Received 8 April 2012
Revised 12 July 2012
21 January 2013
3 September 2013
8 December 2013
11 April 2014
Accepted 14 April 2014

Local agricultural financing and Islamic banks: is Qard-al-Hassan a possible solution?

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Abstract

Purpose – This paper aims to study *Qard-al-Hasan* (QH) (good loan) from the stand point of its possible application to agricultural farming with a view to augmenting the sources of Riba (interest)-free agricultural financing for Muslim farmers of Islamic countries like Pakistan.

Design/methodology/approach – This paper is a study of QH (good loan) from the stand point of its possible application to agricultural farming with a view to augmenting the sources of Riba (interest)-free agricultural financing for Muslim farmers of Islamic countries like Pakistan.

Findings – The study reports that Riba-free financing is essentially needed by poor Muslim farmers who, owing to prohibition of Riba, do not rely on interest (Riba)-based financing. The study also shows that QH is a viable option for fulfilling this need and is beneficial for the farmers as well as for the Islamic banks or financial institutions.

Research limitations/implications – The case of QH as a potential mode of agricultural financing, as presented in this paper, is based on a theoretical or conceptual framework. The findings need to be further substantiated with empirical evidence. A future study, based on reliable empirical data would certainly add value to the subject.

Originality/value – Islamic banks and financial institutions typically rely on Musharakah (partnership), Murabaha (sale with profit), Ijarah (leasing), Salam (advance payment sale), Istisna' (manufacturing contract), etc., and they rarely use QH as a mode of financing. Despite its huge utility, QH is practically non-existent in its application as an agricultural financing instrument. This paper presents a case for QH that can be adopted by Islamic banks or financial institutions for provision of the much needed financing for the small farmers of Islamic countries, as well as those living in non-Islamic countries.

Keywords Farmers, Agriculture, Crop and non-crop, Islamic financial institutions, *Qard-al-Hasan*, Shari'ah

Paper type Research paper

Journal of Islamic Accounting and Business Research
Vol. 6 No. 1, 2015
pp. 122-147

1759-0817
DOI 10.1108/JIABR-04-2012-0018

1. Introduction

The Lord of the Universe (*Allah SWT*), the real and absolute owner of all wealth, guides Muslims to pass on some of the wealth that He provides them to those who are in need. This wealth has been conferred by The Lord to His vicegerent and representative on this universe, who has the responsibility to use it as prescribed by Him. Abdul Qadir Awdah terms this the "provisional ownership" (Mushtaq, 1995).

According to the Holy *Qurān*, the wealth is distributed unevenly (*Al Qurān*, 16:72) whereby some receive or inherit more than others. In the wake of this inequity, Islam instructs the more fortunate Muslims who possess greater resources to share these bounties with their fellow brethrens. This is the basic premise of *Qard-al-Hasan* (QH) (good loan).

Agriculture in Pakistan accounts for 23 per cent of gross domestic product, and employs 42 per cent of its labour force (Draft Guideline for Livestock Financing, 2006). Agricultural land in Pakistan is predominantly characterized by small holdings, which, owing to their size, have a detrimental effect on farm productivity, income and investment (Ahmed, 2004). A vast majority of the country's population (62 per cent), of which a large portion is composed of small farmers, belong to the rural areas and has direct or indirect linkages with agriculture as a prime source of living (Farooq, 2010). Such farmers deserve assistance by the Islamic banks and other Islamic financial institutions through the mode of QH (charitable loan or interest-free loan or good loan). However, in Pakistan, most of these financial institutions do not advance loans on the basis of QH (Economic Survey of Pakistan, 2009/2010), whereas other Muslim countries such as Iran efficiently apply QH for the development of all sectors of society (Askari *et al.*, 2009).

Islamic banks and other financial institutions in Iran currently advance interest-free loans to young people for marriages. In addition, they also provide loan facility to farmers with a low interest rate (Ilias, 2007). In some cases, these financial institutions charge a very small percentage as an administrative cost per loan (Yazdani, 2006).

In India, Muslim farmers struggle to obtain interest-free term loans (Haque, 2012). In Malaysia, the banks lend money without charging any interest, but they cover their expenses through service charges. The limit on such service charges is set by the concerned authorities (Gafoor, 1995). In Bangladesh, interest-free loans are provided to the farmers, particularly those of rural areas, with certain conditions (Arveen, 2009).

In Pakistan, the Islamic banks and other Islamic financial institutions, particularly those found in the Muslim world, can also effectively apply QH for the development of the agricultural sector both for crop and non-crop activities. However, applicability of this mode of financing for such a sector and its acceptance and adoption by the Islamic banks and financial institutions is likely to raise a number of pertinent questions related to: possible problems in the execution of QH; the benefits of QH for the farmers; application to local farming; benefits for Islamic banks and financial institutions, the form QH should take; the sources for granting QH; how QH would be recovered; the limits of QH; and the farmer's purpose for accruing such a debt (for crops or non-crops activity). These issues will be addressed within the confines of the *Shari'ah* (Islamic law) parameters and are presented in Section 4 of this paper.

In addition to the issues mentioned above, a vigilant reader may ask how an Islamic bank or any other Islamic financial institution would provide interest-free loans for local farming when their basic purpose is to earn profit from each and every commercial activity undertaken? To understand this, it is important to know that by establishing a financial system, the Islamic law pursues the achievement of two goals. These include, first, earning of intangible or immaterial profit, which means contribution and helping out poor sectors of the society (the best example of which is the provision of QH to the needy sectors) and, second, earning of material or tangible profit (which is done through a trade-based mode). This approach is totally different from that of conventional financial institutions, which strongly emphasize the maximization of profit through the provision of interest-based loans and its rescheduling.

Additionally, according to the classical Islamic jurisprudential approach, if a bank is granted a legal status of a "Juristic Person", treated at par with a natural person in all respects (as Islam recognizes the concept of Juristic personality), it must perform the duties and obligations as expected of a natural person (Usmani, 2008). A bank must, therefore, introduce charitable and cooperative measures to help the needy and the poor, broadly in the same manner as is obligated by *Shari'ah* for a natural person. Moreover, there are many material and immaterial benefits for the Islamic bank in the advancement of interest-free loans on the basis of QH including unstipulated excess, service charges, publicity, expansion of business, etc.

There are several major objectives for the research under discussion. First, the majority of farmers located in rural areas belong to the lower classes (Farooq, 2010). As such, they are not in a position to transact with Islamic financial institutions through other modes of Islamic finance like *Mushārakah* (partnership), *Diminishing Mushārakah* (decreasing partnership), *Mudārabah* (a special type of partnership where one partner provides investment while the work and/or skill is provided by the other), *Musāsqat* (the contract of irrigation), *Muzāraat* (agricultural partnership), *Murābaha* (cost plus financing), *Musawamha* (sale without mentioning the cost), *Salam* (advance payment sale), *Istisnā'* (manufacturing contract), etc. Each of these transactions bear potential risks and, therefore, are not viable options, either for poor farmers, or for Islamic financial institutions. The only practical substitute to all of these is QH, as it bears no financial risk.

Second, Muslims are strictly forbidden by *Shari'ah* to procure interest-based loans from formal or informal institutions (Al Qurān, 2:278-279) (Al Qurān, 30:39). This restriction creates serious issues for Muslim farmers to locate other sources of *Shari'ah* compliant financing to fulfil their crop and non-crop sector needs. QH is the best possible and viable alternate for the interest-based loan with the condition that it is applied in its true spirit and philosophy, as envisaged by the Islamic legal system.

Third, QH (benevolent loan) can be used for the development of local farming in rural areas of Pakistan as it pertains to small sums, which are sufficient for the farmers to fulfil their basic agricultural needs both for crop and non-crop activities. If the Islamic banks and other Islamic financial institutions take this responsibility upon themselves to enthusiastically offer QH to deserving cases, they will not only be meeting *Shari'ah* requirements but will also be helping the poor in the same vein as is mandated in Islam, i.e. provide *sadaqah* (charity and alms) to the needy (Jalil and Rahman, 2010).

Fourth, as mentioned above, a vast majority of farmers belong to the lower class of society in the developing countries (Schaefer *et al.*, 1986), and are always in need of money in the beginning of a season to buy basic agricultural inputs like seeds, fertilizer, pesticides, herbicides, manual sprayers, etc. On the other hand, large farms constitute only 7 per cent of the total farms but account for as much as 40 per cent of the total cultivated area (Ahmed, 2004). The Islamic banks and other Islamic financial institutions tend to favour financing the needs of this upper class of farmers and ignore the lower class farmers who exist in much larger numbers and live in the rural areas of the country (Farooq, 2010). This paper calls attention to the major problems that emerge due to this unequal distribution and attempts to discover solutions related to Islamic agriculture finance.

Fifth, The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) present's a specific procedure for the application of the different modes of the Islamic financial system. The organized process, however, seems very difficult and often times beyond the comprehension of ignorant farmers, particularly those residing in the rural areas of Pakistan. This paper aims to offer a simple procedure as compared to the one provided by the *Shari'ah* standards (AAOIFI, 2010).

The present work consists of two parts. The first considers the theoretical aspect of *QH* and provides the introduction, literal and technical meanings, literature review, various rules and regulations of QH and its legality. The second part of the work is related entirely to the practical application of QH for the development of local farming. This portion encompasses a discussion related to potential problems faced by the Islamic banks in the practical application of the proposed mode, i.e. QH, various areas of local farming that can be covered through QH, benefits of Islamic banks from QH, its repayment and other related issues, possible social and institutional implications, etc.

2. Literature review

The classical Muslim jurists like Ābidīn (2005), Kāsānī (1996), Murginanī (2008), Ibnī Qudāma (1988), Ibni Rushd (2003), Sarakhsī (2002), etc. have discussed various aspects of QH in detail. They, however, provide little information on QH in regard to the agricultural sector. In those times, the QH facility was applicable at the social level and, hence, its structure was simple and ideally suited for the poor members of the society.

In the present-day world, the Muslim jurists, predominantly those related to Islamic banks and other Islamic financial institutions functioning in the capacity of *Shari'ah* advisors, have not paid the requisite attention to this concept. There are many reasons for their approach to this subject. Being advisors, they are not in a position to set up this mode of Islamic finance in which the financial institutions act as benevolent institutions and advance interest-free loan on the basis of QH. For instance, an eminent scholar of Islamic finance, who wrote the well-renowned work "An Introduction to Islamic Finance", did not even make a cursory reference to the concept of QH in his work (Usmani, 2008). Similar is the case of Usmani (2002). Other scholars who have worked on Islamic agriculture finance have also not discussed QH and its role in the growth of the agricultural sector (Crane and Leatham, 1993; Elheraika, 2003; Gulaid, 1995; Mohsin, 2005). However, a few of the scholars have discussed the concept of QH and developed a mechanism for its application in Islamic banking and finance. They focused their work on the viability of the proposed mode, both for famers and financial institutions. In this regard, the work of Askari *et al.* (2009) is remarkable. These scholars devoted a separate chapter of their work to the concept of QH and discussed the same in minute detail. To convince the Islamic banks and other Islamic financial institutions about the viability of the proposed model of QH, they narrated its success stories in Iran and how it was used for the development of various sectors of the society including agriculture. The statistics they presented therein are quite extraordinary. However, their work is purely concentrated on a particular country and, hence, cannot be generalized to all countries due to the diversity that nations possess owing to different environmental/cultural factors. Mirakhor and Iqbal (2007) have played the same role in this regard. In their work, both scholars discuss the issue and its religious importance as well as provide arguments for financial institutions to embark on QH. However, they did not pay much attention to the literature available in the classical books of Muslim jurists. Saqib (2011) also devoted a comprehensive chapter to the concept of QH in his work and discussed its application to the agricultural sector in Pakistan. He addressed a variety of objections raised by financial institutions in lieu of its expected application in the banking sector. However, his work did not concentrate on local farming which is a major segment of agriculture. Yazdani (2005) has also compiled precious work on the application of interest-free loans to the agricultural sector. However, his work concentrates on Iranian agriculture and lacks generality in its contents.

The works of Islamic jurists and prominent scholars play a vital role in urging and convincing Islamic banks and other Islamic financial institutions to consider the various modes of agriculture financing. The bank's *Shari'ah* advisors, accordingly, complement the initiative by preparing necessary guidelines for financing to different sectors. They have considered several modes of Islamic finance toward agricultural financing, especially local farming, poultry farming, livestock, horticulture, dairy farming, fish farming, etc. (Guidelines for Poultry Financing, 2007; Guidelines for Fisheries Financing, 2007; Scheme for Small Farmers, 2008). However, their main emphasis in these guidelines is directed to facilitate those sectors of agriculture that belong to upper- and middle-class farmers pursuing the aforementioned types of farming and overlooking local farming which is the backbone of the economy (Saqib, 2011). QH is not even featured as a sub-heading in their work. The Guidelines on Islamic Finance for Agriculture (2008) provide the application of various modes of Islamic finance to agriculture such as *Mushārakah* (partnership), *Diminishing Mushārakah* (decreasing partnership), *Mudārabah* (a special type of partnership where one partner provides investment, while the work/skill is provided by the other), *Musāsqat* (the contract of irrigation), *Muzāraat* (agricultural partnership), *Murābaha* (cost-plus financing), *Salam* (advance payment sale), *Istisnā* (manufacturing contract) and the others mentioned in the introduction of this work, etc. Surprisingly, no reference is made to the concept of QH. There may be a few reasons for this glaring omission. The predominant one being that financial institutions, created on the premise of securing interest payments, do not like to adopt a mode of financing which shuns it categorically.

3. The theory of QH

The theory of QH can be traced back directly from many verses of the Holy *Qurān*, *Sunnah* of the Holy Prophet (PBUH) and *Ijmā* (consensus of opinion over an issue by Muslim jurists at a particular period of time).

3.1 Literal and technical meaning of QH

The word "*Qard*" and "*Hasan*" are Arabic's equivalent of the English word loan and beautiful, respectively. Its literal meaning is to "cut off" (Kāsānī, 1996). In the view of *Hanfiez* (*Hanafī* school of thought), "it is a specific transaction in which one party gives fungible property to another party for the purpose to receive from him the fungible property back without any excess" (Zuhali, 2006). Some other contemporary scholars define it as "a voluntary loan without the lender's expectations of any return on the principal" (Askari *et al.*, 2009).

3.2 Legitimacy of QH

The Holy *Qurān* describes:

> Who is it that will lend Allah a goodly loan [QH] that He may multiply it for him manifold? And Allah receives and enlarges, and to Him shall you be made to return (Al Qurān, 2:245).

In another verse, it states:

> Allah did a foretime take a covenant from the Children of Israel, and we appointed twelve captains among them. And Allah said: I am with you: if ye (but) establish regular prayers, practise regular charity, believe in my apostles, honour and assist them, and loan to Allah a beautiful loan [QH], verily I will wipe out from you your evils, and admit you to gardens with rivers flowing beneath; but if any of you, after this, resisteth faith, he hath truly wandered from the path or rectitude (Al Qurān, 5:12).

A similar message is found in another verse:

> Establish regular Prayer and give regular Charity; and loan to Allah a beautiful loan [QH] And whatever good ye send forth for your souls ye shall find it in Allah's Presence, - yea, better and greater, in Reward and seek ye the Grace of Allah, for Allah is Oft-Forgiving, Most Merciful (Al Qurān, 20:73).

In the Chapter of *Taghābun* (mutual disillusion, haggling) the *Holy Qurān* confirms the same by stating:

> […] ye loan to Allah, a beautiful loan, He will double it to your (credit), and He will grant you Forgiveness: for Allah is most Ready to appreciate (service), Most Forbearing (Al Qurān, 17:64).

While referring to these verses, Mirakhor and Iqbal (2007) describe that whenever an individual lends money to another on the basis of QH, i.e. without any increase over and above his principal sum on return, he is promised by the Lord of the universe the multiplication of that amount for him many times. He further adds that in most verses of the Holy *Qurān* regarding *QH*, the word "*kaseera*" is used, which is synonymous with the word "many" in English, and hence, such promised excess by Allah to the lender has no limits.

In a narration, the Holy Prophet (PBUH) said:

> Whoever takes money (on *QH* basis) of the people with the intention of repaying it, Allah will repay it on his behalf, and whoever takes it to spoil it, then *Allah* will spoil him (Khan, Hadith 572).

It is also reported from the Holy Prophet (PBUH) that "anyone who gives QH two times, is just like he advances *Sadaqha* one time" (Shawkani, 2001).

The classical Muslim jurists have largely discussed QH's basic rules and regulations criteria for those who can benefit from it, the rules and structure pertaining to its repayment, time frame, reimbursement procedures and issues related to securities therein, etc. (Ābidīn, 2005; Kāsānī, 1996; Murginanī, 2008; Ibnī Qudāma, 1988; Ibni Rushd, 2003; Sarakhsī, 2002). These jurists, by discussing various theories of QH, indirectly prove the legitimacy of such transactions in Islamic law.

3.3 QH rules and regulations

Kāsānī (1996), in his study of the *Hadith* (traditions) of the Holy Prophet (PBUH), indicates that QH is given by the *Muqrez* (creditor) to *Muqtarez* (debtor) for charitable purposes. The *Muqrez* cannot use it as a source of profit; otherwise, the whole philosophy behind the transaction is defeated. A contemporary jurist, Usmani (2008), has the same view where the lending party can only have a claim on the amount extended, or the principal amount, and not to any additional amount in excess of the principal which may be generated as a consequence. The Islamic commercial law prohibits the excess amount over and above the principal amount of QH (*Al Qurān*, 2:278-279; *Al Qurān*, 30:39; Hazm, 1988), as it is tantamount to *Ribā*. This clearly indicates that the advancement of a loan for any other purpose, beyond the help it provides, such as receiving of profit, is prohibited by Islamic commercial law (Kāsānī, 1996).

In a *Hadith* of the Holy Prophet (PBUH), it is explicitly mentioned that a creditor is not allowed to accept any gift from his debtor (Shawkani, 2001). Similarly, if the excess is not stipulated by the parties in the contract, but subject to a prevailing custom and is given over and above QH, then that too is prohibited. Same is the case of gifts given by the *Muqtarez* (debtor) to the *Muqrez* (creditor) (Zuhali, 2006). However, if the excess amount is not conditioned, it does not count as *Ribā* (Kāsānī, 1996; Shawkani, 2001). Some of the Muslim jurists, particularly those who belong to the *Hanafī* school of thought, consider the repayment of a debt along with an excessive amount, that is not stipulated in the contract of QH, as the best repayment (*Husn-ul -Adā*) (Kāsānī, 1996), which is also advised by the Holy Prophet (PBUH). However, if such a rule is applied without proper constraints, it will open the floodgates for interest-based loan transactions.

It can, therefore, be concluded from the above-mentioned discussion that if an excess over the principal amount is not conditioned in the contract of QH, and neither is it a custom, then any addition to the principal amount is not prohibited by Islamic law. Such additional amount will be considered as a gift from the *Muqtarez* (debtor) to the *Muqrez* (creditor).

Similarly, a majority of the Islamic jurists hold the view that Islamic law of options (*Khayarāt*) cannot be applied to loan transactions, as it is not a binding contract, and hence, any party can terminate it without taking consent from the other party.

As a principle of Islamic commercial law, the time for the repayment of the principal amount cannot be framed in the QH transactions (Kāsānī, 1996). However, it does not mean that the creditor cannot demand his amount at all. He has the right to ask for the recovery of the loan at any time (which is reasonable), after which, it becomes binding upon the debtor to make the payment. Islam advises creditors to give relaxation to the debtors until a time of ease, i.e. if the debtor is unable to repay the amount at the given time, and in special cases, it is advised that the same may be remitted as charity. In this regard, the *Qurān* says:

> And if any debtor be in straitened circumstances, and then grant him respite till a time of ease. And that you remit it as charity shall be better for you, if only you knew (Al Qurān, 2:281).

Based on the previous discussion, the following conclusions can be summarized:

- Loans should be given by *Muqrez* (creditor) only for charitable and cooperative purposes.

- The time of repayment should not be specified in the contract, but *Muqrez* (creditor) can demand it from *Muqtarez* (debtor), after a reasonable time.
- Once the *Muqrez* (creditor) makes a demand for the repayment of the loaned amount, it is obligatory for the *Muqtarez* (debtor) to repay.
- No excess should be stipulated over the principal amount in the contract of QH.
- The payment under QH would not be governed by a custom that permits excess over the principal amount, even if it is not stipulated in the contract of QH.
- An excess over principal, paid by the debtor to the creditor, in the absence of a stipulated condition in the contract of the QH or customary practice, is permissible under Islamic Commercial Law. However, this provision must be practised sparingly and with utmost care; otherwise, the excess payment could become a custom and, thus, lose its permissibility.

4. Application of QH to the agricultural sector

The financial institutions, constituted on profit maximization and operating under the interest-based system, find little room for advancing interest-free loans to the deserving people of the society. However, a look at the financial statements of the Islamic banks and other Islamic financial institutions reveal that they have also left this high potential area of Islamic finance, i.e. QH, unexplored and untapped. Mirakhor and Iqbal (2007) struggled to understand how something as important as QH could be ignored as a viable means of providing help to the needy in Muslim countries. It prompted them to urge sociologists and economists to investigate the reasons of the underutilization of this huge redistributive mechanism. Table I reveals the same fact.

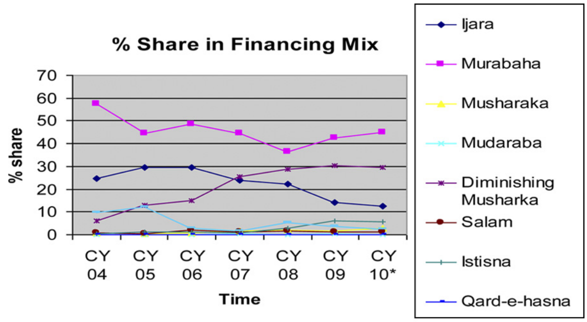
Both Table I and its graphical presentation (Figure 1) clearly illustrate that from 2004 to 2010, the market share of Islamic banks and other Islamic financial institutions have had no involvement with QH financing. It means that in this duration, not a single penny was advanced on interest-free basis. This fact clearly indicates the unwillingness of the conventional and Islamic financial institutions to advance loans to poor sectors of the society on the basis of QH. They are very cautious regarding the implementation of this mode, particularly when the applicants relate to agribusiness, directly or indirectly.

The concerns which were raised in the introduction of this article and may also come to the minds of various stakeholders of Islamic banks and other Islamic financial

Mode of financing	CY 2004	CY 2005	CY 2006	CY 2007	CY 2008	CY 2009	CY 2010*
Murabaha	57.4	44.4	48.4	44.5	36.5	42.3	44.9
Ijara	24.8	29.7	29.7	24	22.1	14.2	12.7
Musharaka	1	0.5	0.8	1.6	2.1	1.8	2.9
Mudaraba	–	–	–	0.3	0.2	0.4	0.2
Diminishing Musharka	5.9	12.8	14.8	25.6	28.9	30.4	29.5
Salam	0.7	0.6	1.9	1.4	1.8	1.2	1.4
Istisna	0.4	1.4	1.4	1	2.9	6.1	5.8
QH	–	–	–	–	–	–	–
Others	9.8	12.1	3	1.6	5.4	3.6	2.6

Note: CY (calendar year)
Source: Economic Survey of Pakistan (2009/2010)

Table I. Market share of Islamic modes of financing (Rs. in million)



Note: Calendar year
Source: Economic Survey of Pakistan 2009-10 CY

Figure 1. Graphic representation of share in financing

institutions (i.e. shareholders, directors, policymakers, etc.) through the application of QH to the local farming of agriculture are discussed below:

4.1 Potential problems faced by Islamic banks in the execution of QH

There are many reasons for the lack of proper execution and implementation of QH by Islamic banks and other Islamic financial institutions in Pakistan, particularly to the agricultural sector in rural areas.

The first reason is that the process of Islamization of economy is very slow as compared to other Islamic countries like Iran where the process of Islamization is strong and vibrant. The desire to practice the Islamic faith is likely more prevalent there as compared to Pakistan (Anwar, 1992). The Islamic banks, therefore, have not started advancing *QH* in Pakistan (Table I). Second, in Pakistan, some of the prominent religious scholars are against Islamic banks. They hold the opinion that the current Islamic banking practices are un-Islamic (Mansoori, 2011). It is because of this that farmers are very reluctant to secure loans (on the basis of QH) from Islamic financial institutions. As an alternate, they secure loans from informal institutions, i.e. relatives, friends etc. In other Islamic countries like Iran, the religious scholars hold a unanimous opinion regarding the permissibility of Islamic banks to extend these types of loans. Third, in Pakistan, the issue of charging a service fee on QH is considered *Ribā*, and therefore, the Islamic banks are hesitant to risk their liquidity without receiving any profit. On the other hand, the Islamic banks in Iran are charging service fees for advancing loans on a QH basis (Anwar, 1992). This has been a stumbling block for the implementation and execution of QH in the Pakistani financial market. Fourth, the agriculture sector is prone to many risks like the incidence of droughts, floods, hail, earthquakes, mud slides and a multitude of other mishaps (Gulaid, 1995). In the case of Pakistan, the chances of such risks occurring are more likely as compared to other Muslim countries like Iran, making the financial institutions hesitant to make any investment in this sector. Finally, the cultivation and harvesting methods in the rural areas of Pakistan are primitive and produce a low yield per acre (Ali, 2010). Because of this reason, there is always a lurking possibility that farmers may not generate enough yields by the end of the harvesting cycle, or the specified time frame, to pay off their debts.

4.2 Benefits for local farmers

A considerable number of farmers hold the land units of less than 12.5 acres, making them barely large enough for providing subsistence standards of living.

Table II illustrates that with the exception of a few big landlords, the average farmers generally remain poor, as they hold a very small piece of land for cultivation of agricultural crops. This pushes them to the back lines of poverty where they continue to face financial problems. They are neither able to buy good quality farm inputs (i.e. seed, fertilizer, pesticides, etc.) nor can they resort to mechanized farming to increase their per acre yield.

The farmers, in an agro-based economy like Pakistan, deserve special attention because they are the major source of producing food for the nation's population. Seventy-four per cent of the country's farmers comprise of small farmers (Financing Scheme for Small Farmers, 2006). It is obligatory of Islamic banks and other Islamic financial institutions to provide due support and help to these poor and small farmers. Khan and Bhatti (2008) endorse the same by mentioning that IBF, as part of its exclusive feature, carries out business with the weakest social groups, duly providing them with economic and technical assistance. In Iran, QH has already been proven fruitful in its application to different sectors of the society for various purposes such as marriages, home repairs, residential rental fees and mortgages, education, small industries, hospital and illness expenses, agriculture, business working capital, etc. (Askari *et al.*, 2009).

Consequently, an efficient and reliable system needs to be established for timely provision of interest-free and *Shari'ah* conforming financing to farmers. Such an arrangement will allow mechanized farming and use of better quality inputs and will result in an increase per acre yield, improving farmers' standard of living. The Islamic financial institutions can play a very important role in this context by applying the QH particularly to local farming of the agricultural sector. Due to the importance of such financing, the Republic of Iran has applied it since the time of its revolution and has achieved substantive success (Mirakhor and Iqbal, 2007).

4.3 Forms of QH

Hazm (1988) mentions that QH as per the Islamic financial system is used as a general term, and covers not only cash or currency but applies to all consumable goods. Kāsānī (1996), the author of *Badā'-al-San'ai*, confirms the same by saying that QH may be in the form of any consumable goods that is weighable, measureable or countable, and that the return of the same goods be applicable at the time of culmination of QH. The Islamic banks and other financial institutions may, therefore, apply this rule for providing farm

Years	Punjab	Sindh	NWFP	Balochistan	Pakistan
1960	3.55	5.94	3.28	9.96	4.07
1972	5.29	5.12	3.69	10.16	5.28
1980	4.75	4.69	3.14	7.80	4.68
1990	3.71	4.34	2.21	9.63	3.78
2000	2.91	4.04	1.67	7.83	3.10

Source: Iqbal and Ahmad (2013)

Table II. Average farm size in Pakistan (in hectares) inputs, e.g. seeds, fertilizers, pesticides, insecticides, herbicides, sprays, etc. Similarly, a farmer who is engaged in poultry, fish or dairy farming may be helped with the inputs (equipment, tools, consumables, etc.), which are normally required for making such farms run as profitable economic units (Financing Scheme for Small Farmers, 2006). However, a very pertinent question arises here which needs to be analyzed and answered. As Islamic jurisprudence requires that QH be provided in kind and has to be returned with the commodity of same quality, quantity and condition; would it not pose a serious handling/storage problem for the financial institutions when various commodities are returned by the borrowers?

It is an established principle of Islamic law (*Fiqh*) that every doctrine of *Shari'ah* has to be applied in its entirety and in conformity with its philosophical spirit. In light of the same, Saqib (2011, p. 28) says:

> It is not permissible in Islamic law to apply a portion of a particular concept and to leave its substantive portion. In Islamic commercial law the concept of QH is applicable to all consumable and fungible goods and it should be applied in the same shape to achieve the intended objectives.

Unlike conventional banks that predominantly deal in cash, the Islamic banks and financial institutions are required to adopt the innovative trade modes to undertake *Murābaha*, *Salam* and *Ijāra schemes* in true Islamic spirit. Usmani (2008) endorses the same view, as he urges the financial institutions to uphold the basic requirements of the Islamic economy by creating special cells dealing exclusively in commodities. These cells will facilitate the purchase of commodities through *Salam* for onward sale in the spot market. This issue could be resolved by implementing either of the following two methods:

(1) To avoid the complexities of commodity handling, the farmer may be appointed as an agent to undertake the QH transaction on behalf of the Islamic bank or financial institution and deposit the sale proceeds of the returned commodities in cash.

(2) The bank or financial institution may establish separate departments for handling the commodities returned by the borrowers under QH, *Salam* and *Murābaha* deals. As the repaid commodities will be sold (either through an agent or by the bank itself) on the prevailing market prices, the risk of decline in the value of money due to inflation will automatically be mitigated.

These ideas will, of course, breed new problems for the banks and pose some new questions for the scholars and researchers of Islamic *Shari'ah*, at least in the initial stages of its practice. However, these would be resolved over time with sincere and collaborative efforts of the bankers and scholars. Fortunately, a rich source of *Shari'ah* knowledge already exists and only needs to be studied and interpreted in light of the prevailing environment. The basic principles of *Shari'ah*, already established through intensive and extensive research, may be applied to the contemporary practices to find solutions for emerging problems and new queries.

4.4 Islamic banks and financial institutions' sources for granting QH

There are various sources for the provision of QH to the needy farmers. The most important source available with the Islamic banks and other Islamic financial institutions for advancing such interest-free loans is the "charitable fund" that is held by almost every Islamic bank. Usmani (2008) explains that such a fund could be created in a variety of ways. For instance, in case of a default of payment on its due date, under the *Murābaha* contract, the client may pay a specific amount in a charitable fund created specifically by the bank for this purpose. However, the bank must guarantee that it will not draw out any amount from this fund and treat it as part of its income from operations. This fund may subsequently be used for charitable purposes as per the approval of the *Shari'ah* board. The bank may also use this fund to extend interest-free loans to other deserving customers.

The second source for advancing QH to the needy farmers is the capital of the Islamic financial institutions. As mentioned earlier, these loans are very small and cannot create liquidity problems for banks. Supporting this, Saqib (2011) iterated that the size of these loans and the short duration for which they are extended are not likely to place any liquidity pressures on banks.

The government may also provide sufficient funds to the Islamic banks and other financial institutions for financing the agricultural sector. The aim of such funds would be to:

- mobilize domestic savings to broaden the resource base for agricultural credit (Mollett and Helm, 1984);
- assure a reasonable price for agricultural produce;
- assist the producers with necessary awareness and proper application of QH; and
- improve the rate of loan (QH) recovery.

The Islamic financial institutions and Islamic banks can also utilize current accounts for QH, as these are considered *Amānah* (trust) from the perspective of Islamic commercial law, and therefore, no surplus is paid to the account holders by the financial institutions. The same philosophy can be applied to savings and fixed deposit accounts. However, the procedure may be a little complex, requiring further academic research from competent scholars of the field.

Additionally, the deposits received in current accounts by the banks as *Amānah* may also be questioned. As further lending of *Amānah* funds is prohibited by *Shria'h*, how then can the Islamic banks be able to use these funds for providing the proposed QH to farmers? This relates directly to Islamic jurisprudence and needs to be answered in the same context.

As a rule of Islamic commercial law, if the money is deposited with the Islamic financial institutions on the basis of *Amānah* (in current accounts), they cannot utilize or mix it with their own liquid resources. Similarly, such amounts cannot be guaranteed by them and, therefore, result in freeing the Islamic financial institution from the liability of loss except in specific cases. According to well-renowned scholars, Shawkānī and Zuhali, when a person deposits money with *Ameen* (the trustee, i.e. the Islamic bank in this case) and it is lost, without negligence, misconduct or breach of the contract, then the individual or bank safeguarding the *Amanah* is not responsible (Zuhali, 2006; Shawkani, 2001). However, where an Islamic bank uses the funds, then the current account used will be treated as QH (the relationship between depositor and Islamic bank would convert into that of creditor and debtor) rather than *Amānah*. The Islamic bank would thus be liable for the safe return of the funds (Zuhali, 2006). Similarly, whenever

Ameen (trustee) mixes the deposits with his property, then he becomes absolutely liable for its repayment (Kāsānī, 1996; Zuhali, 2006). Some of the contemporary scholars have a completely different approach toward this issue. In their opinion, current accounts will be treated as loans from their initiation and can then be used by the Islamic financial institutions for any purpose (including agricultural financing), without any prior permission from the account holders. Farooq (2010) states that: "Current accounts of IFIs (Islamic Financial Institutions) are treated as Qard-al-Hasan or Qard, alternatively, as wadi_ah/amanah". Samdani (2007) holds the same view.

It may be concluded from the preceding discussion that money deposited by the customers with the Islamic bank is not an *Amānah* (trust) but "Guaranteed *Amānah*" which is synonymous to the term "Qard" in legal connotations, and thus the Islamic banks and other Islamic financial institutions are at liberty to deal with such amounts in any way they deem appropriate.

4.5 Farmers' use of QH?

The most important question related to the employment of QH to the agricultural sector is, how can it be applied? Before addressing this question, it will be useful to review the basic needs of local farming.

Local farming is mainly related to local crops which can be classified into two categories, i.e. non-fruit crops and fruit crops.

The non-fruit crops are considered the most important from the perspective of local farming of the agriculture sector. They can be further classified into two sub-categories, i.e. major crops and minor crops. The major crops are those that are cultivated by the majority of farmers and are divided into four types, i.e. cotton, sugarcane, wheat and paddy (rice) (Table III).

Minor crops, on the other hand, are in greater numbers and have more diversity because they depend mostly on particular environments, i.e. tobacco, maize (hybrid), mash, canola, lentil, soybean, groundnuts, sunflower, etc. As far as fruit crops are concerned, they are also numerous, i.e. pear, date, loquat, strawberry, plum, apple, pomegranate, almond, palm, coconut, lichi, walnut, cherry, banana, watermelon, peach, musk melon, citrus, etc.

The cultivation of all the above-mentioned crops require the fulfilment of the basic needs that farmers have such as seeds, agricultural equipment and implements (i.e. rakes, trowels, shovels, spades, forks, hoes, hand forks, wheelbarrows, watering cans,

	Wheat		Rice		Cotton		Sugarcane		Maize	
Administrative unit	Area	(%)	Area	(%)	Area	(%)	Area	(%)	Area	(%)
Pakistan	**28.23**	**100**	**9.36**	**100**	**9.23**	**100**	2.63	**100**	**2.39**	**100**
Khyber Pakhtunkhwa	3.24	**11**	0.18	2	0.02	*	0.41	16	1.64	68
Punjab	18.68	66	6.26	67	6.63	72	1.59	60	0.64	27
Sindh	4.69	17	2.44	26	2.53	27	0.63	24	0.04	2
Balochistan	1.62	6	0.48	5	0.05	*	*	*	0.07	3

Note: Figures may not add up exactly to their respective totals because of rounding effect; *Represent less than 0.5%
Source: Agricultural Census (2010)

Table III.
Major crops by province (area in million acres)

etc.). They may also need minor transportation (i.e. motorcycle, bicycle, etc.). Therefore, Islamic banks and other financial institutions need to advance the proposed QH to farmers, so that they can meet all of their agricultural requirements related to crop or non-crop activities.

4.6 Limitations of QH

It is important to know the limitations of such QH or what amount will be given to a farmer by Islamic banks and other Islamic financial institutions as an interest-free loan. In actuality, the amount loaned by the Islamic banks to a farmer is different for different commodities. Based on the study of the agricultural sector (Saqib, 2011), and the data available at the official Web site of a specialized agricultural bank, namely, Zarai Taraqiati Bank Limited (formerly, Agricultural Development Bank of Pakistan), a scale was designed for the advancement of such loans (Table IV). This estimation is on the basis of per acre, and the values are given in Pakistani currency (Pak Rupees).

Tables IV-VI display various loan amounts that are suggested for each and every crop. The rationale is an accepted one as each, and every crop is offered in the market at a distinctive price as a variant from the other. Moreover, a larger proposed loan amount is recommended for fruit crops in the supposed model as compared to that recommended for non-fruit crops. The reason is that fruit crops are more expensive as compared to non-fruit crops in the local market of Pakistan, so the financial facility needs to be provided to the farmers accordingly.

4.7 Benefits to the Islamic banks

Conventional banks are advancing loans on the basis of interest and, thus, do not face any problems regarding the benefits they reap from such advances. However, as far as the Islamic banks are concerned, they avoid advancing such loans because of the prohibition of receiving any excess over and above the principal sum as discussed earlier. As a reminder, this excess amount is prohibited only when it is the outcome of a contractual obligation or originates from a customary practice (Zuhali, 2006). Therefore, when such excess is not the outcome of a contractual obligation, or when there is absence of any customary rule in this regard, the debtor can give some amount of his own free will as *Hibah* (gift) to the creditor as accepted under the rules of Islamic commercial law (Hazm, 2008; Kāsānī, 1996). If the farmer gives any excess over and above the principal loan by his own free will (keeping within his financial ability), it will not only help the Islamic banks to grow but will also encourage them to advance more loans to the agricultural sector in the future. However, it is the duty of the state and educated people to create such awareness for the illiterate farmers.

Major crops Name of the crop	Amount proposed (in PKR)
Wheat	8,000
Sugarcane	18,000
Paddy (rice)	8,500
Cotton	13,000

Sources: Saqib (2011); and Zarai Taraqaiti Bank Limited (Pakistan)

Table IV. Major crops with proposed loan amounts (in Pak rupees)

Minor crops Name of the crop	Amount proposed (in PKR)
Mustard Mung	4,000
Tobacco	3,000
Maize (Hybrid)	1,200
Barley	9,000
Mash	350
Lentil	6.000
Groundnut	8,000
Berceme	5,000
Soybean	6,000
Canola	5,000
Castor Oil	6,000
Bajra	4,000
Jawar	5,000
Gram	4,000
Guara	3,000
Rapeseed	5,000
Sunflower	9,000
Potato	15,200
Janter	4,000
Tomato	1,600
Maize (Local)	4,500

Sources: Saqib (2011); and Zarai Taraqaiti Bank Limited (Pakistan)

Table V.
Minor crops with proposed loan amounts (in Pak rupees)

A second benefit to the Islamic banks, as a result of advancing QH to the local farmers, is that it will encourage participation with the banks by way of other modes of financing. They may opt for other trade-based modes of financing where the Islamic bank operates as a trader and supplies the desired goods to the customer after making the required purchases, either directly or through an agent just like *Murābaha*, *Musaw̄amha*, *Salam* and *Istisnā'* (i.e. rental-based modes of financing where the bank makes the relevant purchases and passes them on to the client on a rental basis as in *Ijārah* or other participatory modes of financing in which the bank and farmer participate in profit and loss like *Mushārakah*, *Diminishing Mushārakah*, *Mudarābha*, *Musāsqat* or *Muzāraat*). Such transactions could be a real benefit from the perspective of future bank loans.

The third benefit for the Islamic banks from advancement of such loans will be found in the form of the healthy publicity it receives in the agricultural sector and, consequently, the attention that passes to its other business activities.

The fourth benefit, which may be the most important for the Islamic banks and other Islamic financial institutions, is that they can procure a service charge on these loans. These service charges, according to some scholars, can be determined by the Islamic banks, keeping in mind the rate of interest charged by the conventional banks. This rule is not in contradiction with the rules of Shari'ah. Usmani (2008), without disputing the logic, argued against computing the profit of a *Halal̄* (permitted) product by using the rate of interest as a yardstick. He emphasized that subject to the intense prohibition of interest, having it resemble an Islamic return, should be cautiously avoided.

Fruit crops Name of the fruit	Amount proposed (in PKR)
Olive oil	14,000
Loquat	19,000
Plum	1,600
Zizi	25,000
Papaya	21,000
Apricot	24,000
Peach	36,000
Citrus	4,000
Dates	24,000
Strawberry	24,000
Tea	53,000
Guava	15,000
Musk melon	12,000
Pear	1,500
Coconut	19,000
Lichi	24,000
Apple	31,000
Mango	29,000
Pomegranate	24,000
Banana	36,000
Walnut	23,000
Cherry	24,000
Palm	15,000
Persimmon	14,000
Almond	19,000
Melon	13,000
Watermelon	12,000

Sources: Saqib (2011); and Zarai Taraqaiti Bank Limited (Pakistan)

Table VI. Fruit crops with proposed loan amount (in Pak rupees)

However, it must be noted that when *Shari'ah* requirements for the QH are fulfilled, then simply applying the interest rate as a benchmark to determine service charges in no way renders the transaction invalid, *Halal̄* (permitted) or *Haram̄* (prohibited) because such commercial transactions in and of itself do not include any element of interest (Usmani, 2008).

The above-mentioned description confirms that the Islamic banks can take service charges on the advancement of loans according to the rate of interest charged by the conventional banks on loans. In the researchers' point of view, service charges of the financial institutions should be less than the interest charged by the conventional banks on the advancement of loans (in cases where these institutions are compelled to take service charges owing to liquidity or other concerns); otherwise, there would be no benefit from the proposed usage of QH. Such charges should be limited to administrative costs incurred by the Islamic bank on transactions. There is no objection from the perspective of *Shari'ah* if such charges are not stipulated in the contract, nor allowed by the prevailing customs, nor related to the principal amount and not even related to time. Farooq (2010) limits the permissibility of such charges if they are related to the original administrative cost. Figure 2 displays the benefits that can be realized for Islamic financial institutions as a result of executing QH.

4.8 Recovery of QH

The most important aspect in the case of advancing QH is its subsequent recovery. Incidents of default and litigation, posing serious handling problems for the bank, can be a real concern.

As far as conventional banks are concerned, they have the flexibility to reschedule the loans as well as charge the penal interest in the event of delayed repayment. Similarly, conventional banks do not provide loans without covering the risk of default with collateral of a suitable value. However, in the case of Islamic banks, delay in the repayment of loans by farmers can create serious problems, as rescheduling of loans is prohibited by *Shari'ah*. It is pertinent to mention that if rescheduling is without any increase over and above the principle amount of QH, then it is not unacceptable to the injunction of *Shari'ah*, rather it advises the creditor to ease up on the debtor until a time when the debtor is in a position to make a payment. If the debtor is unable to repay the

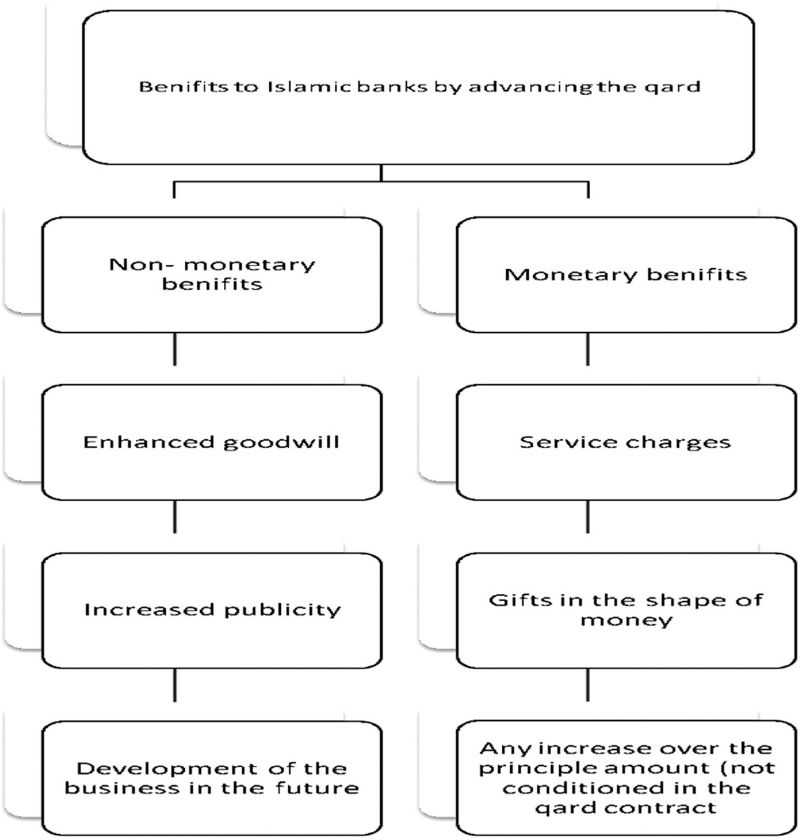


Figure 2.
Benefits of QH for Islamic financial institutions

amount at the given time, in special cases, it is advised that the amount may be remitted as a charity. As referenced earlier, the Qurān says:

> And if any debtor be in straitened circumstances, then grant him respite till a time of ease. And that you remit it as charity, shall be better for you, if only you knew (Al Qurān, 2:281).

Of course, there is the danger that this restriction may be misused by dishonest farmers, knowing that they are not legally bound to pay the additional amount to the principle loan. Usmani (2008, p. 131) indicates the same when he discusses the case of *Murābaha*:

> Another problem in Murābaha […] But in Murābaha once the price is fixed, it cannot be increased. This restriction is sometimes exploited by dishonest clients who deliberately avoid paying the price at its due date, because they know that they will not have to pay any additional amount on account of default.

Hence, it is clear that a very strict procedure should be followed for the recovery of QH. In this regard, a guideline is provided by Islamic commercial law. According to a Hadith of the Holy Prophet (PBUH) "The well-off person who delays the payment of his debt, subjects himself to punishment and disgrace" (Asqalañi, 2001). The Holy Prophet (PBUH) continues, "The intentional non-payer of debt is tantamount to transgression" (Asqalani, 2001). An extra emphasis has been given by the Holy Prophet (PBUH) on the repayment of QH:

> If I had a gold equal to the mountain of Uhud, it would not please me that it should remain with me for more than three days, except an amount which I would keep for repaying debts (Khan, Hadith 574).

While following the essence of all these sayings of the Holy Prophet (PBUH), if a farmer does not repay the debt intentionally, he may be subjected to punishment. However, due care needs to be taken that those farmers who are really unable to repay the debt may not be punished and disgraced (black-listed owing to the default). It is the duty of the Islamic state to help out the Islamic financial institutions in this regard by creating an affective legal system that includes affective legislation and a judicial system. The role of The Central Banks (State Bank in the case of Pakistan) is very vital in this relationship.

It is also worth mentioning that the procedure for the recovery of a debt prescribed by the Auditing Organization for Islamic Financial Institutions must be followed for the recovery of a loan because a loan comes under the preview of debt, as it is also a financial liability. According to an established principle of Islamic commercial law, non-payment of a loan by the loanee, who is capable of paying, is strictly prohibited. A farmer who is a real believer of the faith must keep this fact in mind and pay the loan on time. The Holy Prophet (PBUH) said, "The best among you, who repays the debt in the best way" (Shawkani, 2001). In another tradition narrated by Abu Hurirah (may Allah be pleased with him), the Holy Prophet (PBUH) said, "The best among the people is he who repays his debts in the most handsome manner" (Khan, Hadith, 577).

Islamic commercial law allows the creditor to demand security from the debtor. The permissibility is based on the Hadith narrated by Hazrat Ayesha (may Allah be pleased with her) that the Holy Prophet (PBUH) bought some food on credit from a Jew (who was a seller) and pledged an iron armour to him (Khan, Hadith, 571). Therefore, the Islamic bank or financial institution can ask a farmer to pledge or mortgage his property, moveable or immovable as security, which, in the case of default, can be sold for the liquidation of the debt. According to an established principle of *Shari'ah*, the institution can also ask the debtor for a guarantor. In this case, it is entitled to demand payment from either the debtor or guarantor.

The time for repayment of such loans may also be of concern to those involved. As mentioned earlier, advancing a loan on the basis of QH is a short-term financing source provided to a farmer to fulfil basic agricultural input needs such as seeds, fertilizers, insecticides, pesticides, etc. The repayment period is different according to the nature of the loan, as Table VII clarifies. The Zarai Taraqiati Bank Ltd of Pakistan has enacted nearly the same scheme for advancing loans to farmers.

As Table VII illustrates, the short-term QH is provided to the farmer to purchase basic agricultural inputs and will be recovered in the shortest possible time with the utmost limit of 14 months. However, in case of a natural disaster like an earthquake, flood, hailstorm, drought, etc., relaxation will be given until the time of easement, as recommended by Islamic commercial law. The medium-term QH and long-term QH should be provided to farmers for the purpose of purchasing basic agricultural machinery and other modern agricultural technological equipment. Both of these types of QH should be recovered within a maximum span of six and nine years, respectively, because both include large loans. Moreover, the short-term QH is more preferable for lower-class farmers, while the second and third types of QH are recommended for the middle- and upper-middle-class farmers.

5. Practical implications of QH on Islamic financial institutions

The Islamic banks or Islamic financial institutions may not be content with the proposed idea of QH for many reasons. Therefore, QH as a financing mode may lead to several implications. First, Islamic commercial law clearly prohibits the creditor from receiving any interest payment in excess of the principal amount of the advanced loan (*Al Qurān*, 2:278-279; *Al Qurān*, 30:39; Hazm, 1988), and taking a gift from a debtor is also not allowed (Hazm, 1988; Shawkani, 2001). These requirements inhibit the attraction of financial institutions toward QH. However, a solution to this issue is offered earlier, noting that Islamic commercial law does not prohibit an excess over the principal amount if it is neither stipulated in the transaction nor prevalent in the local custom (Zuhali, 2006). It is essential that proper awareness is created in the citizens of the Islamic state regarding the true concept of Ribā.

Second, under QH, the creditor is not allowed to fix a specific time frame for loan recovery. The *Hanafī* school of thought holds this view (Hazm, 1988). As a vast majority

Types of loans	Recovery period
Short-term *QH* (good loan)	Crop production working capital *QH* recoverable in lump sum commencing after the harvest/marketing of respective crops and within maximum period of 14 months
Medium-term *QH* (good loan)	Dairy farming and livestock, etc., in yearly/half yearly/monthly installments and within maximum period of six years
Long-term *QH* (good loan)	Tractor, agricultural machinery, poultry farming, orchards, etc., in yearly/half yearly instalments within maximum period of nine years

Sources: Saqib (2011); and Zarai Taraqaiti Bank Limited (Pakistan)

Table VII.
Loan recovery periods

of Pakistanis follow the *Hanafī* school of thought, the same concept is applied for QH, which contradicts the practice of Islamic financial institutions, as they are averse to losing their liquidity for an unknown time frame. However, this issue is misunderstood by contemporary Islamic financial institutions. If the Islamic commercial law does not allow the creditor to specify time for the recovery of the loan, then it does not mean that the debtor will return the loan as per his own wishes. Instead, the debtor is under legal obligation to return the amount whenever demanded by the creditor. Here, the Islamic bank is advised to send a notice to the farmer after a reasonable time for recovery of the loan. Such notice will be considered binding in nature. The Islamic state is under obligation to amend the existing recovery laws in this regard.

Another reason the Islamic financial institutions are not interested in encouraging QH relates to the investment risks they associate with the agriculture sector such as the incidence of droughts, floods, hail, mud slides, earthquakes and a variety of other calamities (Gulaid, 1995). However, this reservation is against the basic philosophy of the Islamic financial system, according to which, a person is entitled to profit on the basis of a liability for loss. However, as there is no trade activity that is without risk, this objection has little basis for support. The risk involved in agriculture can also be covered under the Islamic insurance strategies. There is a dire need to change the mentality of the customers of Islamic banks regarding the Islamic economic system, in which there is always a potential risk for loss (Usmani, 2008).

Islamic banks are also not ready to invest in the agricultural sector through QH. This could be due to the old cultivation and harvesting methods which continue to exist in the rural areas, providing low yield per acre (Ali, 2010). This situation creates a possibility whereby famers may not be in a position to pay off their loan when it becomes due by the end of the harvesting cycle. Other reasons that may be cited for financial institution's lack of interest in offering QH loans include property rights, ownership transfer procedures, non-transparent costly and public registries, high transaction costs, legal enforcement problems, political instability, inadequate laws and law and order situations. The support of government, which has the responsibility to introduce new technologies to the agricultural sector, should be able to answer these concerns by providing subsidies on the agricultural machineries provided to deserving farmers and by providing proper legislation to deal with the other issues.

Islamic banks or other financial institutions in Pakistan are very concerned about the liquidity that can be provided for the advancement of QH. The shareholders are not ready to spend their liquidity without any return. This also contradicts the main philosophy of business improvement, increase of share value and profit maximization. However, this issue can also be worked out through the introduction of other sources for the provision of interest-free loans without affecting shareholders' liquidity except in rare cases. These sources include charitable funds (Usmani, 2008) provided by the government for agriculture including donation and Zakat of various institutions, and funds provided by Baitul Mal, penalty funds.

Islamic financial institutions are allowed to secure service charges from the farmers while advancing QH. However, this provision may be misused if the same charges are required as those set by the conventional banks in the form of interest. If that is the case, then there would be no benefit of advancing QH. Farooq (2010) limits the permissibility of such charges if they are related to the original administrative cost.

When applying the proposed model of QH, it is quite possible that the transaction’s true purpose may be fashioned in a way that big landlords could also approach the Islamic banks for securing loans on a QH basis. Although the banks may feel that such loans are more secure, specific stipulations must be crafted to restrict access to QH by wealthy or well-off farmers. QH will be used only for the benefit of deserving farmers (i.e. the lower-class farmers).

6. Practical implications of QH on society

The projected plan to employ QH has much potential if it can be efficiently applied to facilitate financial assistance for the poor sectors of the society. However, the anticipated objectives can only be achieved if this mode of Islamic finance is applied by the Islamic banks and other Islamic financial institutions in accordance with the rules and regulations approved by the Holy *Quran*, Hadith of the Holy Prophet (PBUH) and classical well-known Muslim jurists. The contract should be applied in its real and true spirit; otherwise, it will become extremely difficult to support poor farmers in their crop and non-crop activities. In the case of exploitation by the Islamic banks and other Islamic financial institutions, the proposed model will put unnecessary financial burden on these farmers and will shift their financial rank from bad to worse. The following are the various implications of the QH model on farmers of lower class:

- The majority of the farmers belong to the lower class and are not in a position to buy basic agricultural products. By applying the proposed QH model, the farmers can fulfil their financial requirements, both for crop and non-crop activities, without resorting to formal and informal sources which provide loans mostly on interest basis.
- Financing small farmers through QH could allow them to send their children, who are mostly deprived of an education due to the lack of financial resources, to school. Advancing QH can, therefore, have direct linkages with the development of the literacy rate.
- By applying the proposed model, farmers will have an opportunity to learn how to deal with financial institutions. This will encourage them to utilize the bank for other purposes (i.e. for account opening or doing business with the bank on *Murābah*, *Musawāmah*, *Salam*, *Istisnā’*, *Mushārakah* and *Ijārah* basis, etc.). Such transactions will create more business awareness with the farmers and will pave a way for further improvements of the agricultural sector as a whole. They will, in the process, learn a lot about the good quality of seeds, new methods of cultivation, use of modern machinery, new methods of irrigation, etc., due to their ability to financially procure such items.
- The farmers, predominantly those who are living in rural areas of the country, normally secure loans from financial institutions on interest basis. On the other hand, QH is provided on an untainted cooperative basis and the financial institutions anticipating minimum profit. This fact generates synchronization and harmonization among various classes of the society. The lower class senses that they are provided due care by the more affluent who help them financially at their time of need. The philosophy of reciprocity creates an exemplary and commendable environment among the blessed and the deprived ones in terms of wealth.

- The proposed model of QH is not only beneficial for the development of the agriculture sector (particularly local farming) but can be equally applied to live stock, dairy farming, poultry farming, horticulture, fish farming and other sub-sectors of agriculture. However, the provision of QH in all these sectors should be restricted when such agribusiness is commenced by the lower middle and poor class of farmers, based on the inherent philosophy of the transaction where the wealth should flow from the rich class toward the lower class and not from the rich to the richer.
- The application of the proposed model of QH can also be developed to help out poor sectors of the society in Pakistan in various other aspects of life. In Iran, QH has been applied to help out the poor in their marriages, home repairs, residential rents and mortgages, education, small industries, hospital and illness expenses, agriculture and business working capital (Askari *et al.*, 2009). The same utilization can also be tested in Pakistan with only a small amount of adaptation.

7. Conclusion

The Islamic financial system comprises financing on two dimensions – one for charitable purposes called QH and the other for trade that includes *Murābaha*, *Musawamha*, *Salam*, *Istisnā'*, *Musharakha* and *Ijāraha*. However, a look at the financial statements of Islamic banks and financial institutions reveal that they follow the trade modes of Islamic finance while completely ignoring QH.

There are many reasons why Islamic banks and other Islamic financial institutions (particularly those existing in Pakistan) do not offer QH to the needy sectors of the society. First, these institutions are based on the philosophy of maximization of profits and do not associate QH with profit earning. Second, the poor class of the society seeks QH, and the financial institutions remain weary in dealing with this class because of their various issues such as illiteracy, meagre economic conditions (inability to provide securities or collaterals) which may lead to default in repayment, lack of accessibility (most of this class live in rural parts of the country) and political instability in the rural areas.

The situation becomes all the more daunting in the case of the agricultural sector in Pakistan particularly that of rural areas of the country where such problems become more prevalent. Natural catastrophes like earthquakes, mudslides and floods are the most ominous. The dreadful and awful earthquake in 2005 and the frightful floods of 2003, 2007, 2010 and 2011 can be cited as the recent examples. The financial institutions, therefore, are justifiably wary about the viability of their agribusiness in such areas. They cannot open their local branches in the rural areas due to the serious law and order situations which lead to the increase in transactional cost and corresponding high interest rates. QH is a new concept suited for these circumstances and, therefore, needs to be deeply embedded into the contemporary Islamic financial system.

As discussed, QH can be effectively applied to the agricultural sector both for crop and non-crop activities and have benefits for the farmers and the financial institutions. It will help the farmers, most of them belonging to the lower class, by improving their living standards. This way, the financial institutions, being juristic personalities, will fulfil their obligation to the society where most are related directly or indirectly to farming. These financial institutions can also receive unstipulated excess over the principle amount, gain publicity which will pave the way for improvement of their future business particularly in rural areas, acquire service charges (proposed to be less than the interest charged by the conventional financial institutions) and make a profit in the case of advancement of consumable commodities on QH from the resale of such commodities. However, they should not always concentrate on direct profit but should expect indirect and future benefits. They can secure their principal amount by getting collaterals in the shape of mortgage and pledge of properties, being backed by a strong legislative and judicial system, and through affective policies that decrease the fear and propensity of default. To foster smooth implementation of the proposed QH model, it is the duty of the state to legislate tough recovery laws, black list habitual non-payers and compensate Islamic financial institutions in case of non-repayment of loans in the wake of low yields due to natural mishaps such as earthquakes, mudslides, hail storms, floods, etc.

The case of QH as a potential mode of agricultural financing is largely viable for the Islamic banks and other Islamic financial institutions. Looking at the economic situation in the country, it is high time to convince these institutions about the tremendous utility of this mode of financing. A very strong theoretical base will be required to influence and propel these institutions in the right direction. This paper was, therefore, presented solely to provide insights into the theoretical and conceptual framework regarding QH. The findings need to be further substantiated with empirical evidence. A future study, based on reliable empirical data, would certainly add value to this vital subject.

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