

Prohibition of Gharar in Islam

There are numerous Hadiths forbidding Gharar sales, and specific instances thereof. One commonly cited Hadith was narrated by Muslim Ahmad, Abu Dawud, AlTirmidh, Al-Nasa'i, Al-Darami and 'Ibn Majah on the authority of 'Abu Hurayra (mAbpwh) (translation of the version in Muslim) that

The Prophet (pbuh) prohibited the pebble sale and the Gharar sale.

A good translation of Gharar is "risk" or "uncertainty". It could also be defined as:

Gharar is the sale of probable items whose existence or characteristics are not certain, due to the risky nature which makes the trade similar to gambling.

Many classical examples of Gharar were provided explicitly in the Hadith. They include the sale of fish in the sea, birds in the sky, an unborn calf in its mother's womb, a runaway animal, the semen and unfertilized eggs of camels, un-ripened fruits on the tree, etc. All such cases involve the sale of an item which may or may not exist. In such circumstances, to mention but a few, the fish in the sea may never be caught, the calf may be still-born, and the fruits may never ripen. In all such cases, it is in the best interest of the trading parties to be very specific about what is being sold and for what price.

For instance, Ahmad and Ibn Majah narrated on the authority of Abu-Said AlKhudriy (mAbpwh):

The Prophet (pbuh) has forbidden the purchase of the unborn animal in its mother's womb, the sale of the milk in the udder without measurement, the purchase of spoils of war prior to their distribution, the purchase of charities prior to their receipt, and the purchase of the catch of a diver.

The last prohibition in this Hadith pertains to a person paying a fixed price for whatever a diver may catch on his next dive. In this case, he does not know what he is paying for. On the other hand, paying a fixed price to hire the diver for a fixed period of time (where whatever he catches belongs to the buyer) is permitted. In this case the object of sale (the diver's labor for say one hour) is well defined. In many cases, Gharar can be eliminated from contracts by carefully stating the object of sale and the price to eliminate unnecessary ambiguities.

In contemporary financial transactions, the two areas where Gharar most profoundly affects common practice are insurance and financial derivatives. Jurists often argue against the financial insurance contract, where premia are paid regularly to the insurance company, and the insured receives compensation for any insured losses in the event of a loss. In this case, the jurists argue that the insured may collect a large sum of money after paying only one monthly premium. On the other hand, the insured may also make many monthly payments without ever collecting any money from the insurance company. Since "insurance" or "security" itself cannot be considered an object of sale (cf Al-Zuh. ayli (1997, vol.5, pp.3415-3420) for more details), this contract is rendered invalid because of the forbidden Gharar. Of course, conventional insurance also suffers from prohibition due to Ribā since insurance companies tend to invest significant portions of their funds in government bonds which earn them Ribā.

The other set of relevant contracts which are rendered invalid because of Gharar are forwards, futures, options, and other derivative securities. Forwards and futures involve Gharar since the object of the sale may not exist at the time the trade is to be executed. As we are going to see, Islamic Law permits certain exceptions to this rule through the contracts of salam and istisna. However, the conditions of those contracts make it very clear that contemporary forwards and futures are not permitted under Islamic law. Classical jurists called such contracts where both the price and the goods were to be delivered at a future date al-bay al-mud e.g.

"I sell you this car for so-much at the beginning of the next month", and considered them non-concluded and thus invalid. Contemporary options were also discussed by traditional jurists, e.g. "I sell you my house for so-much if my father returns", and called it a suspended conditional sale (al-bay' al-mu'allaq). They have also rendered such sales invalid due to Gharar (c.f. Al-Gharar wa Atharuhu fi AlUqud by Siddiq AlAmin (pp.137-149) for a full discussion).