

**TRADE BASED TRANSACTION IN
ISLAMIC COMMERCIAL LAW AND
THEIR ROLE IN THE
DEVELOPMENT OF THE
RURAL AGRICULTURE SECTOR IN
KHYBER PAKHTUNKHWA
(PROPOSED ISLAMIC FINANCING MODELS)**

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Agriculture is the most noteworthy source of food through which farmers augment food supply for themselves and others. Majority of these farmers in Pakistan, predominantly in the KPK, belong to the lower class and, as a result, are not in a position to bear out their basic agricultural wants. They borrow it, therefore, from various sources on interest basis including organizations, banks and other various financial institutions. However, these institutions offer loan facility on interest basis which is stringently prohibited by *Shari'ah* for a Muslim farmer. Being a complete code of life, Islam gifts, as alternate, a comprehensive way for farmers and Islamic banks to enter into various commercial trade based transactions, feasible and worthwhile for all the stake holders. These transactions can be divided into *Murābahah*, *Salam*, and *Istiṣnā'*. The theoretical part of the work is primarily based on qualitative research technique and, therefore, the theoretical part is entirely based on secondary data, derived from the work of Muslim scholars. A focussed group technique is used where the farmers and agricultural credit officers are interviewed regarding the proposed models. The testing of the proposed models proves that how the newly developed models are very much operable at ground level, having a potential to fulfil all farmers' basic agricultural needs, both for crop and non-crop activities.

Keywords: Agriculture, Farmer, Islamic Bank, Islamic Financial Institutions, Rural Areas.

Introduction

Food is the most imperative source for the survival of human life, and agriculture is one of the most important sources for such food. The people who belong to agriculture sector i.e. the farmers, majority of them belong to the lower middle class and lower class of the society and, therefore, facing financial problems, which must be removed.¹ Due to their meager economic condition, they are not in a position to get their agriculture requirements both for crop and non-crop activities i.e. seeds, fertilizers, herbicides, insecticides etc. As a result, they are incapable to take the intended benefits from their farming activities, and consequently, no mentionable change occurs in their economic growth. Their living standard remains unchanged, and hence, no positive change befalls in their economic stability. The financial needs arise at three different phases i.e. in the beginning of a season, at the middle of a season and at the end of a season. To fulfil their agriculture needs, they resort to formal and informal sources.²

The informal sources of finance include friends, families, sellers and money agents.³ Before the inception of Pakistan, the farmers had used to receive loans from money agents. After 1947, the short term credit needs of the farmers were fulfilled by commission agents and relatives. Such advances were for a short span of time and were mostly provided for productive purposes.⁴

The major formal sources of farm credit are ZTBL (Zar'i Taraqiati Bank Limited),⁵ Commercial Banks, Cooperatives Credit and Taccavi Loans. These financial sources, however, provide financing on interest basis which is strictly prohibited by the Islamic *Shari'ah* (law). Being typical Muslims, the farmers in Pakistan avoid securing loan on interest basis.⁶ Therefore, there is a need of some alternative arrangements; acceptable in the commercial legal stream of Islam. Such problem may be solved by the Islamic financing through the application of various modes of the Islamic finance like trade based models, such as, *Murābahah*, *Salam* and *Istisnā'*; participatory modes, such as, Diminishing *Mushārakah*, *Muḍārabah*, *Musāqah* and *Muzāra'* (all these are various kinds of *Sharikāt*);⁷ rent based modes, such as *Ijārah*.^{8,9} All these financing models can be meritoriously applied for the expansion of agriculture sector, like livestock, poultry, fish, dairy, horticulture and local

farming etc. But among these various modes there are some modes that can play comparatively a major role in the uplifting of agriculture sector, especially local farming in the rural areas of Pakistan. These modes include *Murābahah*, *Salam* and *Istiṣnā'*. Some renowned scholars of the field approve the same. *Murābahah* is the most important and suitable transaction for financing agriculture that may be applied to agriculture sector both for crop and non-crop activities.¹⁰ *Salam* on the other hand is specially designed and structured for financing agriculture in the era of the Holy Prophet (ﷺ) and surely can be applied in the contemporary world for the same purpose.¹¹ In addition, *Istiṣnā'* is a mode of finance, which may be effectively used for financing non-crop agricultural activities.

Objectives of the Study

The basic purpose of the present work is to investigate the basic agriculture requirements of local farming in Khyber Pakhtunkhwa (K.P.), predominantly of those who are living in rural parts of the province. Moreover, it will strive to bear out all these primary requirements through the application of trade based modes of the Islamic finance. A comprehensive structure and mechanism, based on the principles of Islamic commercial law, will be developed for the implementation of these modes. Being the most important objective of the present work, the viability of trade based modes of the Islamic finance for all stake holders (local farmers, Islamic banks and other Islamic financial institutions) will be substantiated with solid arguments at ground level.

Limitations

The present work has some inbuilt limitations. For instance, the application of only trade based mode of the Islamic finance has not been applied for the development of local agriculture sector. There are some other modes as well like *Ijārah*, *Mushārakah*, and the Diminishing *Mushārakah* that can be pragmatic for the same purpose. However, in the present work all these modes are not debated and the whole focus

is made on trade based modes of financing. In addition, the application of the trade based modes of the Islamic finance is made to the local farming and other sector of agriculture like poultry farming, fish farming, dairy farming, horticulture etc. are left. The reason is that all these sectors are usually in need of huge investment, while the present work is only related to help out poor farmers; particularly those who are related to local farming in rural areas of KP. Such shortcoming can be fulfilled through some other studies. The third limitation is related to the fact that models are proposed only for the local farmers of KP and, therefore, extension of such models cannot be made for other provinces of the country like Sindh, Baluchistan and Punjab. For these regions same models can be proposed with major changes in their structure and mechanism; owing to the fact of variation in agricultural environment and requirements.

Review of Literature

Agriculture financing is worthwhile option for Islamic banks/ Islamic financial institutions and farmers, as the former get reasonable profit, while the latter fulfills his basic agricultural requirements both for crop and non-crop activities. Owing to this fact, many researchers have started work on various models of agriculture financing and its various facets.

Christen and Pearce established a model for the financial requirement of rural communities.¹² The model enlightened agriculture finance from various aspects. However, it was not practicable at ground level because of the idealistic approach of the authors. Prowse presented a model on contract farming with minute details, beginning with the historical background of contract farming, followed by the limits of its use in the United States and other countries' agriculture.¹³ However, the model presented in the work was not suitable for developing and underdeveloped countries; as the contract farming and its basic features were discussed in a special reference to advanced and developed countries like the United States and Europe.

Pandey worked on contract farming models and declared them a suitable way for financing agriculture.¹⁴ Pandey's work covered all aspects

of agriculture finance comprehensively. However, the work was purely related to the Indian's agricultural sector and, therefore, could not be extended to other countries' agriculture.

Mittal, Rashi, and S. P. Singh maintained the high interest rate is a major constraint for farmers to get agricultural credit. They further added that almost seventy two percent (72%) of farmers consider high interest rate as an exertion in getting agricultural finance.¹⁵

The above mentioned Conventional agricultural financing models are very much viable for banks and farmers. However, such models are not that much favourable for Muslim farmers, owing to the fact that they avoid to secure loan on interest basis. Being a typical Muslim Country, the case of Pakistan is not different. Because of this reason, the Muslim scholars have worked out some agricultural financing models which are in compliance with the basic principles of Islamic commercial law.

Saqib has worked on the application of various Islamic financing modes to the agriculture sector in Pakistan.¹⁶ The work is peculiar in nature; as being the first comprehensive work over the issue. All modes of the Islamic finance and their applications to the agriculture sector in Pakistan are discussed therein with minute details. Nevertheless, the work is more theoretical in nature as the author did not test his proposed financing models through quantitative or any other method of testing.

Al-Hashimi, Muhammad Ali Alula have worked for the development of agriculture sector through the use of *Mudārabah* financing.¹⁷ Their work is very useful, as it moves majority of farmers from conventional financing system to Islamic finance. However, it does not reflect the real structure of *Mudārabah* envisaged by the Islamic commercial law.

Lutfullah Saqib, Nadia Nazeer, Khurram Khan, and Mueen Aizaz Zafar have worked on the application of *Murābahah* mode of financing for sugarcane industry in the developing countries and suggest the active use of such mode for small farmers and small business owners for fulfilling their financial needs.¹⁸ But the study is theoretical and not based on empirical data, and hence, cannot be used with perfect approach.

Haroon Rasheed and Muhammad Mudassar have developed practical innovative models that can be used in Pakistan for financing

agriculture.¹⁹ They offer various models for the possible application of *Salam* for financing agriculture with the claim that such models are beneficial equally for farmers and Islamic banks/Islamic financial institutions.

Muhammad Taimoor Hassan, M. Atif Sattar, M. Adnan Tousif, Nukhba Nasir, Mehwish Sadiq and Malka Yasmeen has conducted a descriptive and qualitative study on the importance of Islamic banking in agriculture sector.²⁰ Their work is composed of all types of Islamic Banking models that can be used for financing agriculture. They maintain that Islamic banking can play a dynamic role in the expansion of agriculture and its various sectors. While having advantageous nature, the work also accommodates some hitches. For instance, the sample size used in their work is very small and, therefore, findings of the study cannot be stretched for other region's agriculture.

Naeem Ur Rehman Khattak and Anwar Hussain maintain that the Islamic banking system is more effective as compared to other conventional banking systems in the distribution of income, reducing monopolies and controlling inflation.²¹ They recommend separate Islamic agricultural banks for backing of the poor farmers, particularly in Islamic world.

Lutfullah Saqib, Mueen Aizaz Zafar, Khurram Khan, Kellie W. Roberts, and Aliya Mueen Zafar have developed *al-Qard ul Hasan*²² model for the development of agriculture sector, both for crop and non-crop activities.²³ The work is virtuously related to the application of the transaction (mentioned above) to local farming and its various sectors. The work is the first one, where *al-Qard ul Hasan* is used as a tool for financing agriculture and, therefore, can be used as guidance for future research in the same field. However, it focuses mainly on local farming, particularly that of rural areas, and does not describe *al-Qard ul Hasan* application to other sector of agriculture like livestock, fish farming, horticulture, poultry farming etc. In other words, the work has a very limited application. Additionally, the proposed model is not tested at ground level and, hence, many questions will arise at the stage of its practical utility.

Lutfullah Saqib, Kellie W. Roberts, Mueen Aizaz Zafar and Khurram Khan have also developed a *Salam* base model for financing agriculture.²⁴ The model is very viable for Islamic banks and farmers. However, the

model has not been tested through any method of quantitative/ qualitative research techniques, and, therefore, cannot be used with utmost certainty.

Organization of the Study

Before embarking on the presentation of proposed models on the basis of various trade based modes of Islamic finance like *Murābahah*, *Salam* and *Istisnā'*, agricultural problems, faced by the farmers of rural areas in Khyber Pakhtunkhwa, are profoundly conversed. These agricultural needs have come to the knowledge of researchers through interview sessions during the collection of data. Following this, the theoretical structure of *Murābahah*, *Salam* and *Istisnā'*, particularly offered in the work of classical Muslim jurists, is presented. This is purposely done in order to keep the proposed models' structure in compliance to such a reliable theory. The theoretical session is then trailed by various trade based proposed models; structured in the light of classical Muslim jurists' work. Such proposed models are then tested at the ground level, through focused group technique of qualitative research, in order to prove their viability, for all stake holders, without any doubt.

Methodology

In the present research work the qualitative research methodology has been used for the investigation of the issue. While following this, first part of the research work is theoretical in nature, where information has been taken from secondary sources. Such sources include books, reputed journals, magazines, newspapers, various official reports of the State Bank of Pakistan and official websites of financial institutions. The work of those scholars is cited and preferred who are very familiar with the field of rural agriculture finance. Additionally, the work of local researchers has been preferred comparatively to others, owing to the fact that their well awareness of local agricultural problems. In order to test the proposed models at ground level, a questionnaire technique has been followed where a questionnaire is developed, containing various questions that are directly related to the proposed models by one way or another. The

population sample has taken two hundred (200) local farmers; particularly those belonging to the rural parts of KP, where they are asked about various aspects of the proposed models. However, some rural areas i.e. Swat, Shangla etc. are resorted more during the collection of data, owing to the fact of their richer agricultural environment comparatively to others. From the sample of two hundred (200) farmers, forty (40) from Swat, thirty from (30) from Shangla, fifty (50) from Malakand, forty (40) from Lower Dir and forty (40) from Upper Dir have been selected for interview. Moreover, the farmers, of all these regions, are further divided into ten (10) members' group in order to interview them with ease. Each member of a group has an opportunity to talk about his various agricultural requirements and the newly proposed models. As majority of farmers are illiterate and, hence, not in a position to readout the questionnaire, the same was explained to them with minute details in very simple way for the purpose to make it more comprehensible. Their responses were then critically analyzed with the proposed models in order to make the necessary changes and turn them more viable for all the parties involved therein. In other words, descriptive analysis of the collected data was made.

Problems of Rural Farmers

There are many agricultural problems faced by the farmers, living particularly in the rural areas of Khyber Pakhtunkhwa. Because of their illiteracy usually they find it difficult to overcome many of these problems.²⁵ Some of the needs and problems are summarized below:

1. Farmers, particularly living in rural areas, are always in need of funds to cater to the financial needs arising at different times of harvesting cycle e.g. at the start of the cycle, money is required to buy basic agriculture inputs like seeds, fertilizers, herbicides and ploughing tools. Similarly, during the middle of harvesting cycle, money is required to purchase ploughing tools, herbicides, weedicides, (weed killers), sprays and different agricultural tools.
2. Farmers living in rural areas are in dire need of heavy agriculture machinery e.g. tractors, rice polishers, threshers, potato planters,

ploughs, diggers etc. Additionally, these farmers are also in need of funds for the maintenance of their farm machinery and other agricultural implements. They have to pay labour charges, water charges, utility charges etc.²⁶

3. One of the main problems of the farmers belonging to the rural areas of Khyber Pakhtunkhwa is the irrigation issues. The problem of improper irrigation is very serious in nature and, therefore, if much attention is not given to the problem, then it can affect the per acre productivity very badly and may cause, food shortage in future.
4. Due to lack of proper transport facilities, the rural farmers are not in a position to transport their crops to the nearest market timely and, therefore, cause huge loss of agriculture productivity.²⁷ The provision of transportation plays a vital role in the development of agriculture sector, particularly in rural and remote areas of Khyber Pakhtunkhwa. Further, these farmers are also unable to find customers who can give them ready cash for their agricultural products and they usually have to sell their yields on deferred payment basis.
5. The farmers are working in their fields from morning time till evening, so they are in need of permanent sheds to protect themselves from hot and cold climate for some time during their work. In addition, they can take rest in these sheds, whenever become tired from their work in the field. Furthermore, majority of the rural farmers usually have their residents away from their fields and, therefore, it is very difficult for them to move necessary equipment like rake, hoe, fork, shovel, spade, hand fork, trowel, wheel barrow etc. to their homes. Further, these farmers can also use these sheds for storage purposes and for keeping their crop and fruits to protect them.
6. The farmers of the rural area in Khyber Pakhtunkhwa are also in dire need of cartons for packing their agriculture products i.e. apple, peach, tomato etc. Moreover, majority of these farmers do not have their own houses, and therefore, live in rented houses.

All these problems can be solved effectively through the application of various Islamic financing modes, particularly trade based modes. The

required objectives (fulfillment of all these needs) can be achieved, when all these transactions are applied in their true spirit, envisaged by the Islamic commercial law.

Shari‘ah’s Solution of Rural Agriculture Problems Through Trade Based Modes of Financing

Theoretical Background

The trade based mode of financing means a way of financing in which Islamic banks provide financing facility through sale and purchase of commodities or assets.²⁸ In the trade based modes, the Islamic bank acts as a trader and provides goods on demand of the customer.

This mode of financing has gained dominance among other products very quickly in the Islamic banks and other financial institutions, owing to the fact that it is a safer mode of investment comparatively to other modes of financing.

The various trade based modes are legalized by *Shari‘ah* (Islamic Law), because sale and purchase are much more important and necessary for the survival of human beings. As a matter of fact, human beings cannot produce each and every thing themselves and they are in a dire need of things like wheat, rice, fruits, vegetables and many more other things, produced by others. Therefore, *Shari‘ah* has introduced the concept of sale and purchase, which is technically called trade based transactions. The legality of such transactions can be proved, generally, from many verses of the Holy Qur’ān and *Sunnah* of the Holy Prophet (ﷺ). The following verses and *Aḥādīth* can be cited as examples:

According to Holy Qur’ān “O ye who believe! When the call is proclaimed to prayer on Friday (the Day of Assembly), hasten earnestly to the Remembrance of Allah, and leave off business (and traffic): That is best for you if ye but knew!”.²⁹ This verse clearly indicates the general permissibility for trade based transaction. Another verse demonstrates the same permissibility by stating “Allah hath permitted trade”.³⁰

The *Sunnah* of the Holy Prophet (ﷺ) confirms legality of the trade based transaction. For instance the Holy Prophet (ﷺ) says “Do not sell the thing which you don’t have”.³¹ This *hadīth* although prohibits the sale of non-existent things (or prohibits the sale of a thing which is not owned by the seller) but circuitously it verifies the legality of trade based mode. Another *Tradition* (*hadīth*) says “The buyer and the seller have the option to cancel or to confirm the deal, as long as they have not parted or till they part, and if they spoke the truth and told each other the defects of the things, then blessings would be in their deal, and if they hid something and told lies, the blessings of the deal would be lost.”³²

Many of the jurists have also established legitimacy of trade based modes in their classical work. These jurists include Imām al-Shawkānī,³³ Imām al-Kāsānī,³⁴ Ibn Qudāmah,³⁵ Ibn Rushd,³⁶ Imām al-Sarakhsī,³⁷ and Ibn ‘Ābidīn.³⁸ Among these jurists, the work of Imām Muḥammad ibn Aḥmad ibn Abī Sahal al-Sarakhsī³⁹ is very remarkable and discusses various aspects of trade based transactions with much detail.

Trade Based Modes of Islamic Finance

The major trade based financing modes, envisaged by the Islamic financing system are *Murābahah*, *Salam* and *Istisnā'*. The classical Muslim Jurists have discussed all these transactions in their research work with minute detail. The following lines will clarify the above statement.

Murābahah

The word *Murābahah* has been derived from the word *Ribh*, which means “profit”. Literally it means “A sale involving the original price along with profit”.⁴⁰ A well renowned Ḥanafī Jurist Imām Sarakhsī considers it as a trust contract.⁴¹ The reason for declaring it as a sale contract is that the buyer trusts the statement of the seller that he has bought the commodity on the mentioned price. The main feature of the contract is that the seller should mention the price otherwise it will not be considered *Murābahah* rather as *Musāwamah*.^{42, 43}

Islamic banks and other Islamic financial Institutions has adopted it as a mode of financing since long time. As a financing technique, it involves a request by the client to the bank to purchase certain goods for him. The bank does it for a definite profit over the cost, which is stipulated in advance with the client in the *Master Murābahah Agreement* (MMA). Additionally, such document also include nature of the price, nature of the installments, place of delivery, time of delivery, nature of the commodity both in terms of quality and quantity and any other necessary conditions. The financial institutions, in order to avoid the potential risks, appoint the customer as an agent for the purchase of the required commodity. This customer agency is allowed with the fulfillment of certain conditions.⁴⁴ After getting the commodity from the supplier, as an agent of the bank, the customer informs the Islamic financial institution about the same and offers for the purchase of the commodity. At this particular stage the *Murābahah* transaction is concluded formally between the parties where the contents of MMA are re-included and signed. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)⁴⁵ has explained a comprehensive procedure which is followed by the majority of Islamic financial institutions in various countries, both Muslim and non-Muslim.

Salam

Salam is an Arabic word, which literally means an “advance”. This meaning has been incorporated in its technical meaning also. According to Kāsānī. “It is a sale in which the price is paid on immediate basis while delivery of the commodity is delayed.⁴⁶ In the view of Imām Shāwkanī. “It is the sale of an ascertained property with a delayed delivery.⁴⁷ Muhammad Taqi Usmani, a modern contemporary scholar, defines this transaction as “a type of sale, whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid on the spot”.⁴⁸

Salam, by its nature, has been structured and designed by *Shari‘ah* for financing agriculture.⁴⁹ The Holy Prophet (ﷺ) has allowed the transaction in order to help out poor farmers in fulfillment of their basic agricultural requirement. It is because of this reason that *Salam* is one

of the best options in Islamic finance in financing agriculture, both for crop and non-crop activities. In such a transaction, the Islamic bank will provide liquidity as price of the commodity in the beginning of a season. In response, the farmers will provide the crop for which they have made the transaction of *Salam* with the bank or financial institution. The quality and quantity, place of the delivery, time of the delivery, price of the commodity etc. must be mentioned in the contract. It is pertinent to mention that the price of the *Salam* commodity must be paid on the spot, otherwise, this will defeat the sole purpose of the transaction i.e. to finance the farmer timely.

Istiṣnā‘

Istiṣnā‘ is an Arabic word that originates from *Sana‘* which means “manufacturing”. It is a contract of something sold on guarantee in which the work is conditioned.⁵⁰ The person who makes the thing is called the *Sāni‘*, while the person who causes it to be made is called *Mustaṣna‘* while the thing made is called *Maṣnū‘*. The legality of this transaction has been proved by the jurists while stating that that the Holy Prophet (ﷺ) once ordered for the manufacture of a ring of gold, and a barber to cut his hair.⁵¹ Because of the legality of the transaction, some of the jurists like Imām al-Shawkānī, Imām al-Kāsānī, Ibn Qudāmah, Ibn Rushd, Imām al-Sarakhsī, and Ibn ‘Ābidīn devote separate chapters to this concept in their classical works.

Istiṣnā‘ is the ideal mode of Islamic finance which can be applied to the agriculture sector especially for non-crop activities. Such mode of finance is not an appropriate tool for crop activities, because it is concluded only when there is a definite demand already established.⁵² The statement shows that this transaction’s role is more dominant in non-crop sector, and hence, can be used for the development of local farming, particularly in the rural areas of the country, where 62% of the country population resides, and is directly or indirectly linked with agriculture for their livelihood.⁵³ There are many non-crop areas in the local farming which are in despairing need of *Istiṣnā‘* contract for their development. For instance, the farmers in rural areas of KP are facing severe irrigation problems.⁵⁴ The farmers use the orthodox method of irrigation

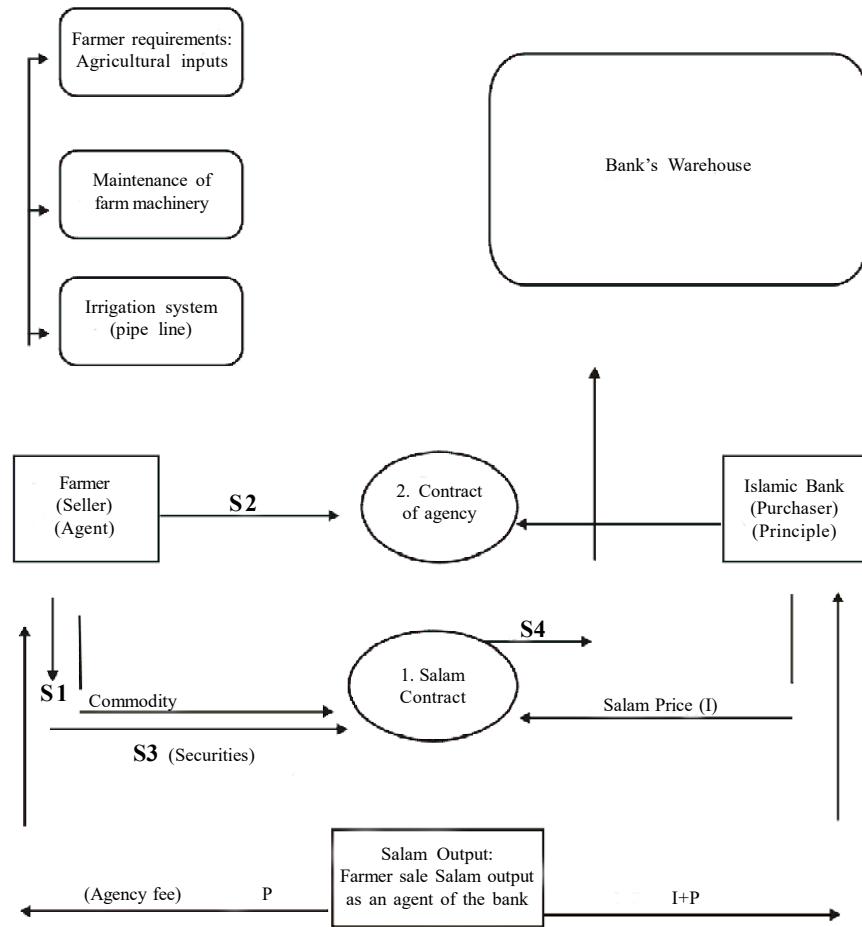
that causes wastage of 50 to 60 percent of water.⁵⁵ Therefore, a technical irrigation based mechanism is required as an alternate which may be done through *Istisnā'*. In a similar way, the canals and tube well mechanism can also be developed by applying the same conventional mode of Islamic finance.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has explained a full-fledged description regarding the advisory procedure that will be followed by the Islamic banks and other Islamic financial institutions for the conclusion of the contract.⁵⁶ In such a case, the farmer will request the financial institution for the manufacturing of a commodity, having specific quality and quantity, and the latter will deliver the same on the due date mentioned in the contract. Moreover, price of the commodity, nature of the installments, place of delivery, time of delivery and any other condition must be mentioned in the contract.

Application of Trade Based Modes of Financing to Agriculture Sector of Khyber Pakhtunkhwa

The problems mentioned in the previous lines can be easily solved by Islamic banks and other Islamic financial Institutions through the implementation of trade based modes of financing i.e. *Murābahah*, *Salam* and *Istisnā'*, if implemented in its true spirit, rules and regulations prescribed by the *Shari'ah* for the same.

The problems mentioned at category No. 1 can be solved through the application of *Salam* based transaction, where the farmer approaches an Islamic bank for the conclusion of *Salam* transaction. The Islamic bank will conclude a contract with the farmer, where it will pay money in advance to the farmer for fulfilling his basic agricultural needs (purchase of seeds, fertilizers, herbicides, ploughing tools, weedicides, sprays and other different agriculture tools) in exchange of the coming crop. By this way the liquidity problem of a farmer can be solved. The following models will elucidate the whole procedure, necessary to be trailed by the Islamic banks and farmers. It is pertinent to mention that all steps should be followed in sequence as mentioned in the proposed model, and in case of non-compliance, birth of some *Shari'ah*'s issues may befall.

Salam Model No. 1**Steps Involved in the Model of Salam**

The following are the various steps involved in the proposed model of *Salam*.

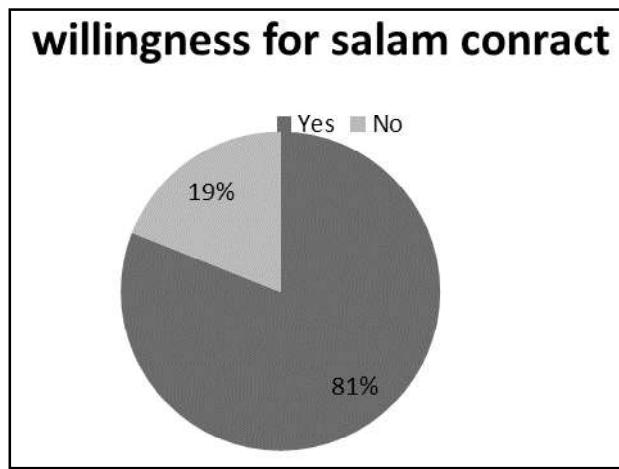
S1: A formal request from the farmer to the financial institution for the conclusion of *Salam* contract.

- S2: A contract between farmer and financial institution for the conclusion of agency contract.
- S3: Provision of securities by the farmer in order to protect liquidity of the financial institution.
- S4: Delivery of the *Salam* commodity as per mentioned in the contract.

Test of the Proposed Model of *Salam*

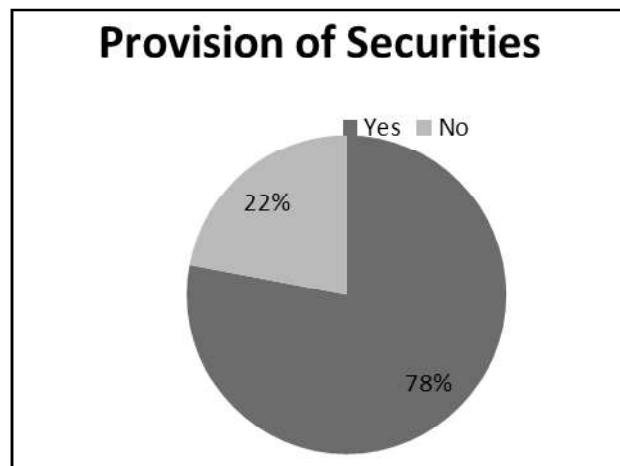
The collected data confirms the viability of *Salam* based model for financing agriculture. After the critical analysis of the filled questionnaire, the following results are derived.

- The data shows that 81% local farmers confirm the viability and applicability of *Salam* transaction for financing purposes. Such sort of recognition (by the farmers) is not given to any other modes of Islamic finance in the collected data. The reason is the natural capabilities carried by this mode of financing for financing agriculture. The Islamic banks and other Islamic financial are required to think on the same way and construct new financing mechanism and structure on the same basis.



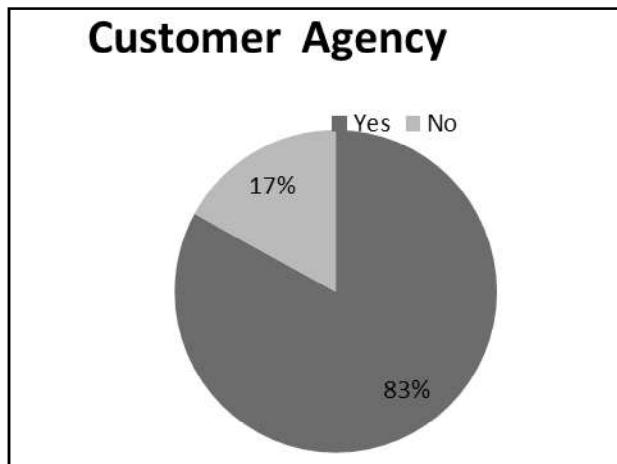
- Majority of farmers (78%) are against the securities required by

the financial institutions owing the fact that they are having meager economic condition and, therefore, are not in a position to pay such collaterals and securities. The following graphical presentation has been drawn from the collected data. The financial institutions should look for other acceptable type of arrangements for the security of their liquidity. Group based financing techniques may be the best alternate option in this regard. A group based security is a mechanism envisaged by the State Bank of Pakistan (The State Bank of Pakistan has Issued Financing Scheme for Small Farmers on group based lending methodology whereby members of the group can borrow up to Rs 200,000/- without any collateral from financial institutions" ... *Handbook on Best Practices in Agri/Rural Finance*, 2014) for the facilitation of agriculture sector. According to this technique, a group of farmers apply to a financial institution for the provision of agricultural credit. All members of the group are made collectively responsible for the repayment of credit. For instance, if a group member does not pay the debt at the prescribed time, the whole group will be held liable for the same. Due to social bonds and deterrence, a member of the group, usually, does not dare to default. By using such techniques, the banks and other financial institutions make safe their advanced liquidity.



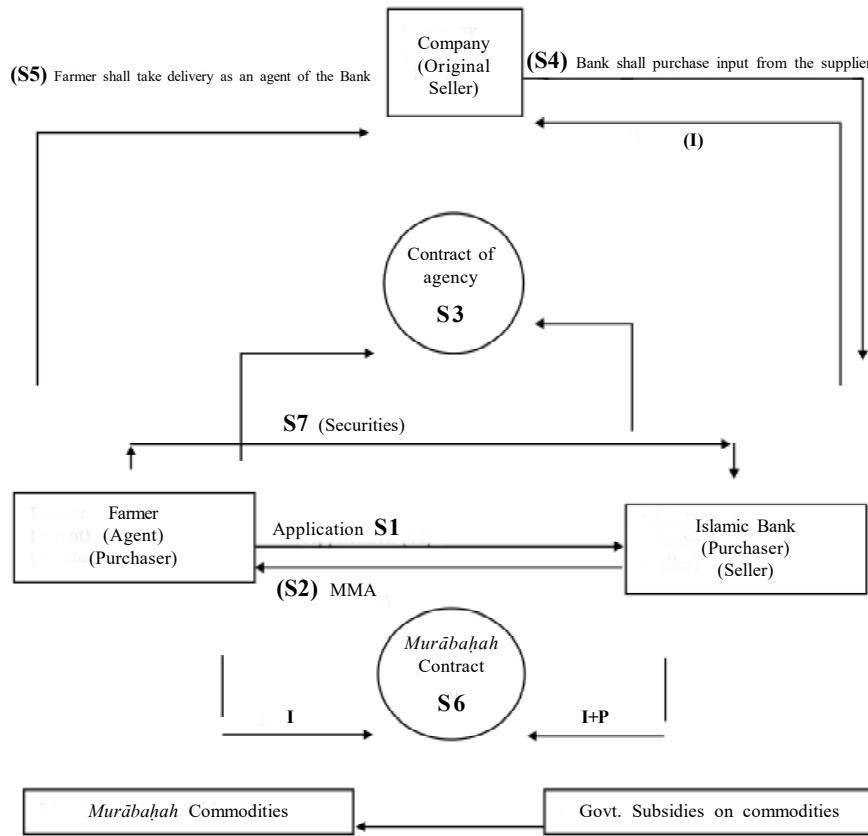
- Majority of farmers i.e. 83% are not in favour of customer agency.

The probable reason for this reluctance is the inbuilt illiteracy in the farmers' community. They always avoid technical type of engagements, like customer agency, with the financial institutions. There should be some alternate arrangement for customer agency. For instance, any farmer of the same locality, other than the customer, can be appointed as an agent by the Islamic banks and other Islamic financial institutions. Such an agent will not only represent the Islamic banks in *Salam* but also in other modes of Islamic finance.



The problems mentioned at category Nos. 2 and 4 can be solved through the application of *Murābahah* based transaction, where farmers approach to an Islamic bank and other financial Institutions for the conclusion of a commercial transaction through *Murābahah*. The Islamic bank signs a Master *Murābahah* Agreement (MMA) with the farmer, which contains different details about the contract. Moreover, the Islamic bank appoints the customer as its agent to purchase the commodity for himself. By this way the bank protects itself from any risk that may arise in future.

Murābahah Based Model



Steps Involved in the Model of *Murābahah*

The following are the various steps involved in the proposed model of *Murābahah*.

- S1: A formal request from the farmer to the financial institution for the conclusion of the purchase of *Murābahah* commodity.
- S2: The finalization of Master *Murābahah* Agreement between the

Islamic bank and farmer in which all minute details of upcoming *Murābahah* transaction are mentioned comprehensively.

- S3: Conclusion of the contract of agency between an Islamic bank and a farmer in which the latter will take possession of the *Murābahah* commodity on the behalf of the former.
- S4: The Islamic bank will purchase the *Murābahah* commodity from the original supplier/seller.
- S5: The farmer will take delivery of the *Murābahah* commodity on the behalf of the bank as its agent.
- S6: After receiving the *Murābahah* commodity, the farmer will offer the Islamic bank for the purchase of the same commodity. At this very point the typical transaction of *Murābahah* will be concluded.
- S7: As the price will be paid in installments, at this stage the farmer will provide securities as a security for the timely payment of all installments.

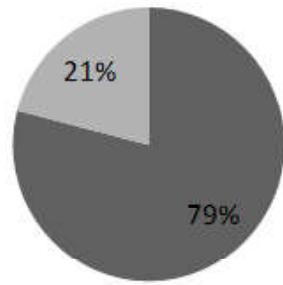
Test of the Proposed Model of *Murābahah*

Murābahah is the most important mode of Islamic finance that is excessively used by the Islamic banks and other Islamic financial institutions for financing purposes. This typical transaction has been proved a very much viable mode for financial institutions in the last few decades. Keeping in view the successful historical background, the *Murābahah* model has been proposed and tested in the present work. The following response has been derived from the collected data.

- Majority of farmers (79%) have favoured the *Murābahah* model for financing their various agricultural activities, both for crop and non-crop sectors. However, they urged that the transaction should be used more for the provision of basic agricultural requirements (like agricultural tools, agricultural seeds, agricultural sprayers and etc.) than provision of heavy agricultural machinery (like tractors, thrashers, harvesters etc.). The following graphical presentation will clarify the situation further.
- Like *Salam* the concept of agency has been disapproved by majority (73%) of farmers. The reason may be the same one as discussed in the previous lines.

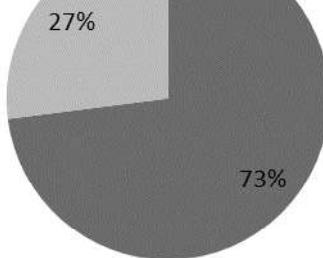
Viability of *Murābahah* for Financing Agriculture

■ Yes ■ No

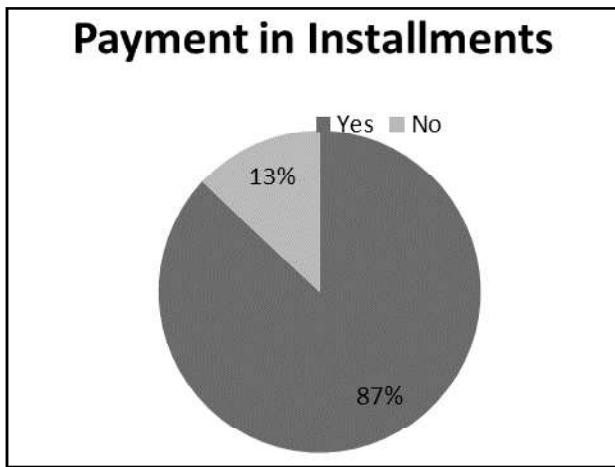


Contract of Agency

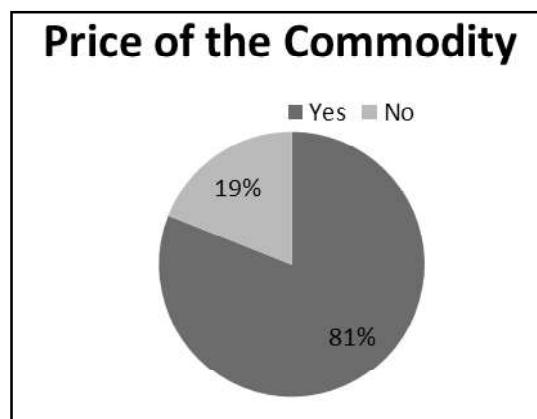
■ Yes ■ No



- Majority of farmers (87%) approve the payment in installments. The reason is the meager economic conditions of farmers. However, 13% farmers, who disapprove the payment in installments and prefer immediate payment, belong to the middle class of farmers and, therefore, having good economic conditions. The following graph has been drawn from the collected data.

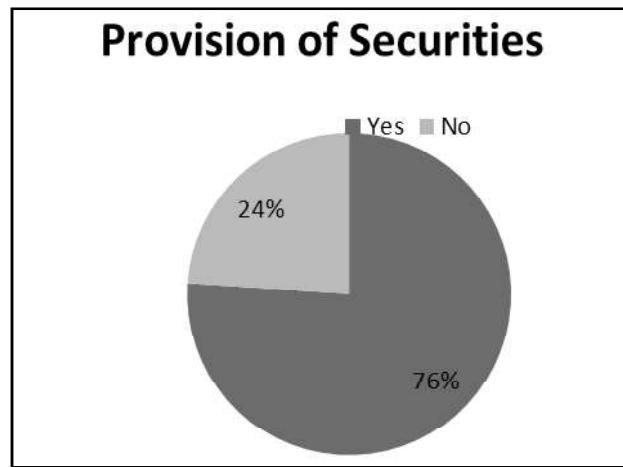


- Majority of farmers (81%) farmers have strict observation regarding higher price of the *Murābahah* commodity than price of the same commodity in the local market. The data shows that this difference is not acceptable to farmers under any stretch of explanation. However, difference is institutional and market price is an indispensable phenomenon and, therefore, cannot be avoided. Some midway approach is required for the solution of the problem. For instance, the banks may reduce the ratio of profit to some acceptable limit while the remaining difference may be subsidized by the government.



- Like *salam*, the requirement of high securities and collaterals in the contract *Murābahah* has been rejected by majority of farmers

i.e. 76%. The reason may be the economic instability of farmers as discussed in the case of *Salam*. Here too, the group based insurance technique can be followed.



Similarly, the problems mentioned in category Nos. 3, 5 and 6 may be solved through the application of *Istiṣnā'* based transaction. In this case, the farmer will go to an Islamic bank and submit an application to the bank along with the specification (type, kind, quality and quantity etc.) of the required commodity. The bank makes a proper contract with the farmer and manufactures the required commodity for the farmer. After manufacturing of the required commodity, the bank delivers it to that farmer on due date and the farmer pays the *Istiṣnā'* price in installments.

Steps Involved in the Model of *Istiṣnā'*

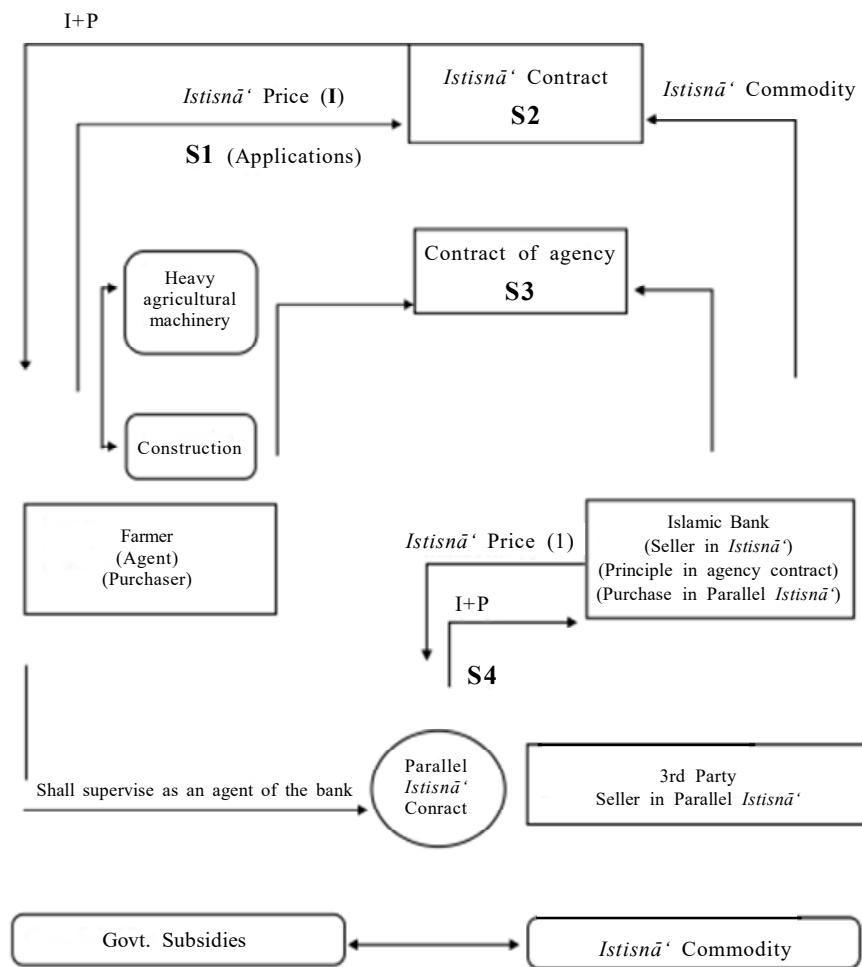
The following are the various steps involved in the proposed model of *Istiṣnā'*:

- S1: A formal application from the farmer side for the conclusion of *Istiṣnā'* contract.
- S2: A contract of *Istiṣnā'* will be concluded between the Islamic bank and farmer where all aspects of the transaction will be included

e.g. quality of the commodity and its quantity, nature of the price, time of delivery, place of delivery and etc.

- S3: At this particular stage the contract of agency will be concluded between the farmer and financial institution where the former will receive the manufactured commodity from the manufacturer on the behalf of the latter.
- S4: A parallel *Istisnā*‘ contract may be concluded between the Islamic bank and a manufacturer to manufacture *Istisnā*‘ commodity of the same quality and same quantity as mentioned in the *Istisnā*‘ contract, concluded between the Islamic bank and farmer.

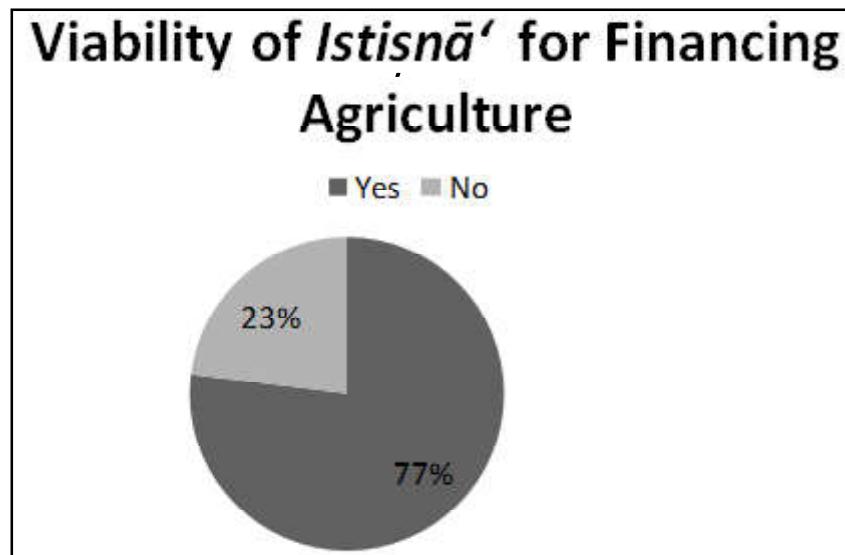
Istisnā‘ Based Model No. 1



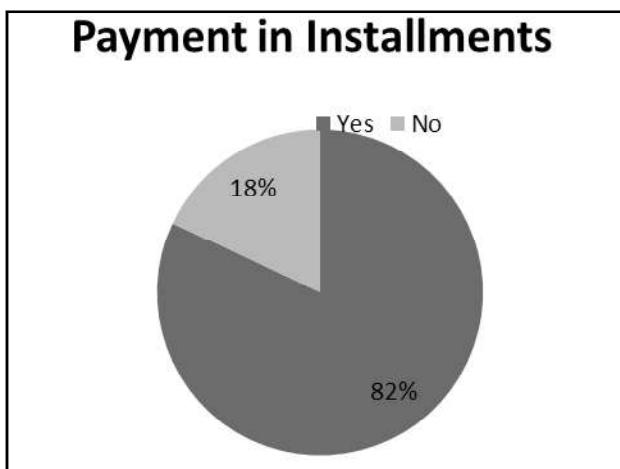
Test of the Proposed Model of *Istisnā'*

The proposed model of *Istisnā'* has been accepted by farmers predominantly for irrigation purposes. However, some numbers of farmers also declare such transaction more suitable for the manufacturing of heavy agricultural machinery. The transaction, therefore, may be used with multidimensionality in agriculture. The response of farmers, given below, may be cited as solid evidence in this regard.

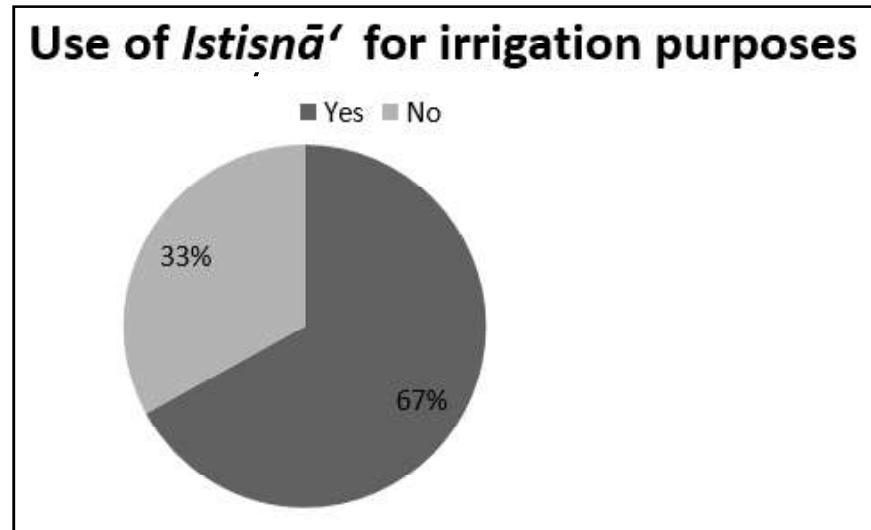
- Majority of farmers (77%) have confirmed the usefulness of the proposed model for financing agriculture. The graphical presentation of the same aspect is given below.



- Like *Murābahah* based model, the issue of payment in installments has been appreciated by majority of farmers i.e. 82 %. Additionally, the farmers also asked for the stretchiness of installments periods. In other words, the price may be paid, for instance, in six months instead of four months. Moreover, the farmers like to link the installments with the harvesting cycle; as they get some money from the sale of their agricultural yields. The following graphical presentation explains the same fact appropriately.



- Majority of farmers (67%) have preferred the proposed model of *Istisnā'* for the development of irrigation purposes rather than its use for manufacturing agricultural commodities . The reason is that that rural local farmers lack proper irrigation mechanism and structure and, consequently, agricultural production per acre is decreased in the last few decades.



Conclusion and Findings

Majority of farmers in Pakistan, particularly in the rural parts of Khyber Pakhtunkhwa (KPK), belong to the lower class. They always face severe meager economic conditions and, therefore, are not in a position to fulfil their basic needs, including social and agricultural. For instance, they can not afford to send their children to schools for basic education, to feed their family properly and to fulfil their basic agricultural requirements. The local farmers of such areas are always in need of financing facility for the purchase of basic agricultural inputs and agricultural machinery. Such financing facility is provided by financial institutions, both for the crop and non-crop activities. While having other numerous flaws, financing is usually provided on interest basis; an economic concept which is strictly prohibited by *Shari‘ah*. Being typical Muslims, such farmers, therefore, avoid securing such agricultural credit and the problem, therefore, still remains unsolved. Islam, as a complete code of life, provides an alternate to its followers in the shape of various modes of the Islamic finance among which *Murābahah*, *Salam* and *Istisnā‘* are the most important. These transactions are also called trade based modes in the Islamic finance. Having flexible nature and mechanism, all these modes may be effectively applied by the Islamic financial institutions for financing local farming. However, the objectives, mentioned above, may be achieved if all these modes are applied in their true spirit i.e. prosperity of the society, and not mere as a source of profit. The proposed models, in the present work, are structured and designed in the present work in such a way to make them viable for all the stake holders i.e. the local farmers and financial institutions. After presenting a strong theoretical background from the work of classical and contemporary Muslim jurists, these models are also tested at ground level to prove their usefulness beyond doubt. The collected data shows a very satisfactory response from the farmers regarding the practicality of such models for financing agriculture. For instance, majority of farmers have approved the expediency of all the three proposed models i.e. *Murābahah*, *Salam* and *Istisnā‘*. In a similar way, the payment in installments have been valued by the farmers in the proposed models of *Murābahah* and *Istisnā‘* owing to the fact that they are not in a position to pay price of the commodity on immediate basis. They need some stretches in the length of installments.

Moreover, the concept of high securities and collaterals has been rejected utterly by farmers. In order to solve the issue, the concept of group based insurance technique has been proposed. In addition, the concept of agricultural subsidies is proposed in the present work. The customer agency's option is disliked by the majority of farmers and, therefore, the alternate arrangements for the appointment of any farmer, other than the customer, of the same locality has been advised. Keeping in view these findings, the present work, indeed, has some inbuilt implications. Firstly, being Muslim the farmers will like such trade based models as they are in compliance with the principles of *Shari'ah*. Secondly, Islamic financial institutions will also be ready for launching such models; as all these are various modes of real trade and, therefore, having the potential to earn more profit comparatively to normal agricultural credit. Thirdly, the Islamic financial institutions, by concluding these transactions with the farmers, may enhance their customership, predominantly, in rural parts of the province. By this way they may also open new branches in such parts and, consequently, may augment their business. Fourthly, by these proposed models,⁵⁷ the farmers may fulfil all their agricultural requirements from the level of basic seeds to heavy agricultural machinery. Fifthly, by entering into such arrangements, particularly *salam*, the farmers will get the reasonable price for their agricultural products. Various studies reveal that they are deprived and cheated by the typical traders by purchasing their products at very low prices.

Notes and References

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3. Muhammad, I. and Muhammad, I. Agricultural Credit Role in the Development of Agriculture, Peshawar, *Journal of Rural Development and Administration*, 1993, vol. XXV, p.4.
4. The details are taken from *The Gomal Journal of Agriculture*. For further detail visit www.gomalagriculturejournal.yolasite.com

5. The role of ZTBL and its success in agriculture sector, particularly in local farming, can be evidenced from the fact that a substantial growth has been witnessed in the last few years in production rate. For example, the annual report of 2012 shows that production of major crops have increased tremendously. The production of Cotton is raised by 18.6 percent, Sugarcane 4.9 percent and Rice by 2.4 percent. Although the bank has disbursed less amount (Rs.64,133 million) in 2012 as compared to 2011 (where Rs.65,452 million has been disbursed). The secret behind this success is the determination for the bank of the development of agricultural sector both for crop and non crop activities, as prescribed in its mission statement ... See Zara'i Taraqiati Bank Limited (Pakistan), *Annual Report*, 2012, p. 32, <http://www.ztbl.com.pk/> (accessed August 12th, 2014).
6. *Shari'ah* strictly prohibits interest based loans. There are many verses of the Holy Qur'an and *Ahādīth* of the Holy Prophet (ﷺ) that confirm this prohibition. For instance, in the Holy Qur'an Allāh, the exalted, says "O Ye Who Believe! Fear Allāh, and give up what remains of your demand for usury, if ye are indeed believers. If ye do it not, take notice of war from Allah and His Apostle. But if ye turn back ye shall have your capital sums: deal not unjustly and ye shall not be dealt unjustly. (Qur'an II:278-279). In another verse the Lord of Universe says, "That they took *Ribā* (usury), though they were forbidden and that they devoured men's substance wrongfully. We have prepared for those among men who reject faith a grievous punishment". (Qur'an, IV:160). Jābir, may Allāh be pleased with him, said: "The Messenger of Allah (ﷺ) has cursed one who charges *Ribā*, he who gives it, one who records it, and the two witnesses; and he said, "They are equal" (*Muslim Sahih*, Chapter on *Ribā*, *Hadīth* no. 1598).
7. *Sharikāt* is an Arabic word literally meaning mixing or *Ikhtilāt*. "Most of the partners are transgressing on each other (Qur'an, XXXVIII:24). *Sharikāt*, in Islamic jurisprudence, is used for describing a contract of partnership. It is defined as, "a contract between two or more persons for participation in capital and its profit". Ibn 'Ābidīn, *Raddul al-Muhtār*, Beirut, Dār al-Fikr, 2005, vol. VI, p. 208.

The *Sharikāt* can be divided into three classes i.e. *Sharikāt-ul-Ibāha* (common sharing of things), *Sharikāt-ul-Milk* (co-ownership) and *Sharikāt-ul-'Aqd* (partnership through contract).

8. The word *Ijārah* is an Arabic word, equivalent of the English word "lease" and means "to give something on rent", (Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, Editon August, 2008, p. 157). Here the word "something" denotes benefits and services. As far as the technical meaning is concerned, the jurists have a different understanding of the transaction. According to Ibn Qudāmah al- Maqdisī "it is the sale of usufructs". (Ibn Qudāmah al-Maqdisī, *Al-Kaft*, 5th Edition, Beirut, Al-Maktab al-Islāmī, 1988. *Kitāb-al- Ijārah*, vol. II, p. 300). In view of Imām al-Kāsānī, "it is a contract on usufructs for a known consideration" Abū Bakr ibn Mas'ād al-Kāsānī, *Badā' al-Šanā'*, 1st Edition, Beirut, Dār al-Fikr Lebanon, 1996, vol. IV, p. 256.
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12. Peck Christen and Douglas Pearce, *Managing Risks and Designing Products for Agricultural Microfinance, Features of an Emerging Model*, 11th Paper, Printed at IFAD in 2006 with the support of Finnish Supplementary Funds, August 2005, <http://www.ifad.org/ruralfinance/pub/risks.pdf> (accessed August 17, 2013) ... Occasional Paper
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22. The word *Qard* and *Hasan* are Arabic's equivalent of the English word loan, and beautiful, respectively. According to well renowned Ḥanafī jurist Imām Kasānī,

its literal meaning is to “cut off”. In the view of Hanafi school of thought, it technically means “a specific transaction in which one party gives fungible property to another party for the purpose of receiving from him the fungible property back without any excess” (Kāsānī, *Bādā'i al-Šanā'i*, *Kitab-al Qard*, vol. VII, pp. 581-583.) Some of the contemporary Muslim scholars signify its technical meaning as “it is a voluntary loan without the lender's expectations of any return on the principal”. Hossein Askari, Zamir Iqbal, Abbas Mirakhor, *New Issues in Islamic Finance & Economics*, 1st Edn., Singapore, John Wiley & Sons, 2009, pp. 197-210.

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39. Imām Abū Bakar Muḥammad ibn Abī Sahal Sarakhsī was a prominent jurist of the Ḥanafi School in the 11th century. He was also known as “*Shamsul al-Ā'immah*” (“the sun of the leaders”). He was in prison for more than 15 years due to his juristic opinion against the ruler of the time. The mentioned book is a collection of his lectures delivered by him to his disciples while he was in

prison. It is a very comprehensive book, spread over 30 volumes, contains detailed discussion of *'ibādah* and *mu'amalah*. He discusses all their related issues in very details and tries to elaborate each and every single issue with practical examples from daily life. His work may effectively be used for introducing new methodology in the field of research related Islamic jurisprudence. He also has a book on the principle of Islamic jurisprudence which is an evidence of his intellectual capacity both in Islamic Law and its jurisprudence. He is considered an authority by the classical and contemporary jurists and weightage is always given to his jurisprudential verdicts.

40. Marghinānī, *Al-Hidāyah Sharḥ Bidāyat al-Mubtadī*, vol. V, p. 152.
41. Sarakhsī, *Al-Mabsūt*, vol. V, p. 77.
42. It is a sale contract in which the seller does not mention the original price and the contract is concluded on bargaining basis. Here the parties conclude the price through mutual agreement.
43. Marghinānī, vol. V, p. 152.
44. “The original principle is that the institution itself purchases the item directly from the supplier. However, it is permissible for it to carry out the purchase by authorizing an agent, other than the purchase order, to make the purchase, and the customer should not be appointed to act as an agent except in a situation of dire need. Furthermore the agent must not sell the item to himself; rather, the institution must first acquire the title of the item and then sell it to the agent” ... Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI), *Shari'ah* Standard No. 8, Rule No. 3/1/23, English Version, p. 117.
45. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an Islamic international autonomous non-for-profit corporate body that prepares accounting, auditing, governance, ethics and *Shari'ah* standards for Islamic financial institutions and the industry. Professional qualification programs (notably CIPA, the Shari'ah Adviser and Auditor “CSAA”, and the corporate compliance program) are presented now by AAOIFI in its efforts to enhance the industry's human resources base and governance structures. This institution was established in accordance with the Agreement of Association which was signed by the Islamic financial institutions on 1 *Safar*, 1410H corresponding to 26 February, 1990 in Algiers. Then, it was registered on 11 *Ramadān*, 1411 corresponding to 27 March, 1991 in the State of Bahrain. <http://www.aaoifi.com> (accessed December 25, 2011).
46. Kāsānī, *Bādā i'al-Ṣanā'i'*, vol. V, p. 201.
47. Nayl al-Awtār, *Kitāb al-Salam*, vol. V, p. 255.
48. Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, Karachi, Maktaba Ma 'ariful Quran, Edition August, 2008, p. 186.
49. *Salam* was allowed by the Holy Prophet (ﷺ) subject to certain conditions. The basic purpose of this sale was to meet the needs of the small farmers who needed money to grow their crops and to feed their family up to the time of harvest. After the prohibition of *Ribā* they could not take usurious loans. Therefore, it was allowed for them to sell the agricultural products in advance. Similarly, the traders of Arabia used to export goods to other places and to import some other goods to their homeland. They needed money to undertake this type of business. They

could not borrow from the usurers after the prohibition of *Ribā*. It was; therefore, allowed for them that they sell the goods in advance. After receiving their cash price, they could easily undertake the aforesaid business ... Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, p. 186.

50. Kāsānī, *Badā'i' al-Ṣanā'i'*, vol. V, p. 213.
51. Sarakhsī, *Al-Mabsūt*, vol. V, p. 139.
52. Muhammad Faheem Khan, *Islamic Future and their Markets, With Special Reference to their Role in Developing Rural Financial Market*, Islamic Development bank, Islamic Research and Training Institute, Paper No. 32, p. 41.
53. Omer Farooq, *Pakistan Economic Survey 2009-10*, Government of Pakistan Ministry of Finance, Chapt. 2, p. 13, <http://www.finance.gov.pk/> (accessed July, 6, 2012).
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56. See for further details ... Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2010, Bahrain, English Version, Istisn 'and Parallel Istisn', Shari'a Standard No. 11.