *op. cit.*, 12:12-13.
7. **Al-Jaziri**, *op. cit.*, 2:832-33.
8. **Allama Muhammad Jawad al-Husayni al-'Amili:** *Miftah-al-Karama fi Sharh Qawaid*, Muassasa Al- Bayt, Cairo n.d. marginal notes by Muhsin b. 'Abd al-Karim al-Hussaini. Also Al-Hilli: *Shara'i at- Islam, Najaf (Iraq)*, 1969, Vol. **II**, p.1.  
  
Article 9 of the Law on Interest-free Banking as passed by Majlis Shurai Islami excludes even private Sector imports from financing by bank. Other commercial operations are included in Mudarabah.
9. **Al-Zarqani, Muhammad:** *Sharh 'ala Mowatta Imam Malik*, Vol. **3**, 352.
10. *Ibid.*
11. **Ibn Qudama, Abdullah b. Ahmad al Maqdisi:** *Al-Mughni*, Vol. **V**, Cairo. 1367 A.H., p.5.
12. *Ibid.*
13. **Al-Kasani, Ala al-Din Abu Bakr b. Masud:** *Kitab Bidli' al-Sinai fi Tartib al-Sharai*, Vol. **6**, Cairo, 1327 A.H., pp.80-85.
14. **Haskafi, Ala al-Din:** *Ghayat al-Awtar* tr. *Durr al Mukhtar*, Vol. **II**, Lucknow, 1893, pp.562-63; *Fatawa-i-Alamgiri*, Urdu tr. Syed Amir Ali, Lucknow, 1932, Vol. **IV**, pp. 40, 42.
15. *Mjalla-Al-Ahkam*, Urdu tr. Abdul Quddus Hashim, Karachi, 1966, Article 23; Ibn Nujaym, Zayn Al-'Abidin: *Al-Ishbah wa'l Naza'ir*, Calcutta, 1370 A.H., p.7.
16. **Al-Rafi'i**, *op. cit.*, 12:11; **Al-Ramali**, *op. cit.*, 5:222.
17. **Al-Rafi'i**, *op. cit.*, 12:12; **Al-Ramali**, *op. cit.*, 5:222.
18. **Alamgiri**, *op. cit.*, 5:475.
19. **Sahnun b. Sa'id al-Tanukhi:** *Al-Mudwwana al- Kubra*, Cairo, 1323 A.H., Vol. **12**, pp.48-49.
20. **Alamgiri**, *op. cit.*, 5:475.
21. **Ibn Qudama**, *op. cit.*, 5:50.
22. **Alamgiri**, *op. cit.*, 6:482; **Al-Sarakhsi, Shamsuddin:** *Al-Mabsut*, Cairo, 1324 A.H., Vol. **22**, p. 67.
23. **Alamgiri**, *op. cit.*, 6:482 **Al-Sarakhsi**, *op. cit.*, **22**: 67-68.
24. **Al-Ramali**, *op. cit.*, 5:234.
25. **Haskafi**, 3:456.
26. **Ibn Qudama**, *op. cit.*, 5:50.
27. **Al-Rafi'i**, *op. cit.*, 12:11; **Al-Ramali**, *op. cit.*, 5:222; **Al-Jaziri**, *op. cit.*, 2:832,833.
28. **Al-Rafi'i**, *op. cit.*, 12:12.
29. **Sahnun**, *op. cit.*, 4:64; **Alamgiri**, *op. cit.*, 6:405; **Ibn Qudama**, *op. cit.*, 5:45, 47.
30. **Al-Sarakhsi**, *op. cit.*, 22:35.

31. *Ibid.*, 35-36.
32. *Ibid.*, 36.
33. **Haskafi**, 3:456.
34. **Haskafi**, 3:456.
35. *Ibid.*
36. **Alamgiri**, *op. cit.*, 6:428.
37. **Ibn Rushd Al-Qurtubi**: *Bidayat al Mujtahid wa Nihayat al Muqtasid*, Second edition, Cairo, 1950, Vol. 2, pp. 240-241.
38. **Mubah al-Asl** in Islamic law means free gift of nature not owned by anybody or anything which is free to be used by public.

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## عقد المضاربة في العمليات غير التجارية

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رئيس قسم الاقتصاد الإسلامي

مصرف الدولة الباكستاني - كراتشي - باكستان

**المستخلص:** يقدم الباحث المضاربة على أنها استثناء للقياس الذي يقتضي أجراً محدداً للعامل (في المضاربة). وهذا الاستثناء أقر للأنشطة التجارية ولا يصح التوسع فيه ليشمل الصناعة والزراعة والخدمات... الخ، ويستنتج الباحث أنه عندما تطبق المصارف الإسلامية المعاصرة عقد المضاربة على مختلف أنواع المشروعات تكون قد تخطت نطاق الفقه السابق.