FINANCIAL RISKS IN (GHARAR) AND (RIBA) TRANSACTIONS

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Abstract
This study critically examines the impact of financial risks arising from excessive gharar (uncertainty) and riba (usury) in financial transactions, emphasizing the distinction between permissible and prohibited risk under Islamic law. Through a comprehensive literature review of classical jurisprudence and contemporary Islamic finance scholarship, the study analyzes the destructive consequences of riba, the regulatory boundaries of gharar, and their implications for financial stability and economic development. Furthermore, the paper explores the dual nature of inflationary finance, which combines the risks of gharar and riba, demonstrating its incompatibility with Shariah principles. The findings underscore the importance of promoting justice, fairness, and transparency in financial practices while managing risks within acceptable ethical and legal frameworks.

Keywords: Gharar, Minor Gharar, Obscene Gharar, Usury, Acceptable risk, Forbidden risk, Negative risk, Positive risk, inflationary finance, Islamic economics.

1. Introduction

Risks represent the greatest concern present in all financial transactions, and they are mostly a direct cause of economic and financial fluctuations that continue to increase despite the ongoing efforts and attempts made by financial and economic leaders to find formulas, contracts, behaviors, and mechanisms that work to reduce these risks. This is literally what financial engineering does in both its conventional and Islamic forms.

Islamic banks and financial institutions have played a prominent and important role in innovating methods and tools that work to minimize and confine these risks to the minimum. Several studies have been conducted, and seminars and workshops have been held on risks, whether at the level of theorization or application.

It is well known that economic activity, indeed all life, cannot be separated from exposure to risks. Risks are like hardship and corruption; just as there is no work free from hardship and corruption, there is no human work free from risk. However, risks in transactions and trades, if within reasonable limits, perform an apparent function in directing incentives and increasing productive efficiency. But if they exceed reasonable limits, they threaten the stability of markets and the wealth of the nation (Dr. Saleh bin Humaid, p. 1).

The concept of risk (mukhatara) in Islamic finance is deeply rooted in the classical notion of gharar, which denotes uncertainty or hazard in financial and commercial transactions. Linguistically, gharar refers to “exposing one’s wealth or life to harm without full knowledge of the outcome” (Ibn Manzur, n.d.). In Islamic law, transactions involving excessive uncertainty are prohibited, as they create conditions for injustice, exploitation, or conflict. The Prophet Muhammad (peace be upon him) explicitly forbade transactions such as selling fish in water or birds in the air, where the exact outcome was unknown.

Classical jurisprudence defines gharar as contracts or sales that appear beneficial outwardly but conceal uncertain or unknown elements that may harm one party. Examples include:

- Selling fruits before ripening.
- Selling runaway or escaped livestock.
- Complex contractual arrangements whose outcomes cannot be guaranteed.

Scholars have debated the distinction between gharar and general risk (khatar). While some schools of thought, such as the Hanbali, equate gharar with general risk-taking, others (Hanafi, Maliki, Shafi'i) define it more narrowly as transactions where the outcome is unknown or unknowable (Al-Zuhaili, 1985). Contemporary scholarship generally interprets gharar as a combination of uncertainty and potential for unfair gain, emphasizing the ethical and legal dimensions of risk in economic activity (Al-Tariqi, 1415 AH).

From a financial perspective, risk can be categorized into two main types:
- Positive risk – Voluntary uncertainty assumed by one party for potential gain. Examples include insurance contracts, trade-based investment, and certain derivative transactions. Positive risk aligns with entrepreneurial activity and is permissible under Shariah when structured transparently and fairly.
- Negative risk – Involuntary risk imposed on a party, often associated with riba (usury). In such cases, one party receives a guaranteed return irrespective of outcomes, transferring potential loss entirely to the other party. This form of risk is strictly prohibited in Islam due to its exploitative nature (Al-Sanhuri, n.d.; Dunya, n.d.).

This study examines three interrelated aspects of financial risk in Islamic finance:
1. The conceptual framework of gharar and its relationship to positive risk.
2. The Shariah perspective on acceptable versus prohibited risk.
3. The characteristics of riba and its connection to negative risk in financial transactions.

By analyzing these dimensions, the study aims to clarify how excessive uncertainty and exploitative financial practices can threaten economic stability and social justice, and to provide insights for structuring Shariah-compliant financial instruments that balance risk and ethical responsibility.

Research Problem
Despite the centrality of risk management in modern finance, there is limited clarity in both literature and practice regarding how Islamic law differentiates between acceptable and prohibited risk, particularly in complex financial instruments such as inflationary finance, derivatives, and structured contracts. Misunderstanding or ignoring these distinctions can lead to exploitation, financial instability, and socio-economic injustice.

Research Goal
This study aims to analyze the conceptual framework of financial risk under Islamic law, emphasizing the distinction between gharar and riba, and to evaluate the impact of excessive uncertainty and exploitative practices on economic development and financial stability.

Research Questions
- How does Islamic jurisprudence define and regulate acceptable and prohibited financial risk?
- What are the characteristics of gharar-based and riba-based financial transactions, and how do they affect economic justice?
- How does inflationary or speculative finance embody dual risks, and what are the implications for Shariah-compliant financial management?

Scope of the Study
- The theoretical framework of gharar and riba as applied to financial transactions.
- The analysis of inflationary finance as an example of dual risk in economic systems.
- Literature from classical jurists, contemporary Islamic finance scholars, and economic research relevant to Shariah-compliant risk management.

The following figure 1 shows the relationship between positive risk and negative risk and the position of acceptable risk under Sharia between them.

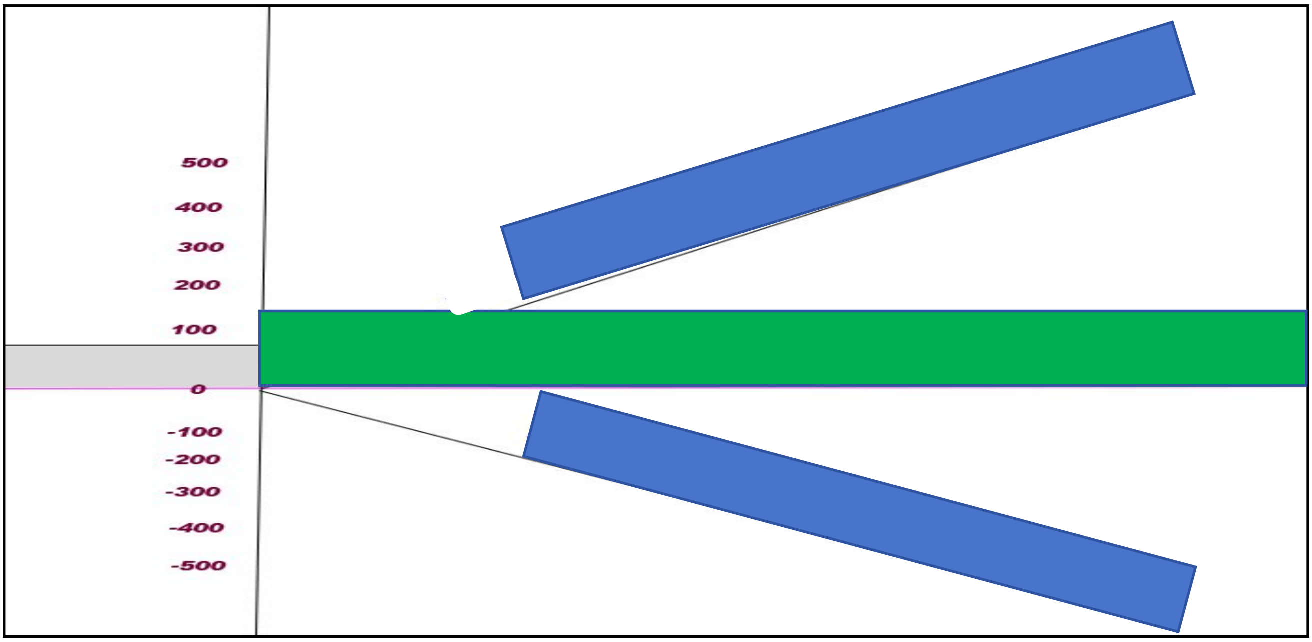

Figure 1: Positive, Negative, and acceptable risk

2. Literature Review

2.1 Conceptual Foundations of Gharar and Riba

The prohibition of gharar (excessive uncertainty) and riba (usury) is central to Islamic finance, aiming to promote fairness and justice in economic transactions. The Qur'an explicitly forbids riba:
“O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful.” (Al-Imran 3:130)

Similarly, the Sunnah provides guidance on avoiding transactions involving excessive uncertainty. The Prophet Muhammad (peace be upon him) prohibited selling goods that one does not possess or that are uncertain in nature, emphasizing the need for clarity and mutual consent in trade.

Classical Islamic jurists have extensively discussed these concepts. For instance, Al-Zuhaili (1985) defines gharar as uncertainty that leads to ambiguity in contracts, while Al-Sanhuri (n.d.) elaborates on the detrimental effects of riba on economic stability and social justice.

Contemporary scholars have built upon these foundations. Camille Paldi (2014) argues that both riba and gharar lead to social harm, including inflation, unemployment, and economic instability, and should be avoided to ensure ethical financial practices. Similarly, Ibrahim Warde (2010) discusses the moral economy of Islam, highlighting how these prohibitions aim to prevent exploitation and ensure equitable economic transactions.

In linguistic terminology, risk means deception, and it appears in Lisan al-Arab with this meaning. Deception: exposing oneself to risk, and one deceives oneself with deception, just as one adorns with adornment, and treats with treatment. It is said: sale of risk, which is prohibited, is what has an apparent aspect that deceives the buyer and an unknown interior. It is said: beware of the sale of risk; it is said: sale of risk is without guarantee or trust. Al-Azhari said: And included in the sale of risk are unknown sales that the contracting parties do not fully comprehend until they become known (Ibn Manzur, Vol. 5, p. 14).

For pure research purposes, risk can be divided into two categories: negative risk and positive risk. We do not mean by negative risk and positive risk the effects that result from the occurrence of some event in the future, meaning that these effects can be negative or positive, as stated in risk management literature, which defined risk in any project as an uncertain event or circumstance that can result in a negative or positive effect (PMBOK Guide, p. 127). Nor do we mean the meaning intended by Dr. Saleh bin Humaid with negative and positive risks, which is that positive risks are praiseworthy and negative risks are blameworthy, saying: "Risk is exposure to the possibility of destruction or damage, and it may be to life or property. It is of two types: praiseworthy, which is bearing the results of investment from profit or loss in trade, and this risk is inevitable in every trade, and this type is expressed by jurists as guarantee, and it is called positive risk. And blameworthy: which is the risk that involves exposing money to destruction and damage through one of the prohibited contracts, such as if the contract involves excessive gharar or gambling or risking the destruction of money, and this type is called negative risk" (Dr. Saleh bin Humaid, p. 1).

Dr. Saleh's words are not far from what we mean, except we see that positive risk is not all praiseworthy, for it includes minor permissible gharar and excessive prohibited gharar.

What we mean here is that negative risk is related to usury in all its types, and positive risk is related to gharar in all its forms and shapes, which is of two types: minor gharar, which is the scope where risk is acceptable, and excessive gharar, where all dispositions are prohibited. Therefore, positive risk does not mean it is acceptable under Sharia in all cases, but its acceptance is within limits, as Islamic Sharia has set a set of controls for accepting risk.

2.2 Inflationary Finance and Economic Development

Inflationary finance, characterized by the expansion of money supply to finance deficits, has been a subject of debate among economists. While some argue that it can stimulate economic growth, others caution against its potential to cause economic instability.

Inflationary finance, or financing through monetary expansion, has been widely studied in conventional economics. Deficit finance can stimulate economic growth but also poses dual risks:
- Positive risk (gharar-like): Uncertainty in contract values, future prices, and investment outcomes.
- Negative risk (riba-like): Guaranteed gains to some parties while imposing losses on others due to currency devaluation.

Economic scholars classify the impact of inflation on development into three perspectives:
- Pro-growth: Inflation motivates savings, capital accumulation, and reinvestment (Keynes, 1936; Friedman, 1968).
- Conditional stimulant: Inflation supports development but is insufficient alone (Inayah, 1981).
- Detrimental effect: Inflation may hinder real growth by eroding wealth and income (Ellis, 1961).

From an Islamic perspective, inflationary finance often embodies both gharar and riba. The uncertainty associated with inflationary policies and the guaranteed returns to certain parties (e.g., creditors) at the expense of others (e.g., debtors) align with the prohibited elements of gharar and riba. As noted by Camille Paldi (2014), such practices can lead to social harm, including inflation and economic instability, which are contrary to Islamic principles.

Inflationary finance mirrors riba and gharar by redistributing wealth unjustly and creating speculative risk. Jurists have consistently criticized monetary practices that erode value and exploit parties, emphasizing fairness and equity in financial dealings (Al-Tariqi, 1415 AH; Dunya, n.d.).

2.3 Risk Management in Islamic Finance

Effective risk management is crucial in Islamic finance to ensure compliance with Shariah principles and promote economic stability. Islamic financial institutions employ various risk-sharing mechanisms, such as mudarabah (profit-sharing) and musharakah (joint venture), to align the interests of parties and share risks equitably.

Recent studies have examined the risk management practices in Islamic finance. A bibliometric analysis by Alam (2022) explored current and future trends in risk management within the Islamic banking sector, emphasizing the need for a cohesive and flexible framework to improve risk management practices and the general stability of the sector.

2.4 Sources from Qur'an and Sunnah

The Qur'an and Sunnah provide explicit guidance on financial transactions, emphasizing fairness, transparency, and the prohibition of exploitative practices:
Qur'an:
"O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful.." (Al-Imran 3:130)
"Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity…" (Al-Baqarah 2:275)

Sunnah:
The Prophet Muhammad (peace be upon him) said: "Do not sell what you do not possess." (Sunan Ibn Majah)
He also stated: "Whoever pays for an uncertain commodity has indulged in forbidden gharar." (Al-Suyuti, n.d.)

These sources underscore the importance of clarity and mutual consent in financial dealings and the prohibition of practices that lead to exploitation or uncertainty.

2.5 Contemporary Research and Applications

Recent research has further explored the implications of gharar and riba in modern financial practices. Camille Paldi (2014) discusses how both riba and gharar result in social harm, including inflation, unemployment, and economic instability, and should be avoided to ensure ethical financial practices.

Additionally, Ibrahim Warde (2010) examines the moral economy of Islam, highlighting how the prohibitions of riba and gharar aim to prevent exploitation and ensure equitable economic transactions.

3. Methodology

3.1 Research Design

The approach is primarily qualitative descriptive-analytical, aiming to synthesize classical jurisprudence, Qur'anic and Sunnah-based guidance, and contemporary research to clarify the concepts of gharar, riba, and their implications for financial management.

Given the conceptual nature of the research, this study does not rely on primary financial data but instead focuses on the interpretation of textual and scholarly sources. This methodology allows for a detailed examination of the ethical, legal, and economic dimensions of financial risk in Islamic finance.

3.2 Data Sources

The study draws on multiple sources to ensure comprehensive coverage:
- Primary sources: Qur'an and Sunnah, emphasizing verses and prophetic traditions related to risk, uncertainty, and usury.
- Classical jurisprudence: Works of prominent jurists, including Al-Zuhaili (1985), Al-Sanhuri (n.d.), Al-Suyuti (n.d.), and Al-Tariqi (1415 AH), which provide interpretations of gharar and riba.
- Contemporary scholarly research: Articles, books, and reports on Islamic finance, ethical risk management, and inflationary finance, including Paldi (2014), Warde (2010), Iqbal & Mirakhor (2011), Alam (2022).

3.3 Analytical Framework

The study uses a comparative-analytical framework to examine financial risk, focusing on three dimensions:
- Conceptual Analysis: Defining and differentiating gharar and riba, including minor vs excessive gharar.
- Ethical Evaluation: Assessing financial practices against Shariah objectives (maqasid al-shariah), including justice, fairness, and protection of wealth.
- Application to Financial Instruments: Evaluating modern financial mechanisms, such as inflationary finance, profit-loss sharing arrangements, and Shariah-compliant derivatives, to assess their alignment with ethical risk principles.

3.4 Scope and Limitations

Scope: Focuses on risk assessment in transactions prohibited by Shariah (excessive gharar, riba). Evaluates both classical and contemporary perspectives to inform ethical financial management.

Limitations: The study is primarily qualitative; quantitative risk measurement is beyond its scope. Analysis is limited to the literature and textual sources; empirical data from financial markets are not incorporated.

3.5 Methodological Rationale

This approach is suitable because Islamic finance principles are normative and ethical, requiring interpretation. It ensures:
- Clarifies the conceptual boundaries of permissible and prohibited risk.
- Links classical principles to modern financial practices.
- Provides a framework for structuring Shariah-compliant financial instruments that balance risk and ethical responsibility.

4. Discussion / Analysis

Financial risk in Islamic finance is governed by ethical and legal principles derived from the Qur'an, Sunnah, and classical jurisprudence. While risk-taking is inherent in business and investment, Islam differentiates between permissible risk, which is equitable and transparent, and prohibited risk, which involves exploitation or excessive uncertainty. This section highlights the role of gharar (uncertainty) and riba (usury) in shaping financial risk, illustrates the dual risk associated with inflationary finance, and discusses modern Shariah-compliant instruments that facilitate productive, ethical risk-taking.

4.1 Positive Risk: Gharar and Its Impact on Financial Transactions

What is meant by positive risk is that risk borne by the first party (the more worthy and capable), as in insurance contracts and financial derivatives, and therefore it mostly relates to gharar. As for negative risk, it is the risk borne by the second party (the less worthy and capable) due to need and compulsion, as in usury transactions.

Therefore, the difference between usury and gharar lies in the relationship of risk to ownership, where usury separates ownership from risk, while gharar separates risk from ownership.

The concept of gharar in Islamic Sharia refers to everything with an unknown outcome in buying and selling. Ancient jurists from the Malikis, Shafi'is, and Hanbalis defined it with many varying definitions, all revolving around three basic pillars:

First: That gharar is based on ignorance of the sold item, as in the definition of al-Sarakhsi and al-Zayla'i from the Hanafis, and al-Shadhili from the Malikis, and it is the view of the Zahiris.

Second: That gharar is based on doubt, and this is the definition of al-Kasani and Ibn Abidin from the Hanafis, and Ibn Arafa from the Malikis.

Third: That gharar is what is unknown or hidden in outcome, most jurists hold this (Daradkeh, p. 78).

One of the definitions of gharar is that it fluctuates between two matters, the predominant of which is the more feared, and the more feared is the dominant. Gharar affects many emerging transactions due to its inclusion, including: options contracts, futures, and commercial insurance contracts. Islamic Sharia has prohibited excessive gharar to achieve the interest of the nation and to fulfill the objectives of Islamic Sharia through preserving economic balance according to the principle of gain and loss (Abbada and Rababah, p. 2).

Scholars divided gharar into three categories: minor gharar, major gharar, and medium gharar, differing on whether to attach it to minor or major (Daradkeh, p. 97).

With these three levels, it represents positive risk that includes acceptable risk (minor gharar), excessive gharar, and medium gharar, which is a level between the two levels.

To distinguish between prohibited gharar and forgiven gharar in financial compensation contracts, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) issued a standard called the control of gharar invalidating financial transactions, and set four conditions for it as follows (AAOIFI, Standard 31):

1. That the gharar is in a financial compensation contract or equivalent, meaning excluding gharar that enters into donation contracts such as gift and will.

2. That the gharar is abundant, excluding minor and medium gharar.
3. That the gharar is in the contracted item originally.
4. That no legitimate need calls for the contract containing gharar.

Prohibited gharar has many forms, including what is unknown in outcome, such as selling a bird in the air or fish in the water, and what is related to the ability to deliver, such as the escaped camel and the runaway horse. Excepted from its prohibited forms is what enters the sold item as a follower, such that if isolated, its sale would not be valid, like selling the foundation of a building as a follower to the building, and the milk in the udder as a follower to the animal. Or what is customarily tolerated, either for its insignificance, or for the hardship in distinguishing or specifying it, and the amount of used water, and drinking from secured water, and the padded robe with cotton, which is known among jurists as minor forgiven gharar (Atiya, p. 2).

The Prophet, peace be upon him, prohibited the sale of gharar by name, as in the hadith of Abu Hurairah that he said: The Messenger of Allah, peace be upon him, prohibited the sale of pebbles and the sale of gharar (Sahih Muslim, Hadith 1513). He also prohibited sales that involve gharar, such as the sale of touch and throw, and the pregnancy of the pregnant, and the fetus in the womb, and fruits before their ripeness appears, and so on from forms that involve gharar and invalidate them due to ignorance of the result that the buyer expects and finds otherwise or perhaps does not find at all.

Islam is the religion of truth, justice, and mercy, so it did not leave any door leading to injustice or ignorance open without closing it. Allah Almighty prohibited all types of injustice in numerous Quranic verses, totaling about 300 verses, and the Prophet, peace be upon him, prohibited injustice in many places, as he prohibited transgression and transgression, and eating people's money unjustly, and other things that enter either into the category of usury or gharar.

Scholars say that the origins of prohibited exchanges do not depart from these two categories, as scholars have established that most of the Sharia prohibitions in voluntary transactions return to usury or gharar, and they said that usury returns to injustice and gharar returns to ignorance, and these two are the roots of deviation in human behavior, and they are combined in His saying Almighty: "Indeed, we offered the Trust to the heavens and the earth and the mountains, and they declined to bear it and feared it; but man [undertook to] bear it. Indeed, he was unjust and ignorant." (Al-Ahzab 72) (Al-Suwailem, p. 117).

Contemporary financial transactions that involve gharar are numerous, and perhaps the most important are derivatives in all their types and commercial insurance contracts.

Financial Derivatives

Financial derivatives are financial contracts whose value is linked to the value of the underlying asset. They are complex financial instruments used for various purposes on a wide scale for speculation and achieving potentially good returns, including hedging and access to additional assets or markets. They are of four main types: Option Contracts, Forward Contracts, Future Contracts, Swap Contracts.

Derivatives are zero-sum exchanges where one party's gain comes at the expense of the other party's loss, whether that party is a seller or buyer; what the loser loses goes as profit to the winner.

Al-Suwailem says: "The views of specialists from both sides almost agree that derivatives by nature are zero-sum exchanges where what one party gains is what the other loses. For example, Alan Greenspan, former Chairman of the US Federal Reserve and one of the prominent supporters of derivatives, states that derivatives are generally a zero-sum game where the loss in market value for one party is the gain for the other" (Al-Suwailem, p. 30).

Therefore, in most cases, derivatives cannot be considered real exchanges because they do not deal with the asset subject to derivation but are mostly settlements for price differences at the end of the contract, and therefore they are defined in the British Financial Services Authority as contracts for differences (CFD) (Al-Suwailem, p. 30).

Islamic Sharia has prohibited imaginary contracts based on ignorance and gharar, such as financial derivatives and hedge funds, and what they may cause of price inflation and inflation as a result of their impact on increasing money supply, as well as causing the rapid collapse of financial institutions dealing with them, due to the generality of evidences prohibiting the sale of debts, including: that the Prophet, peace be upon him, prohibited the sale of kali' by kali', which is the sale of debt by debt (Ababneh, p. 10).

With a scrutinizing look at derivative contracts in all their types, it becomes clear that the motive for them initially is quick profit based on speculating on price differences, even if the names differ; the intent and purpose is to obtain the maximum possible profit in the shortest time with the least risk. It is known that this profit is for one party without the other, and this is injustice that the tolerant Sharia rejects, and the aspect of injustice is completely depriving one party to the contract of it because the exchange - as we mentioned - is zero-sum.

It is known that all contracts recognized under Sharia and law aim to achieve mutual interests for both parties, and are almost balanced in terms of profit and loss even if one loses and the other wins. Therefore, a contract that results in the benefit of one party at the expense of the harm of the other is contrary to all recognized contracts under Sharia and law, and resembles or matches in every way only what is in the way of gambling. The motive, then, is speculating on price differences, and as for the outcome of these contracts, it is represented in the negative effects these contracts cause, which return to financial markets in general with harm and danger. To prove this assessment, we explain the negative economic effects these contracts cause in financial markets (Mahidat, p. 10).

Mahidat sees that the origin in all compensation contracts is justice, and options contracts are not so; rather, they are injustice to one of the contractors, and this injustice lies in giving one of them the opportunity to achieve profit at the expense of the other party, through what these contracts grant investors the opportunity to foresee securities prices, and then compare them with contract prices, to decide whether to execute the contract or cancel it, and whether to increase selling or buying or suffice with the contracted quantity, and the results that will follow from these maneuvers. Accordingly, it can be said that financial options contracts traded in financial markets in their current form have no real economic value in themselves, and therefore all the economic effects of financial options contracts promoted by investors are not economically valid under Sharia; rather, they are imaginary effects by which money owners are lured to pump their money into the market, to be snatched by speculators on price differences. Evidence of this is that reality has proven that 98% of these contracts are not executed, and this is another proof that these contracts have no clear economic value (Mahidat, p. 10).

Commercial Insurance

Among the contracts that involve gharar is the commercial insurance contract, which is also a zero-sum exchange. If the insurance company wins the premium paid by its client due to no accident covered by the insurance occurring during the period specified in the contract, this means that the insured has suffered a loss equal to the same profit the company obtained.

Commercial insurance is insurance in which a company agrees with its clients to compensate them for risks insured against in exchange for each paying a fixed premium, i.e., a premium whose amount is determined at the time of the contract. If the accident does not occur, the insured loses his right to the premiums, and they become the right of the insurer (Arafa, p. 4).

The company in this insurance seeks profit, so it tries to set a system where premiums exceed insurance amounts to obtain abundant profit, and the system set by the insurance company for contracting in this form is actually based on a commercial basis (Arafa, p. 4).

This type of commercial insurance is prevalent; rather, it is what the word insurance refers to when used absolutely. In this type, the insurance company is completely independent from the insured, and it is the one that contracts with them. The shareholders in these companies are the insurers, and the clients who conclude insurance contracts with this company are the insured. The interests of the two groups in their relationships differ and conflict.

Contemporary jurists have differed in classifying the commercial insurance contract; some permitted it, and some prohibited it. Those who permitted it see that it achieves interest for both parties, and there is no Sharia text prohibiting it, as it is one of the modern contracts. Those who prohibited it see it as a form of excessive gharar (Al-Sheikh, p. 281).

The decision of the International Islamic Fiqh Academy was issued in its second conference session in Jeddah from 10-16 Rabi' al-Akhir 1406 AH, corresponding to 22-28 December 1985, with three directives as follows:

First: That the commercial insurance contract with a fixed premium dealt with by commercial insurance companies is a contract with significant gharar invalidating the contract. Therefore, it is prohibited under Sharia.

Second: The alternative contract that respects the principles of Islamic dealings is the cooperative insurance contract based on donation and cooperation, and the same for reinsurance based on cooperative insurance.

Third: Calling on Islamic countries to work on establishing cooperative insurance institutions and cooperative reinsurance institutions, to liberate the Islamic economy from exploitation and from violating the system that God approves for this nation (International Islamic Fiqh Academy, Decision No. 9-9/2).

Whatever the disagreement or agreement on the justifications for the legitimacy of the commercial insurance contract, it does not depart from being a zero-sum exchange whether the insured is compensated or not. If we assume that one of the insurance company's clients insured his car and paid a premium of 3,000 Saudi Riyals to the insurance company, and did not suffer any accident throughout the contract's validity period, in this case, the insurance company has profited the entire premium amount, and the client has lost the same amount. If we assume that the client suffered an accident costing him 10,000 Riyals, and the insurance company covered it, then in this case, the client has profited 7,000, and the company lost the same amount. The following figure 2 shows that the exchange is zero-sum in both cases.

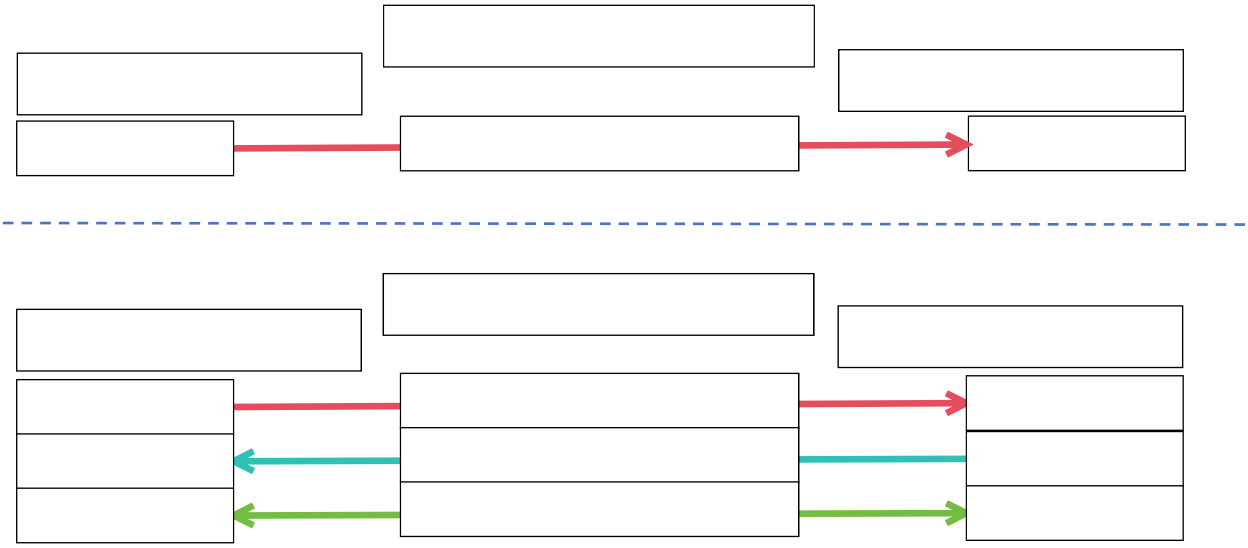

Figure 2 Insurance transactions in case of compensation and non- compensation

Someone may say: This also extends to the cooperative insurance company, and there is no difference between the two cases. But the difference actually lies in the return method that the cooperative insurance company does at the end of the year, where there is a percentage of profit for the insured, making the benefit of both parties evident, and the exchange upon return is not zero-sum. As for commercial insurance companies, all profits obtained from insurance operations are for the company only.

Gharar and positive risk: Gharar refers to uncertainty in transactions that could lead to dispute or injustice (Al-Zuhaili, 1985; Al-Tariqi, 1415 AH). Positive risk—voluntarily assumed in trade, insurance-like arrangements, or profit-loss sharing—is permissible if contracts are clear and equitable (El-Gamal, 2006; Iqbal & Mirakhor, 2011). Excessive gharar, akin to gambling (maysir), remains prohibited. Qur'anic guidance emphasizes transparency: "O you who believe, when you contract a debt for a fixed period, write it down…" (Al-Baqarah 2:282).

4.2 Acceptable Risk

Acceptable risk is the commendable part of positive risk, and as we mentioned, it represents the scope in which goods and services are offered within the framework of Islamic Sharia, and it represents the lower part of the positive risk chart, and what exceeds enters the scope of excessive gharar. As for the negative part of risk, it represents usury in all its forms and shapes, and it is all blameworthy.

From this, it becomes clear that positive risk is divided into two parts: a permissible part under Sharia, which is minor gharar, which cannot be remedied in transactions, and includes customary trade risks such as damage to goods, loss of some debts, price fluctuations, and the like, and a prohibited part, which is the upper part representing excessive gharar that the Prophet, peace be upon him, prohibited, as explained in Figure 1 above.

Accordingly, acceptable risk is trade risk, which is every risk related to buying, selling, investment, leasing, and the like, in other words, bearing the results of investment, profit or loss, or bearing the results of the commercial operation or speculation, profit or loss, which means the correlation and inseparability between gains and losses (Aweidah, p. 30).

In modern banking supervision, there is a level of risks that the financial institution can bear to achieve its strategic objectives, called the acceptable level of risks (Risk Appetite) (Kokash, p. 1).

In Islamic Sharia, there is a level of risks called acceptable risk, which jurists call forgiven gharar, and they set important conditions and controls for it, which we summarize as follows:

1. The risk that cannot be guarded against, as it follows economic activity and is included in it such that it is difficult to achieve the interest of exchange without the possibility of these risks occurring.
2. That it is minor, meaning that the probabilities of loss are few or low, and jurists have stated that prohibited gharar is what has a lower probability of safety than destruction, or what equates existence and non-existence, or as scholars said, what fluctuates between two matters, the predominant of which is the more feared.
3. That it is not intended, but emerges from the wealth-generating activity, such as loss occurring due to unexpected damage to goods or sudden drop in prices for the seller and the like (Al-Suwailem, p. 68).

Accordingly, positive risk oscillates between acceptable risk at its minimum, which is the case where the one who acquires the return bears the risk, as per the Prophet's saying, peace be upon him: "The yield is with the guarantee" (Sahih Ibn Hibban, Hadith No. 4927), meaning that whoever gains from something guarantees it, i.e., bears its risk, and prohibited risk at its maximum, which is where the more worthy party bears the loss if it occurs in all cases, as in derivatives and commercial insurance contracts.

4.3 Negative Risk: Riba and Its Impact on Financial Transactions

It has been mentioned previously that what is meant by negative risk is that the less worthy and capable party is the one who bears the risk, and this only happens in usury where the indebted borrower bears the consequences of the risk in full, and the usurer creditor enjoys all guarantees that protect him from risks.

Usury is one of the seven destructive major sins (Sahih Al-Bukhari, Hadith 2766), and it has been prohibited with definitive evidence in the Quran, Sunnah, and consensus. The prohibition of usury is not limited to Islam but is prohibited in all divine religions and laws (Nawasrah, p. 16-20).

The matter of usury may be confused for many people, as it is one of the most ambiguous chapters of jurisprudence, as Ibn Kathir said (Ibn Kathir, 1/327). Imam Al-Shatibi says: Why is this permitted in other than cash and edibles and not permitted in them? Usury is a matter of consideration whose aspect is hidden from mujtahids, and it is one of the most obscure matters whose meaning has not been clarified to this day (Al-Shatibi, 4/24). Therefore, some followers of the Prophet's hadiths, peace be upon him, may be surprised when they find that he permitted selling one sheep for two sheep hand to hand (Ittihaf Al-Khirah Al-Mahrah, p. 3/398), and a horse for mares, and a camel for camels (Ibn Hazm, Al-Muhalla, 8/478), while he did not permit selling one sa' of good dates for two sa' of poor dates (Sahih Al-Bukhari, 2302/3).

By comparing these permissible and prohibited categories, the picture becomes somewhat clear, that usury does not apply to all monies but to specific monies and not to others, which jurists called usurious monies. Jurists specified these monies from the famous hadith of the Prophet, peace be upon him, narrated by Abu Sa'id Al-Khudri, may God be pleased with him, from the Prophet, peace be upon him, that he said: Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, like for like, hand to hand. Whoever increases or asks for increase has committed usury; the taker and giver are equal in it (Sahih Muslim, Hadith 1584).

Most scholars hold that usury applies to these six categories and what takes their place in the rationale, which most scholars specified as currency for gold and silver, and measurement and weight for the other categories, with differences in details. The Malikis added linking these four categories to food, and a hadith narrated by Sa'id bin Al-Musayyib, weakened by Al-Albani, that the Prophet, peace be upon him, said: No usury except in what is measured or weighed from what is eaten or drunk (Al-Albani, Irwa' Al-Ghalil, 1343).

It requires unity of time, type, and amount (Al-Masri, p. 79).

Usury has types: loan usury and sales usury, and the first is called deferment usury, and it is also of two types: debt usury, which is the worst type of usury absolutely, called Jahiliyyah usury (compound interest usury), and loan usury (simple interest), which is the usury practiced by banks in what is known as short-term loans. As for sales usury, it is also of two types: excess usury and deferment usury, where the first relates to extending the term without increase in amount, and the second to increasing the amount without extending the term.

If wheat is exchanged for wheat, hand-to-hand and equality (term and amount) are required. If wheat is exchanged for barley, hand-to-hand without equality (term without amount) is required. If gold is exchanged for wheat or barley or dates, neither hand-to-hand nor equality is required. Therefore, scholars interpret the difference in categories in the sales usury hadith as having two meanings: difference of type from type in one usurious category like gold and silver, and like barley and dates, and difference of type from one category to type from another category like gold and barley or silver and dates. The first difference allows excess without deferment, and the second allows excess and deferment (Al-Masri, p. 81).

It is not conceivable to exchange wheat for wheat like it in amount, type, quality, and time, because that achieves no benefit for either party. Rather, the intent is that one of the types is better than the second, like exchanging Yemeni dates for Australian dates, or Sukari dates for Saq'i dates. Here, the risk is greater for the one who takes the lower quality type.

Therefore, the party with the better type tries to take two or more amounts of the lower quality type to shift the risk to the other party, and here usury enters and injustice occurs, because the exchange is not equivalent and cannot be compensated except in one of two cases: either the owner of the better type accepts the lower quality type in the same amount and at the same time without regard to quality, or mediates the two with money by selling his good type for money, then buying with the money an equivalent of the lower quality type.

This is what the Prophet, peace be upon him, said in the hadith narrated by Abu Sa'id Al-Khudri and Abu Hurairah that the Messenger of Allah, peace be upon him, appointed a man over Khaybar, and he brought them good dates, so he said: Is all the dates of Khaybar like this? He said: We take one sa' of this for two sa', and two sa' for three. He said: Do not do that; sell the mixed for dirhams, then buy with dirhams the good, and he said the same for the scale (Sahih Al-Bukhari, Hadith 2302).

Mediating money is the optimal solution, because money creates equivalence on both sides of the sale, as every commodity has a known price, and thus negative risk is eliminated, and acceptable risk remains related to the commodity's yield after purchase until sale or consumption.

This also extends to gold and silver because gold types and karats are many; there is Hijazi gold, Kuwaiti gold, Bahraini gold, and so on. And there is 24-karat gold, 21-karat, 18-karat, and so on. If the direct exchange occurs, it must be like for like, hand to hand, equal for equal, without regard to karat or country of manufacture, gold for gold as in the hadith. But mediating money is the solution, as the seller sells his 24-karat gold at its market value, then buys 18-karat gold at its market value, and here the transaction occurs with two separate contracts and acceptable risk, as follows:

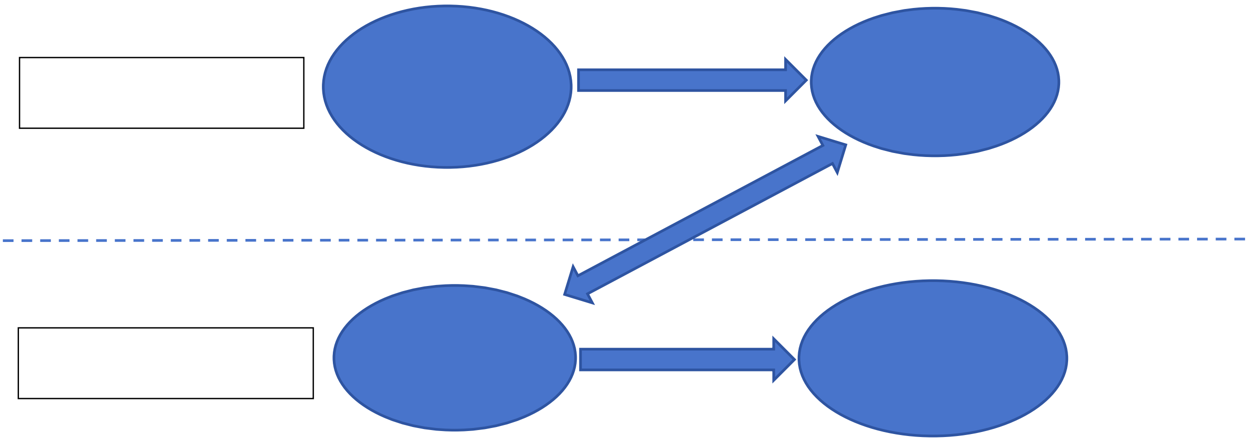

Figure 3: how to exchange gold with gold in the right way

There is no doubt that usury has a negative and destructive impact on economic activity, because it is a burden on the investor, especially deferment usury, because the lender bears nothing of the risks, but puts all he can to recover his money with interest from guarantees and study of the borrower's eligibility, knowledge of his financial solvency, ability to repay, and not procrastinating in paying dues, with requesting real estate mortgage or shares equivalent to or exceeding the required amount. As for the investor, he adds to his general commercial risks from circumstances related to study errors or management or unexpected circumstances not in his calculation from social, behavioral, economic, or other circumstances, and everything that may lead to loss or loss of some profit, he is also initially affected by the interests imposed on his loan, which are certain, while all other expected losses and even expected profits are conjectural.

If we assume that the investor borrowed one hundred thousand dollars from the bank at 10% interest rate for one year, and at the end of the year, the internal rate of return for his project (IRR) was around 15%, this means that his net profits are around 5% only, which is between 10% and 15%, expressed by triangle ACD, equivalent to only 33% of the total net present value (NPV), noting that net profits if the interest rate is zero as in the Islamic system, will be as represented by triangle ABD in the following figure 4, i.e., full 15%. This with optimism, but if the internal rate of return is 10% only, this means that all net profits will go to pay the interest, and then the net present value will be zero, and the project will be at risk, and yet there is a worse probability, which is that the internal rate of return decreases below the interest rate, and then the project will be completely losing, and if the investor insists on the project's continuation, he must pay part of the interest from his personal account, while bearing all the project's losses. Therefore, the risk here is called negative because the less capable party, the borrowing investor, bears the risk, while the lending creditor (usurer) will not be affected by the project's losses, and in all cases, he will recover his loan fully plus what was agreed between him and the other party in interests. The following figure 4 shows the relationship of net profits that the investor can obtain with the interest rate.

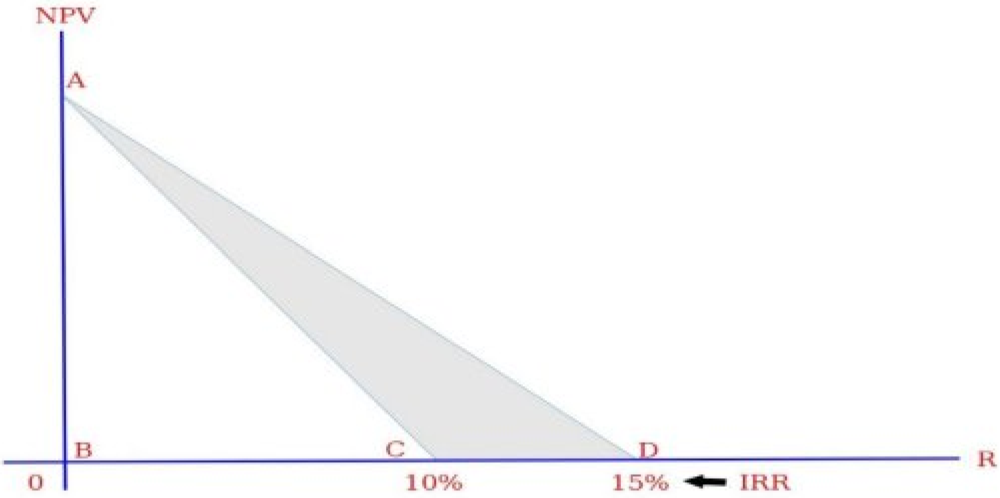

Figure 4: interest earned by riba

Therefore, Islam has provided many alternative solutions to the usury system, all based on both parties bearing potential losses according to the nature of each contract, in exchange for obtaining potential profits, such as partnership, speculation, manufacturing, salam, leasing, and other legitimate contracts.

Even contracts where the exchange is not zero-sum, i.e., exchanges that include a positive result and a zero one, such as the farming contract, for example, their permissibility in Islamic Sharia is linked to the predominance of the positive aspect over the negative aspect, where it is very permissible for both parties to benefit from the transaction, meaning the landowner and the one who cultivates it reap profits, even if their ratios differ, and the case where the farmer may incur a loss was not certain but the predominance of profit is more apparent, and the evidence for that is the unreasonableness of the farmer accepting investment in any project if the loss in it is certain.

Riba and negative risk: Riba imposes involuntary risk on the debtor and guarantees profit to the creditor, which the Qur'an explicitly forbids: "Those who devour usury will not stand on the Day of Resurrection except as one stands whom Satan has driven to madness…" (Al-Baqarah 2:275). Inflationary finance often produces riba-like effects by eroding real value and creating unjust enrichment for some parties (Paldi, 2014; Warde, 2010).

4.4 Relationship Between Inflationary Finance and Development

Economic thought has introduced deficit finance or monetary expansion to cover the gap between public expenditures and revenues, particularly in cases where states cannot rely solely on savings, taxation, or loans. This approach aims to implement planned investments by deliberately increasing prices through the expansion of the money supply or bank credit, effectively enforcing a type of compulsory saving while reallocating resources according to state priorities (Dunya, n.d., p. 571).

However, compulsory saving through monetary expansion is not guaranteed to succeed in all contexts, particularly in low-income populations. Continuous price increases may undermine individuals' ability to meet basic needs, causing economic hardship and hindering sustainable development.

Economic scholarship presents three perspectives on the relationship between inflation and growth:

Inflation as Necessary for Development
Some economists, including Inayah (1981, p. 128), argue that inflation stimulates production and economic activity. Rising prices motivate investment, facilitate capital accumulation, and increase employment and income. Supporters of this approach include Keynes, who emphasized monetary injections as necessary in both short and long terms, and monetarists such as Friedman, who stressed long-term impacts (Friedman, 1968).

Inflation as a Conditional Stimulant
A second perspective recognizes inflation's role as a growth stimulant but not as a sufficient or independent cause. Inflation operates alongside other growth factors, such as technological progress and skill acquisition, providing conditional support (Inayah, 1981, p. 129).

Inflation as Detrimental to Development
The third approach, represented by Ellis (1961), views inflation as potentially harmful. Monetary expansion facilitates economic processes but does not create them. True drivers of growth include wealth, security, technological progress, capital formation, and population growth.

Evaluation
The most realistic view is that inflation interacts with development in a context-dependent manner. It is neither strictly necessary nor universally harmful. Therefore, resorting to inflationary finance should be limited, temporary, and applied only when natural financing sources (savings, non-usurious loans, taxation) are insufficient. Excessive reliance risks undermining intended developmental gains.

4.5 Islam's Position on Inflationary Finance
4.5.1 General Prohibition
Islamic law prohibits inflationary finance because it involves unjust consumption of wealth, eroding money value without compensation. Monetary expansion depreciates currency, imposing losses on creditors, wage earners, and savers, while unjustly benefiting debtors and speculators. The Qur'an states:
"And do not consume one another's wealth unjustly…" (Al-Baqarah 2:188)

The Prophet (peace be upon him) also forbade any exploitation or deception in trade. Inflationary finance violates these principles, creating hidden taxes on the poor and distorting wealth distribution.

4.5.2 Objectives of Shariah
From the maqasid al-shariah (higher objectives of Islamic law) perspective, inflationary finance contradicts key principles:
- Protection of wealth: Inflation erodes rather than preserves financial resources.
- Fairness in exchange: Distorted market prices prevent goods and services from being exchanged at their just value.
- Elimination of exploitation: Wealth shifts unjustly from savers and wage earners to debtors and speculators.

Thus, inflationary finance undermines justice, transparency, and social balance.

4.5.3 Negative Consequences
Islamic jurisprudence recognizes several severe outcomes of inflationary finance:
- Unfair redistribution of income and wealth, favoring speculators and the wealthy.
- Unjust enrichment of debtors, as debts are repaid in devalued currency.

- Weakening of trust in money as a reliable medium of exchange and store of value.
- Encouragement of usurious practices, since lenders may seek interest to hedge against inflation (prohibited in Islam).
- Erosion of savings, discouraging investment and sustainable development.

These consequences highlight why jurists equate inflationary finance with both riba (usury) and excessive gharar (uncertainty) (Al-Zuhaili, 1985; Al-Tariqi, 1415 AH; Paldi, 2014).

Conclusion of Section 4.5: Inflationary finance is incompatible with Islamic economic principles, as it violates justice, transparency, and fairness.

4.6 Connection Between Inflationary Finance and Financial Risks

4.6.1 Risk and Gharar

Risk (mukhatara) is closely linked to gharar, defined as uncertainty in transactions that may lead to disputes. Classical examples include selling goods with unknown quantity or quality, such as birds in the air or fish in water (Ibn Manzur, n.d.; Al-Suyuti, n.d.).

In financial dealings, positive risk occurs when a party voluntarily assumes risk for potential benefit, as in insurance or derivatives contracts. Islam permits such risk when reasonable and equitable, but excessive gharar is prohibited because it transforms transactions into gambling (maysir), where outcomes are unjustly unpredictable.

4.6.2 Risk and Riba

Unlike gharar, riba imposes negative risk on one party. The creditor gains guaranteed profit, while the debtor bears the loss. In inflationary finance, wage earners, savers, and creditors experience real value erosion, while debtors and speculators benefit—analogous to riba-based exploitation. The Qur’an explicitly forbids this:
“Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity…” (Al-Baqarah 2:275)

4.6.3 Dual Risk of Inflationary Finance

Inflationary finance combines the risks of both gharar and riba:
- Gharar aspect: Uncertainty in currency value, contracts, and future obligations.
- Riba aspect: Unjust enrichment of some parties at the expense of others.

This dual risk results in:
- Market instability and distorted resource allocation.
- Increased social and economic inequality.
- Erosion of trust in financial institutions.

Islamic finance solutions—profit-loss sharing contracts (mudarabah, musharakah), takaful schemes, and ethical derivatives—allow legitimate risk-taking while avoiding excessive gharar and riba (El-Gamal, 2006; Iqbal & Mirakhor, 2011).

Conclusion of Section 4.6:
Islam does not oppose legitimate risk; it prohibits unjust risk, whether in the form of excessive uncertainty (gharar) or guaranteed profit at another’s loss (riba). Inflationary finance exemplifies prohibited dual risk, conflicting with the principles of justice and fairness in Islamic finance.

Dual Risk and Modern Applications:
Inflationary finance demonstrates dual risk: gharar in the uncertainty of value, and riba in involuntary loss. Shariah-compliant instruments such as mudarabah, musharakah, takaful, and ethical derivatives mitigate these risks, allowing equitable and productive financial activity consistent with Islamic ethical principles (El-Gamal, 2006; Iqbal & Mirakhor, 2011).

5. Conclusion

Risks are a predestined matter like calamities that afflict the believer in his body or money, and they follow any activity a person undertakes, whether private or public, and surround the human wherever he is, including traffic accidents, earthquakes, floods, fires, wars, diseases, and so on. But what is meant by risk here is commercial risks related to incurring loss in compensation contracts, so the matter differs somewhat because some trade risks follow economic activity and cannot be independent of it or separated from it, and some result from recklessness or adventure or speculating with money whether with study or without.

Islamic Sharia did not command people to expose themselves to risks; rather, Allah Almighty warned against falling into perils in His saying "And spend in the way of Allah and do not throw [yourselves] with your [own] hands into destruction [by refraining]. And do good; indeed, Allah loves the doers of good" (Al-Baqarah 195), and commanded caution, saying Almighty: "O you who have believed, take your precaution and [either] go forth in companies or go forth all together" (An-Nisa 71), which are great meanings with general indications, even if they came in specific contexts. The Prophet, peace be upon him, said: Do not wish to meet the enemy and ask Allah for well-being (Sahih Al-Bukhari, Hadith 7327). But there is a type of risks that a person cannot repel from himself, which is acceptable risk under Sharia, because it follows commercial activity, and has incentivizing benefits for production and growth and encouraging investors to diligence and necessary hedging.

Risks following economic activity are like hardship, not intended in themselves, but work is not achieved except with them increasing and decreasing, and they are permissible because Allah, exalted be His power, does not charge a soul except [with that within] its capacity, and it is what is between negative risk (usury) and positive risk exceeding the limit (gharar).

People in them are of two types: an adventurous type seeking risk based on high returns according to the famous rule "High risk high reward", and a type that hates risk and avoids falling into it, where the first is called the speculative investor and the other the conservative investor.

For example, the one who insures his car against accidents is the one who avoids risks despite knowing the probability of not occurring, while the one who buys a lottery ticket is the one who intends risks despite the probability of occurring.

Therefore, Islamic Sharia calls for moderation and intention and warns against excess, extravagance, and overindulgence, and commands everything that brings benefits and repels harms; rather, the great jurisprudential rule says: Repelling harms takes precedence over bringing benefits.

From this perspective came the prohibition of usury and the prohibition of gharar; the prohibition of usury requires bearing the minimum risks that economic activity cannot be separated from, and growth and prosperity are not achieved except with them, and the prohibition of gambling and gharar requires excluding risks harmful to economic activity. The difference between these two types centers around ownership, as the guarantee required by the Prophet, peace be upon him, relates to ownership, and it works to stimulate money growth and preserve it from waste and recklessness, while gharar is bearing risks independent of ownership (Al-Suwailem, p. 64).

Based on this, acceptable risk is the healthy choice between bearing risks without precaution as in gharar, and not bearing risks without mercy as in usury.

This study has examined the nature of financial risk in Islamic finance, focusing on the dual role of gharar (excessive uncertainty) and riba (usury) in economic transactions. The analysis demonstrates that while risk is inherent in legitimate business and investment activities, Islam distinguishes between permissible (equitable) risk and prohibited (exploitative) risk.

Key findings include:
- Inflationary Finance as Dual Risk: Inflationary finance embodies both gharar and riba, creating uncertainty in value and contracts while enabling unjust enrichment. This dual risk leads to economic instability, inequality, and erosion of social trust, confirming classical jurists' concerns and aligning with Qur'anic prohibitions .
- Positive vs. Negative Risk: Permissible risk, such as entrepreneurial ventures or Shariah-compliant insurance and derivatives, encourages productive economic activity. Prohibited risk, including riba and excessive gharar, undermines justice and violates ethical financial principles.
- Islamic Ethical Framework for Risk Management: Shariah principles and the maqasid al-shariah (higher objectives of Islamic law) provide a comprehensive framework to distinguish between acceptable and unacceptable risk. Instruments such as mudarabah, musharakah, and takaful demonstrate how risk can be managed equitably, supporting development without exploitation.

Implications:
- Policymakers and financial institutions should avoid inflationary or riba-based financing mechanisms that impose involuntary risk.
- Shariah-compliant financial instruments offer practical alternatives, enabling economic growth while adhering to ethical and legal principles.
- Development strategies must consider the broader social and ethical consequences of financial risk to ensure sustainable and equitable outcomes.

Recommendations for Future Research:
- Comparative empirical studies on the economic performance of Shariah-compliant vs conventional risk-based financing.
- Assessment of modern financial instruments, such as ethical derivatives and digital takaful, in mitigating dual risk.
- Exploration of inflationary finance mechanisms in emerging economies under Islamic ethical guidelines.

In conclusion, the study reaffirms that Islamic finance is not risk-averse, but risk-conscious. By distinguishing between permissible and prohibited forms of risk, Islamic financial principles foster justice, fairness, and sustainable development.

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