

Is the Current Practice of Murabaha In Pakistan Literally Based on Islam?

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Introduction:

Strong edifice of conventional banking is standing tall on the pillar of interest. Despite strict prohibition of interest in all revealed religions- Judaism, Christianity and Islam, it has permeated in the life of every one. Quran, Exodus, Deuteronomy and Leviticus disapproved interest with an overt clarity. The last word of Allah- The Holy Quran- takes clear stance against riba and gives final notice to the people who are still indulge in the interest.

“O believers fear Allah and abandon interest if you are true believers. If you don’t give up interest then be ready for war against Allah and his prophet. However if you repent the principal is yours. Neither you should do injustice to others nor others should do injustice to you” (1)

All monotheistic religions discourage interest therefore it remained subdued till the proliferation of banking system. But now it has become an integral part of economic system. Despite its diffusion throughout the world, a sense of its illegitimacy remained associated with it. The situation was grimmer for Muslims because primary source of Islamic Jurisprudence “The Holy Quran” has a clear stance against interest. It was argued that interest based banking system is the root cause of some severe economic problems like concentration of wealth and economic injustice. On the other hand some people believed that banking is indispensable for economic activity and religion has no alternative of banking system. Therefore people especially Muslims had no choice except living between the devil and the deep sea.

In the latter half of 20th century some Muslim scholars stood upright against this notion and proposed an alternative of conventional banking which ultimately emerged as Islamic banking system. The basic principle of Islamic banking system is economic justice. The contracting parties are bound to share risks as well as return. The concept of risk free profit is rejected by Islamic banking and alternative products were introduced by ensuring their compatibility with basic injunctions of Quran, Sunnah and Fiqh.

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A set of various modes of financing were developed by the scholars. These modes includes Murabaha, Musharka, Mudarba, Ijara, Salam, Istisna and qarz e hasna. The goals of this system were to bring economic justice in the society and reduce concentration of money in few hands. The real objective of Islamic banking was economic well being of whole society which can only be achieved by building and converting major portfolio of Islamic Banking on Mudarba and Musharka². However less than 5% of the portfolio of islamic banking sector of pakistan consists of Musharka and Mudaraba by september 2013³. This situation is not very encouraging for proponents of Islamic Banking because it is preventing the Islamic Banking System to achieve desired goals. The failure to achieve higher economic objectives invited a sheer criticism on Islamic Banking. It is Murabaha, Ijara and Diminishing Musharaka that are criticized but it is murabaha which came under hypercriticism. Due to extravagant resemblance of Murabaha with conventional banking practices, a general impression is being build up that islamic banking and conventional banking are two faces of the same coin. This situation is desparately calling for a reexamination of Murabaha in a special context of Quran and Hadith. It is imperative to evaluate the criticism and advocacy of contemporary islamic banking in order to sketch a true picture of the situation.

The study is confined to Musharka, Mudarba and Murabaha therefore it is necessary to have basic concept of these terms. **Musharka** is the partnership business where all partners contribute capital and share profit according to predefined and agreed upon ratio. However loss is shared according to the ratio of their contribution towards total invested capital. **Mudarba** is also a partnership where one partner (Rabbul Mal) contributes capital and other partner (Mudarib) manages the business. Profit is shared according to predefined ratio while loss is borne by Rabbul Mal only. **Murabaha** is a kind of sale where seller clearly mentions cost of the underlying product to the buyer. Then he sells the product at a price which comprises of cost plus profit. In Murabaha, seller divulges cost and markup price to buyer.

Purpose of the study is to bring clarity about Murabaha among muslim community. The study identifies Quran and Hadith as “Revealed Knowledge” and fiqh as “Acquired Knowledge”. The acquired knowlege can be mistaken but revealed knowledge is the true, final and free from any mistake. The study claims that revealed knowledge can’t go wrong therefore special reference to it would bring more clarity in analyses of criticism on murabaha.

“And if you disagree over anything, refer it to Allah and the messenger, if you believe in Allah and the last day. That is the best and best in result”⁴

1. Is There Any Evidence Of Contemporary Murabaha In Quran And Sunnah?

The contemporary mechanism of Murabaha used in Islamic Banking can't be traced back to Quran and Sunnah. Murabaha is mentioned in Mouta Imam Malik that implies simply a sale where cost and profit are divulged at outset of the transaction.

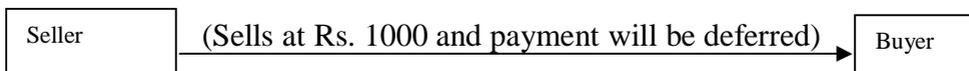
Yahya related to me, that Malik said, "The generally agreed on way of doing things among us about a man buying cloth in one city, and then taking it to another city to sell as a Murabaha, is that he is not reckoned to have the wage of an agent, or any allowance for ironing, folding, straightening, expenses, or the rent of a house. As for the cost of transporting the drapery, it is included in the basic price, and no share of the profit is allocated to it unless the agent tells all of that to the investor. If they agree to share the profits accordingly after knowledge of it, there is no harm in that."⁵

Contemporary Murabaha is more closely related to Inah and Twarruq instead of classical Murabaha.

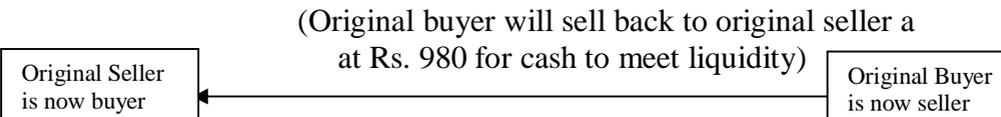
Inah is a sale of an asset on deferred payment basis and subsequently repurchase of that asset by seller from purchaser at price lower than deferred price but on cash payment. This is used to meet liquidity requirement of buyer.

Inah comprises of two phases which are elaborated graphically hereunder;

Phase 1



Phase 2



Twarruq is a transaction when a person sells goods to another person on credit (at higher price) and subsequently purchaser sells those goods to some other party on cash to bridge his liquidity crunch.

Murabaha is similar to Twarruq and Inah. Here commodity is sold at higher price on deferred payment basis like phase 1 of Inah transaction. However subsequent sale of the commodity differs with Inah as it is sold to a third party but resembles with Twarruq. In short underlying thought and results of the transactions are same.

Classical Murabaha was sale of goods with disclosure of cost and mark up price. However contemporary Murabaha has more resemblance to

Inah and Twarruq. However Inah is disliked in Islam and Twarruq is often discussed under Inah Transactions which is excoriated by The Holy Prophet (SAW)

Narrated Abdullah ibn Umar: "I heard the Apostle of Allah, (peace_be_upon_him) say: When you enter into the inah transaction, hold the tails of oxen, are pleased with agriculture, and give up conducting jihad (struggle in the way of Allah). Allah will make disgrace prevail over you, and will not withdraw it until you return to your original religion."⁶

2. It Closely Resembles With Conventional Banking Practices:

Murabaha is a mode of trade where cost of the product is known and it is sold at cost plus profit. It is extensively used product by Islamic Banking. However it appears very similar to the products of conventional banking. The difference is very theoretical and philosophical in nature. In fact Murabaha is the mimic of conventional banking products. The difference is that it is not described as interest based instrument. While implicitly the product is still the same⁷.

On the other hand supporters of Islamic Banking are of the view that these suspicions and doubts are just based on misunderstanding. In Murabaha banks are dealing in commodities which have intrinsic value and utility while conventional banks deal in money which has no intrinsic value⁸. The advocates refer to The Holy Quran

"Allah has permitted trade and prohibited riba"⁹

Islam sets very high moral grounds for trade which ultimately brings well being to whole society. Murabaha is not the best available mode of Islamic Finance¹⁰ therefore use of this verse to defend current practice of Murabaha by Islamic Banks can be questioned. Although proponents of Islamic banks are defending this product at every forum but it is obvious that contemporary Murabaha has very close resemblance with interest based products and creates serious doubts in the minds of common people. In this situation guidance may be sought from following Hadiths

The Holy Prophet (PBUH) Said

"Both legal and illegal things are obvious, and in between them are (suspicious) doubtful matters. So who-ever forsakes those doubtful things lest he may commit a sin, will definitely avoid what is clearly illegal; and who-ever indulges in these (suspicious) doubtful things bravely, is likely to commit what is clearly illegal. Sins are Allah's Hima (i.e. private pasture) and whoever pastures (his sheep) near it, is likely to get in it at any moment."¹¹

He (SAW) also said:

“There will come a time when people consider riba lawful by means of trade”¹²

3. Murabaha Is Not The Best Available Islamic Mode Of Financing:

Excessive reliance on Murabaha, Ijara and Diminishing Musharaka is another problem with Islamic Banks in Pakistan that receives criticism. Musharka and Mudarba are considered best modes of Islamic Banking while these are completely being ignored. The share of these modes in Pakistan’s Islamic banking sector is less than 5% ¹³.

This deliberate neglect of Musharka and Mudarba on the part of Islamic Banks is a serious problem with contemporary Islamic Banking. It indicates that only those modes of financing are being adopted which can easily imitate practices of the conventional banks. This trend is the main hindrance in achieving the real objectives of Islamic Economic System and attracting clients.

Advocates of Islamic banking are also highlighting this problem and of the view that real objectives of Islamic banking could only be achieved through Musharka and Mudarba¹⁴.

4. Risk Sharig In Murabaha Is Theoretical Instead Of Practical:

Since Islamic Banks are using non profit and loss sharing financing modes excessively and secure the exposure through collateral security therefore it can’t be said that there is a meaningful risk sharing.¹⁵ Concentration of Islamic banks is on murabaha, Ijara and Diminishing Musharkah which are not extended without securing the exposure through collateral. At the same time products remain insured and any loss due to some mistake of buyer (agent) is born by the buyer (agent). Therefore banks have no risk of loss and have a guaranteed profit. This is again a clone of conventional banking. Absence of risk sharing exposes this transaction to injustice which is prohibited in Quran

“Deal not unjustly, and you shall not be dealt with unjustly”¹⁶

On the other hand advocates of Islamic banks say that they purchase product and get their constructive possession and as such fully exposed to risks associated with ownership of products. But again this is more theoretical than practical and critic’s point of view appears to have more weight.

5. Pricing Of Murabaha Is Highly Synthetic:

Murabaha is just a trade where price is set higher than market price which is tantamount to interference in market mechanism of price setting. Moreover, customer resorts to bank because he doesn’t have money to purchase the assets. So the buyer will not be in a position to exercise his free will in negotiation which is necessary to keep the prices at appropriate level. Charging a higher price is injustice and exploitation of the customer.

Moreover element of free will is also compromised because customer is suppressed by immediate need and scarcity of funds.

“O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent.”¹⁷

Another objection on Islamic Banking is that if higher price is charged due to deferred payment than it is time value of money which is implicit interest.

On the other hand advocates of Islamic Banking do have sound arguments. Money and commodity are two different things. Money has no intrinsic value while commodities do have intrinsic value and utility. Therefore owner is at liberty to sell the product at any price subject to forces of demand and supply. Moreover the seller can sell even on a price higher than the market with consent of buyer¹⁸.

There is evidence from Hadith which can be helpful to understand the legitimacy of charging higher prices. It is reported that once the prices shot up during the period of the Prophet (SAW). The people said:

“O Messenger of Allah! Prices have shot up, so fix them for us. Thereupon the Messenger of Allah said: ‘Allah is the One Who fixes prices, withholds, gives lavishly, and provides, and I hope that when I meet Allah, none of you will have any claim on me for an injustice regarding blood or property.’”¹⁹

“Ma‘qil ibn Yasar narrated from the Prophet (SAW), he said: “Whoever interferes in any of the prices of the Muslims in order to increase its price for them, it is a duty on Allah to throw him into the greater portion of the Fire while his head is at its bottom.”²⁰

It is evident from both Ahahdiths that in Islamic System prices should be set by market forces but Islamic Banks are using KIBOR as benchmark to set the price. The KIBOR has nothing to do with market of underlying asset. Therefore use of KIBOR is equivalent to interference in price mechanism of the product market.

It may be the trade of fertilizer, cotton, textile made ups or some machinery, the pricing bench mark remains the KIBOR. However market mechanism demands that price of every commodity should be set according to the demand and supply of that very commodity. Prices in commodity markets can be higher or lower than KIBOR plus spread. Therefore using KIBOR to set prices for all commodities appears interference in the market.

6. It Facilitates Concentration Of Money:

Excessive reliance of Islamic Banks on Murabaha is causing concentration of money in few hands just like conventional banks while Quran prohibits concentration of wealth in the hands of few people.

“So that wealth may not circulate only between the rich among you”²¹

It is one of the building blocks of Islamic Banks that circulation of wealth should not be confined to few people of the society. But contribution of Islamic Banks to achieve this objective can't be identified even after the four decades since their inception. The results of non Profit and Loss Sharing modes of financing are the same to those of conventional banks. These modes are based on acquired knowledge which can be put to test and reexamination. However Revealed knowledge is true problem solver. Therefore, if some practice contradicts the revealed knowledge and fails to achieve objectives set by Allah then it must be get rid of. Since current practices of Islamic Banking are contributing in concentration of money therefore these practices need a complete overhaul. Profit and Loss sharing modes of financing are the best available modes which have no doubts in their legitimacy and thought to be ideal to achieve the desired well being of society.

7. Late Payment Penalty Is Against The Guidance Of Quran And Sunnah:

Another problem with Islamic Banking is imposition of penalty upon delay in payment. Islamic Banks themselves consider this practice un-Islamic therefore they don't keep this amount with them and give that in charity. First of all this penalty is in contradiction with Quranic verse

“If the debtor is facing financial difficulty, allow him time until he is easy”²²

The use of this penalty as charity is another matter of concern because Allah Ta'la says

“O you who believe! Spend of the good things which you have (legally) earned, and of that which We have produced from the earth for you, and do not aim at that which is bad to spend from it”²³

Advocates of Islamic banks are claiming that this penalty is to deal with treacherous buyers but how the bank will differentiate between treacherous buyers and genuine buyers who are actually facing problems? How many genuine buyers are given relaxation is still a question.

As islamic banking system is developed to achieve a greater casue of socio economic justice and its foundations are laid on islamic teachings therefore Islamic Banks should not go for such a paltry gains by voilating instructions of Quran. The exposure of islamic banks remain secure through collateral security. Therefore chances of loss of principal amount are very bleak. The only loss will be the time value of money in case of delayed payments even by treacherous buyers. So clear instructions of Quran shouldn't be overlooked for small gains.

Conclusion and Recommendation:

Despite the fact that many scholars vigorously defend current practices of Islamic Banking in Pakistan, a handful of scholars have completely opposite stance and criticize these practices openly. The Murabaha is dominant in Islamic Banking and at the same time attracting most of the criticism. Therefore the study explores various issues related to Murabaha and seeks guidance from relevant sections of Quran and Hadith.

The study reveals that there are certain issues with current practices of Murabaha in Pakistan. The criticism is not based on mere misunderstandings. There are some attributes of prevalent Murabaha which deviate from Quran and Sunnah. The deviation from the principles set by Quran and Sunnah is ample reason to reject the legitimacy of current practices of Murabaha. The study clearly denounces the contemporary Murabaha and firmly believes that it needs a complete overhaul.

The study recommends that Islamic Banks should concentrate on ideal Islamic modes of financing i.e, Musharka and Mudarba. They should abstain from Murabaha as much as possible. However if Murabaha is inevitable then its share in total portfolio should be minimal. Moreover following measures could be helpful to improve its compatibility with the spirit of Quran and Sunnah.

1. Islamic banks should set up their own godowns and ensure physical possession before selling the product to buyers.
2. The banks should also find some specialists in frequently traded commodities to appoint them as agents instead of appointment of buyer as agent to purchase the product. These specialists should be appointed as bank's agents more frequently. Appointment of buyer as agent for every transaction is not the spirit of Murabaha. Moreover it gives resemblance to Murabaha with conventional banking transactions.
3. Murabaha is essentially a trade instead of lending. Therefore price benchmark should be taken from the market of underlying commodity. The use of money market pricing as bench mark is tantamount to interference in price mechanism of underlying commodities. If the commodity in Murabaha is an intermediary product, the effect of higher price (KIBOR based) can disturb the price mechanism of other products as well. For example price of the products, that use commodity, purchased through Murabaha as input, will also be affected. Futures on commodities are frequently written and not an alien phenomenon in today's world. Therefore future prices of the underlying commodity can be used as bench mark to set price of Murabaha.

4. The practice of late payment penalty should be discontinued. It is directly against the prescription of Quran.
5. It is usually observed that transaction flow of Murabaha is not practiced as prescribed. Moreover pledge line swapping is against the spirit of Murabaha whereas some time Islamic Banks swaps the pledge lines by wiping out documentary proofs in wild pursuits of business . To fend off such anomalies Islamic Banks should recruit only those people who deeply understand and believe in the rulings of Islam and understand the importance of strict adherence to the guiding principles of Murabaha.

These recommendations are not collectively exhaustive and can be modified. There is always room for improvement. The objective of the study is to bring clarity and diffuse the confusion on Murabaha. Current practices of Murabaha are not based on true essence of Islam. The study highly recommends that Murabaha based exposure should be curtailed to minimum and use of Mudarba, Musharka and Qarz e Hasna should be promoted. The scholars should take firm stance to improve practices of Islamic Banks so that real objectives of Islamic Banking may be achieved. The owners of Islamic Banks should modify their orientation of profit maximization into the orientation of economic justice coupled with reasonable profit. Otherwise Islamic Banking will remain a rhetoric which would create no difference in society and overall economic system.

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