

Conventional Bank Interest and the *Murabahah* (cost-plus-profit) Contract in Islamic Finance: Two Sides of a Coin or two Coins of Different Sides?

By

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Abstract

The emergence of the Islamic banking system led to the introduction of some financial transactions which were not hitherto considered in the classical books on Islamic financial system. Murabahah is one of such innovations. Like most of those newly introduced products of the Islamic Financial System or Arrangement (IFS or IFA), otherwise referred to as Products of Islamic Banking (PIB) or Products of Islamic Finance (PIF), arguments have been canvassed for and against the legality of Murabahah under Islamic Financial Principles (IFP). Of all the criticism against its operation, the most pronounced deprecation against it posits that, Murabahah is too close to interest transaction in the conventional banks, and cannot therefore be legally allowed in IFS. This paper examines the criticism and posits whether the criticism is tenable or not on the scale of the Islamic Law and given the financial market challenges facing the contemporary Muslim world.

Key Word: Bank Interest, Murabahah, Islamic Banking, Financial System

1. INTRODUCTION

“A *murabahah* facility may appear similar to conventional bank financing with the profit rate or mark-up being contemporaneous with the rate of interest. Indeed the distinction between the two may disappear if proper care is not exercised. *Shari’ah* therefore imposes several constraints and prescribes certain norms in order that a

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murabahah facility is free from *riba*. Conditions that aim to keep the product free from prohibited *gharar* are also prescribed.”¹

One of the innovations of the modern Islamic Financial System (IFS), otherwise called Products of Islamic Banking (PIB), is *Murabahah*, translated as *cost-plus-sales sales*.² *Murabahah*, which has become the backbone of contemporary Islamic banking, is commonly used for financing the purchase of raw materials, machinery, equipment, and consumer durables³. By its nature, it is a form of trust sales in IFS⁴ and it is one of the five categories which sales as exchanges can be classified into under IFS.⁵ Because of the trust involved in its operation and the aspiration of people which *Murabahah* is able to meet⁶, it has been widely embraced and customers of Islamic banks all over the world have been making a preferred choice for it over other PIBs.⁷

In grounding the legality of *murabahah* under Islamic Financial Principles (IFP), reliance has been placed on the major proofs of Islamic law⁸ and practices of the early generations of Muslims⁹. However, notwithstanding the seemingly proofs found for its

¹ http://www.ashurst.com/doc.aspx?id_Content=4298. See also Muhammad Taqi Usmani, *An Introduction to Islamic Finance, Part Two* (1999 Edition: private), p.97.

² It would be noticed that this form of financial arrangement is not treated in the classical books on Islamic transactions. See for instance, Ibn Rushd, *Bidayat al-Mujtahid wa Nihayat al-Muqtasid* – Imran Ahsan Khan Nyazee (trans), *The Distinguished Jurist's Primer*, Volume II (Garnet Publishing, Southern Court, UK: 1996) pp153-572.

³ Bala Shanmugam and Zaha Rina Zahari, 'A Primer in Islamic Finance' (The Research Foundation of CFA Institute 2009), p.32

⁴ It is called trust sale because of the confidence the contracting parties have in the valid information given by the seller about the cost price. See Bakr Abdullahi Abu Zayd 'fiqh al-nawaazil qodoya fihiyyah mu'asiroh,' (Riyad, Muassasatu al-risalah, vol.2.1401AH), p.67

⁵ Wahbah Al-Zuhayli, Mahmoud A. El-Gamal (trans), *Financial Transactions in Islamic Jurisprudence, Volume 1* (Dar al Fikr, Damascus, 2003) p353.

⁶ For instance, *Murabahah* is commonly used by Islamic banks for the short-term trade-financing needs of their customers. see Bala Shanmugam and Zaha Rina Zahari, above note 3, p.31

⁷ Ashurst Islamic Finance Institution, in its January 2009 Briefing, while making reference to the *Middle Eastern Insurance Review December 2008*, observed that, "At the end of 2008, the size of the Islamic finance market was estimated to be US\$1tn. Of this, the commodity *murabahah* market was alone estimated to be US\$100bn". See http://www.ashurst.com/doc.aspx?id_Content=4298

⁸ Al-Zuhayli, above note 5, p354. The major proofs of Islamic law are the Qur'an, *Sunnah*, *Ijma'* and *Qiyas*. For a study on all these proofs and the arguments surrounding their acceptance as such, see Abdul-Wahab Khallaf, *'Ilmu Usul I-Fiqh*, (Darul Hadith, Cairo, 2002), 'Abdul-Qadir Zubair, *The Sunnah Between Its Adherents and Adversaries – As-Sunnah Baynah Ansoriha Wamunkiriha* (Lagos: Al-Madinah Heritage Publications, 1995); Dr. Mustofah As-Suba'i, *As-Sunnah Wamakanatuha fi Tashri'I Islamy* (Private Publication, nd); Justice Muhammed Taqi Usmani, *The Authority of Sunnah* (Private Publication, nd); and Sheikh Mana'u Khaleel Al-Quto, *Ujub Tahkeem Shari'at-I-Islamiyyah* (Jami'at Immam Muhammad bn Su'ud, Saudi Arabia, 1985) pp37-48 and Abdullahi Saliu Ishola, "An Exploration of the Basis of the Arguments for and Against the Adoption of *Qiyas* as a Valid Proof of Islamic Law (Shari'ah)" (Seminar Paper presented to the LL.M Class of *Usul al Fiqh*, 2009/2010 Session, Postgraduate School, Faculty of Law, University of Ilorin, Ilorin – Nigeria in March 2010).

⁹ These are the generations of the Companions of Prophet Muhammad (*Ashabu Rasul*); of those that followed them (*Tabi'*) and of those that followed *Tabi'* (*Tabi'-tabi'*). For a study on the nature of these generations and the landmark contributions they made to the

justification, *murabahah* has not been completely free from the shackle of criticism and condemnation of some contemporary jurists, for example M. Siddiqi¹⁰. The most pronounced of such deprecation against its operation is the argument that, *murabahah* is too close to bank interest, which is condemned as a form of *riba*¹¹, or even that, it is the same as bank interest, but just not so called or called with another nomenclature. In essence, some Muslim scholars reject *murabahah* because, to them, it is another *riba* product packaged in another brand, but with the same ingredients and taste which bank interest gives in the conventional banks. Certain reasons were advanced for this criticism.

Accordingly, this paper examines the arguments canvassed as criticism against the operation of *murabahah* as one of the PIB in the contemporary world. The significance of this study is to disclose if there is truly no dichotomy between *murabahah* and bank interest; i.e. if both are placed on a liberal scale of Islamic law, will the scale tilt to adjudge them as the same? The paper will provide answers to this poser. The paper will take a position on whether the criticism is tenable or not.

II. PURPORT OF MURABAHAH AND HOW IT OPERATES

In a simple term, murabahah, which is also called bai' as-salam al-hal (immediate forward sale)¹² can be explained as a sale on a cost-price basis where payment of the price (including the mark-up) is deferred to a later date.¹³ It is a financial arrangement whereby a fixed profit is agreed to between the seller and the buyer while both of them have the knowledge of the cost price of the commodity¹⁴. Siddiqi describes it as follows: "Murabahah may be defined as a sale in which the margin of profit is mutually agreed upon between the buyer and the seller. The payment of sale price, inclusive of the agreed profit margin, may be immediate or deferred and either in lump sum or in instalments".¹⁵

development of Islamic law, see M. Atiqul Haque, *Muslim Heroes of the World* (Alrisala Books, nd); Muhammad Hamidullah, *The Prophet's Establishing A State and His Succession* (Adam Publishers and Distributors, New Delhi: 2007); Sayyid Qutb, *Milestones* (I. I. F. S.O., 1978); and Abu Ameenah Bilal Philips, *The Evolution of Fiqh (Islamic Law and the Madh-habs)*, (International Islamic Publishing House: 1990).

¹⁰ Nabil A. Saleh, 'Unlawful Gain and Legitimate Profit in Islamic Law' (Graham & Trotman Ltd, London, 2nd ed., 1992), p.117

¹¹ Muslim jurists seem not to have a consensus on the equivalence of *ribbah* with interest. For a study on this, see Muhammad Omar Farooq, "The Riba-Interest Equivalence- Is there an Ijma (Consensus)?" available at <http://www.globalwebpost.com/farooqm/writings/islamic/r-i-consensus.html>. See also, Abdul-Razzaq Abdul-Majeed Alaro, "Islamic Law of Banking: A Discourse of Riba and Its Modern Instruments", *The Jurist*, Vol. 12, 2009, pp.167 – 182

¹² Bakr, above no 4, p. 67

See Asurst Financial Briefing, January 2009, available at http://www.ashurst.com/doc.aspx?id_Content=4298

¹⁴ ,above no 4, p.67. For a study on sort of expenses in *murabahah* transaction which can be added to the price and constitute a basis for the calculation of the profit, see Nabil A. Saleh, above note 10, pp 118-119.

¹⁵ Muhammad Nejatullah Siddiqi, *Issues in Islamic Banking* (The Islamic Foundation, 1983), p137, footnote 1.

The quantum of profit agreed to can be in form of specific amount or stated in ratio or percentage form. The seller (i.e. the Bank) to the ultimate buyer (i.e. the Bank's Customer) essentially stands in the position of a financial facilitator between the original vendor and the ultimate buyer, while it also, through that facilitating role, transacts business and makes profit. At its initial introduction and operation, *murabahah* was a form of sales arrangement, but it is now utilised primarily as a mode of financing in the modern Islamic financial institutions.¹⁶ On the strength of this, *murabahah* contract is of two forms, namely simple *murabahah* and *murabahah* to subscribers¹⁷. The former is "when the seller market their goods to the buyer at a price corresponding acquisition cost plus a profit margin desired" while the latter, which is the form that is commonly operated by modern Islamic banking in financing, "involves three parties, namely the subscribers, the buyer and seller...also involves as an intermediary buyers for their expertise or because the buyer will need financing".¹⁸

Operation of the *murabahah* transaction in Islamic Financial institutions can be illustrated as follows:

*Person A is in need of commodity X. A approaches Bank B. B buys X from vendor/supplier V at price P. This price is also known to A. Next, B sells X to A at a marked-up price, say P+M, where M is the agreed profit or mark-up taken by B. Typically, the mark-up charged will be based on a benchmark such as LIBOR plus a margin, ... The payment of price P+M is now deferred to a future date and is made in full or in parts.*¹⁹

The operation of *murabahah* in the modern time as illustrated above can, according to Bakr, take three forms:

1. It may be that the contracting parties i.e. the bank and its customer, mutually make unbinding promise to enter into this arrangement and without mentioning a marked-up price in advance before the delivery of the commodity.
2. This is akin to the first form above except that a marked-up price is mentioned before the delivery of the commodity.
3. Here, the contracting parties mutually agree that both parties are liable to complete the contract and a marked-up price is mentioned before the commodity is delivered²⁰.

The first form is allowed because there is no binding promise between the parties as to the completion of the contract and that the customer is not liable to compensate the bank in case the commodity perished before the final delivery to the former. Also, there is the presence of risk as the bank is not even sure that the customer is going to buy the

¹⁶ Al-Baraka Bank Release, available at: http://www.albaraka.co.za/Islamic_Banking/Features_of_Marabaha_and_Leasing/Murabahah_as_a_Mode_of_Finance.aspx

¹⁷ Atima Shofawati, 'Murabahah Financing in Islamic Banking: Case Study in Indonesia,' Proceedings of 5th Asia-Pacific Business Research Conference 17-18 February, 2014, Hotel Istana Kuala Lumpur, Malaysia, ISBN:978-1-922069-44-3, p. 4

¹⁸ Atima Shofawati, above note 17, p.4

¹⁹ Asurst Financial Briefing, January 2009, above note 7, p2.

²⁰ See Bakr, above no 4, pp 79-80

commodity from it with profit²¹. However, the second and third forms are unlawful because in the second the profit accruable to the bank has been fixed before the actual delivery of the commodity while in the third form, which is akin to arrangement obtainable under conventional banks, both parties have agreed as to the liability of the parties to the completion of the contract and fixed profit accruable to the bank even before the actual delivery of the commodity. Also both have mutually stipulated that one of them is liable if the commodity is perished.²²

It would be observed that the object of transaction upon which the whole activities involved in *murabahah* is the commodity which the customer of the bank is in need of. This point must be noted as it is going to serve lots of purposes in appreciating the extent of justification or otherwise of the arguments of those who condemn *murabahah* transaction. Before proceeding, it is necessary to understand the conditions and principal steps in *murabahah* transaction.

III. CONDITIONS AND PRINCIPAL STEPS IN THE *MURABAHAH* TRANSACTION

Generally, five major conditions have been laid down to be fulfilled for any sales on *murabahah* arrangement to be valid under Islamic law.²³ Also, four principal steps have equally been designed to be followed for *murabahah* transaction not to be observed in a way bank interest is practiced in the conventional banks. For an easy appreciation of the conditions and the steps, the paper will look at them one after the other as examined below.

i. *Conditions for a Valid Murabahah Sale*

- a. **Knowledge of the initial price by the parties:** There must be certainty about the original price of the commodity or object of sales as at the time of the agreement.²⁴ This is to avoid transaction involved in *gharar* (uncertainty). The sale based on *murabahah* arrangement will be invalidated for defectiveness if the initial price of the commodity is not known to either or both parties.²⁵
- b. **Knowledge of the Profit Margin:** As parties enter into the *murabahah* agreement, they must specify the quantum of profit to be made by the seller, which may be expressed in terms of cash sum, ratio or percentage.²⁶ Failure to do this will defeat the whole essence of *murabahah* and invalidate the transaction as a whole.²⁷

²¹ See Bakr, above no 4, p.90

²² See Bakr, above no 4, p.90

²³ For a comprehensive study on other conditions and rules governing a valid *murabahah* transaction see Mansour A. Al-Meaiter and Chris J. Mitchell, 'A Secure Electronic Murabahah Transaction,' 16th Bled eCommerce Conference eTransformation Bled, Slovenia, June 9-11, 2003, p.664, also Imran Ahmad and Ghulam Shabbir, 'Frequently Asked Questions (FAQS) On Islamic Banking,' pp 22-23, and Faisal Nasim, 'PROSPECTS OF ISLAMIC BANKING: Legal and Other Challenges and Issues,' p. 18

²⁴ Faisal Nasim, above note 23, p.18, Mansour A. Al-Meaiter and Chris J. Mitchell, above note 23, p.664, and Imran Ahmad and Ghulam Shabbir, above note 23, p.23

²⁵ Al-Zuhayli, above note 2, p.355, Bakr, above no 4, p.68

²⁶ Mansour A. Al-Meaiter and Chris J. Mitchell, above note 23, p. 664

²⁷ Al-Zuhayli, above note 2, p.355

- c. **That the original price is fungible:** This implies that the price must be measurable in terms of number, weight or volume. For example, if the commodity, subject matter of the *murabahah*, is measured in tonnes, the price of a tonne of the goods must be capable of usage in calculating and ascertaining the original price. If this cannot be done, then the *murabahah* will not be valid.²⁸
- d. **The goods in which the *murabahah* is traded must not be eligible to *riba*:** It is required that the transaction is conducted in a way that will not give room to *riba*. Thus, the focus of the transaction must be on the commodity itself and not on bringing about increase on the money released.²⁹ However, in a situation where the customer defaults, bank can impose penalty if stipulated in the original contract of *murabahah* even though same cannot be included in income of the bank but instead be spent for charitable purposes.³⁰ Notwithstanding that the bank can impose penalty in case the customer defaults, certain conditions are required, namely penalty is imposed during the pendency of *murabahah* transaction and that the customer is in fact in good financial status to complete the *murabahah* contract but he chooses to deceive the bank.³¹
- e. **That the initial contract is valid:** It should be noted that there are two contracts involved in *murabahah* transaction. One is between the Bank and the Vendor of the commodity while the other is between the Bank and the last buyer of the goods, who is the customer of the Bank and in whose favour the contract of *murabahah* has actually been prepared.³² What this condition therefore stipulates is that if the contract between the bank and the vendor is defective or invalid for whatever reason, the contract of *murabahah* built on it will equally be defective or invalid, as the case may be.³³

ii. **Principal Steps in Murabahah Transaction**

In Islamic finance markets, the following have been identified as the principal practical steps that must be followed for execution of a valid *murabahah* sale:

- a. client indicates an interest in purchasing a particular asset from the bank for a certain price (a combination of cost price plus profit) at a certain time (the utilisation date)³⁴.
- b. The client identifies the vendor, selects the goods and advises its particulars, including the vendor's name and its cost price to the bank in writing. Often the

²⁸ Al-Zuhayli, above note 2, p355

²⁹ Al-Zuhayli, above note 2, p356

³⁰ Muhammad Hanif, 'Differences and Similarities in Islamic and Conventional Banking,' International Journal of Business and Social Science Vol.2 No.2, FEBRUARY 2011, p.170, also Rifki Ismal, 'Assessing Moral Hazard Problem in Murabahah Financing,' Journal of Islamic Economics Banking and Finance, Vol-5 No-2, p.109

³¹ Rifki Ismal, above note 30, p.109

³² Al-Baraka Release, above note 9. ,also Mansour A. Al-Meaitheer and Chris J. Mitchell, above note 23, p.664

³³ Al-Zuhayli, above note 2, p356.

³⁴ This is the reason why modern *murabahah* transaction is also known as "murabahah to the purchase orderer" (*bai' murabahah lil amir bish- shirai*). See bakr, above note 4, p.81, also Bala Shanmugam and Zaha Rina Zahari, above note 4, p.32

bank will appoint the client as its *wakil* (agent) to acquire the asset on the bank's behalf.

- c. The bank acquires the asset and offers to sell it to the client. The vendor will typically make delivery of the asset to the client (as the bank's agent). Delivery need not to be physical, it can also be constructive (i.e. evidenced by delivery of documents of title).
- d. The agency comes to an end. The client accepts the offer and the bank immediately sells the asset to the client, with payment due on the agreed date in future.”³⁵

It is worth noting that all the analysis made so far on *murabahah* is to give a general background knowledge on the whole essence of the transaction. Without doing this, one may not appreciate what the paper intends to bring out on the relationship between *murabahah* and bank interest, which has informed the condemnation made against *murabahah*. The paper will therefore proceed to briefly look at the basics of interest in the conventional banking system.

IV. INTEREST IN THE CONVENTIONAL BANKING SYSTEM

The word “interest” on something in finance parlance is lexically defined as ‘money charged for borrowing money, or paid to somebody who invests money’.³⁶ In the legal parlance, interest ‘signifies a sum payable in respect of the use of another sum of money, called the principal’.³⁷ Activities involved in the transaction based on interest revolved round preservation of the money given out. Bank interest is identified as a product of capitalist economy which is antithetical to the Islamic economy system.³⁸ More significantly, bank interest arises in money-lending business, which is equally not permissible in Islamic financial system.³⁹ This explains why the Qur'an condemns those who equate money-lending business with trading that is permitted in Islam.⁴⁰

What may occur to parties in money-lending business, which is the basic activity in which interest is involved, but, which cannot happen, to those who are involved in *murabahah* transaction, can be explained in the following terms:

“...one person lends out capital in the form of a debt, and a second person puts in his labour; if there is a loss, it has to be borne by labour, but, profit or loss, interest does accrue to Capital in any case”.⁴¹

The point being made is that, in the transactions involving bank interest, the loss that may occur on the loan is not attached to the loan while the loan capital will continue to yield benefit to itself whether profit is made or not. This is contrary to the practice and

³⁵ Asurst Financial Briefing, January 2009, above note 7, p3.

³⁶ Jonathan Crowther (ed.), *Oxford Advanced Learner's Dictionary of Current English, Fifth Edition* (Oxford University Press: 1995) p622.

³⁷ Leslie Rutherford and Sheila Bone (eds), *Osborne's Concise Dictionary, Eighth Edition* (Sweet and Maxwell, London: 1993) p182.

³⁸ Mufti Muhammad Shafi, *Distribution of Wealth in Islam, 4th Edition* (Begum Aisha Bawany Wakf, Karachi, Pakistan: 1975) p20.

³⁹ Shafi, above note 19, p16.

⁴⁰ See Qur'an 2: 275.

⁴¹ Shafi, above note 19, p16.

ethics of business transaction allowed in Islam in a situation where a person borrows second person's money for the purpose of business or for any purpose howsoever. Shafi draws home the point as follows:

“Thus, under the Islamic system of economy, if a man wants to lend his money to a businessman for being invested in business, he will have first to decide clearly whether he wishes to lend this money in order to have a share in the profit, or simply to help the businessman with his money. If he means to earn the right to a share in the profit by lending his money, he will have to adopt the mode of ‘partnership’ or that of ‘Co-operation’. That is to say, he too will have to bear the responsibility of profit or loss – if there is eventually a profit in the enterprise, he shall have a share in the profit; but if there is a loss, he shall have to share the loss too”.⁴²

The foregoing has illustrated the mode of financing in the conventional banks; how and why it attracts interest. The point must be made that the parties under that arrangement have no concern for mutual benefit of each other particularly the bank is not bothered about the benefit of the customer. This is unlike what is obtainable in Islamic Financial Institutions products, including *murabahah*.

V. BANK INTEREST AND CRITICISM AGAINST *MURABAHAH*

i. Overview of the Criticism

As earlier observed, reliance has been placed on the major proofs of Islamic law to ground the legality of *murabahah* under the Islamic Financial Principles. In the same token, it has equally been noted that bank interest did not receive the sanction of Islamic financial system. In fact, this is the major reason why Islamic banking system is otherwise variously referred to as “Interest-Free, Zero-Interest or Non-Interest Banking System”.⁴³

The general principle of Islamic financial system is that, the risk inherent in the capital engaged in any business is borne mainly by the capital. This is why Islam has therefore put in place different ways in which capital can be invested in a business venture, not inclusive of the money-lending method. Thus, once the moral objectives of the Islamic financial system is preserved, Islamic banks would be justified to adopt new financing policies and methods and explore new channels of investments which may encourage development and support the small scale traders to lift up their economic level.⁴⁴ To this end, operation of *murabahah* in Islamic Financial Institutions may be justified.

⁴² Shafi, above note 19, p17.

⁴³ For analysis of Islamic Banking System with all these nomenclature, see Nejatullah Siddique, *Banking Without Interest* (Markazi Maktaba Islam, Delhi, 1979); Waqar Masood Khan, *Towards an Interest-Free Islamic Economic System – A Theoretical Analysis of Prohibiting Debt Financing* (The Islamic Foundation, U.K. and The International Association for Islamic Economics, Islamabad: 1985); and, Muhammad Nejatullah Siddiqi, *Issues in Islamic Banking* (The Islamic Foundation, 1983).

⁴⁴ Muhammad Taqi Usmani, *An Introduction to Islamic Finance, Part Two* (1999 Edition: private), p100.

It is interesting to note that, the argument that *murabahah* has close similitude or proximity to bank interest has been advanced based on the similarity in the operation of the two systems. An illustration will draw the point home. When the conventional bank advances loan to its customers, the amount to be paid as interest is fixed and agreed upon. Similarly, in *murabahah* transaction, the mark-up or the profit margin to be made by the Islamic bank is also fixed and agreed upon. Besides, under either of the two arrangements, the payment of the principal sum or cost price, as the case may be, and the interest charged thereon or the profit put on it will be paid in deferment either in cash or instalments. There is no doubt that these two activities are too close for one not to take them as the same. But, it will be too premature for that conclusion to be drawn.

It should be stated that *murabahah* has also been rejected by those who do not welcome it on the ground that, contrary to the arguments of the proponents of the transaction that it is supported by the proofs of Islamic law, it is based on a particular juristic opinion not shared by many eminent jurists.⁴⁵ It has also been argued that, *murabahah* is a mere cover for continuing interest-based transactions.⁴⁶ Thus, the whole fear expressed against *murabahah* vis-à-vis its proximity to bank interest has been summed up by Siddiqi as follows:

“Those needing finance for purchase or import of inputs would approach the banks to buy the item for them, with the commitment to buy it from the bank at a higher but deferred price. The mark-up will naturally tend to be higher the longer the period of time involved. The banks will have a guarantee of receiving back the price they actually pay plus a predetermined return as the result of the mark-up. For all practical purposes this will be as good for the bank as lending on a fixed rate of interest.”⁴⁷

Before concluding this segment, it is worthy of note that *murabahah* has equally been condemned as a *riba* transaction in disguise and especially regarded as a camouflage introduced to present Islamic banking as truly Islamic when in actual fact, the whole idea of Islamic bank has no valid basis in Islamic law. Thus, they posit that since Islamic banking system itself is *haram* (Islamically forbidden), *murabahah* is also *haram*⁴⁸. Their deprecation of the *murabahah* is finally hinged on the argument that, *murabahah* has the great potential of leading to *riba*, even if it is conceded that it is not by itself a *riba* activity; and, that the principle of Islamic law stipulates that anything leading to what is prohibited stands prohibited.⁴⁹ The paper will now proceed to critically analyse the criticism against *murabahah* stated above.

⁴⁵ Siddiqi, above note 9, p138.

⁴⁶ Siddiqi, above note 9, p138.

⁴⁷ Siddiqi, above note 9, pp138-139.

⁴⁸ For a comprehensive argument against the institution of Islamic banking in this direction, declaring it as *haram*, see Umar Ibrahim Vadilo, *Fatwa on Banking and the Use of Interest Received on Bank Deposits* (October, 2006), available at <http://zakat.files.wordpress.com/2006/11/fatwaonbanking.pdf>

⁴⁹ Siddiqi, above note 9, pp139. For a study on this principle and other legal maxims of Islamic law principles, see Mohammad Hashim Kamali, “Qawa‘Id Al-Fiqh: The Legal Maxims of Islamic Law” in Association of Muslim Lawyers, UK Journal.

ii. A Critique of the Criticism

The starting point is to look at the definitions of both *murabahah* and interest and consider the subjects or objects of transaction in the two financial activities. Without engaging in any unnecessary repetition, it is glaring from the previous analysis above that the two transactions are not equal in definitions and neither are their objects or subjects the same nor similar. The definition of *murabahah* falls squarely under trading or business transaction which is permitted in Islam while interest is within the scope of *riba*, which is not permitted. Thus, the basic dichotomy a critical study of both *murabahah* and the bank interest will show glaringly that, bank interest accrues to the bank without any attendant risk attached to it in the event of loss whereas in *murabahah* risk is attached to the capital advanced and even the goods purchased by the bank will remain the property of the bank until final valid delivery of same is made to the bank's customer and in the event of any loss before such delivery, the customer will not share from it.⁵⁰

Coming to the criticism of *murabahah* based on the fixed rate of benefits to accrue to the bank on the money released to the customer, which is common to both *murabahah* profit-margin or mark-up and bank interest, the criticism will seem not to have been properly placed. There is no principle of Islamic financial transaction against fixing of profits once the parties are *ad idem* on the arrangement and it is to their pleasure and mutual satisfaction, which is the ultimate goal of trading in Islam⁵¹.

Further, the criticism against *murabahah* will also be unfounded considering the fact that all the conditions laid down to be fulfilled before any *murabahah* transaction will be valid are not stipulated and completely out of place in the transaction where bank interest is involved. Usmani properly captures this point when he expressed his view against the criticism as follows:

"I do not subscribe to the view of those people who do not find any difference between the transactions of conventional banks and Murabahah and Ijarah for perpetuating the same business with a different name, because if Murabahah and Ijarah are implemented with their necessary conditions, they have many points of difference which distinguish them from interest-based transactions".⁵²

The point being made is that, the conditions prescribed to be complied with before a *murabahah* transaction can be valid, which are not of concern to the conventional banks, stands as a major ground while the criticism against *murabahah* as being close to bank interest cannot hold water. This paper also does not find the criticism well founded at all. Al-Baraka Bank also draws home the point further in the following words:

"The murabahah transaction does not come into existence by merely replacing the word 'interest' by the words 'profit' or 'mark-up'. Actually, murabahah as a mode of financing, has been allowed by the Shariah scholars with some conditions. Unless these conditions are fully observed, murabahah

⁵⁰ Imran Ahmad and Ghulam Shabbier, above note 23, p.22

⁵¹ Quran 4, verse 29 vindicates this assertion when Allah says: "O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent".

⁵² Usmani, above note 1, p97.

*is not permissible. In fact it is the observance of these conditions which can draw a clear line of distinction between the interest-bearing loan and the transaction of murabahah. If these conditions are not observed, the transaction becomes invalid according to Shariah”.*⁵³

A consideration of the basic features of *murabahah* will also bring into fore the fallacy of the criticism against its operation in Islamic financial institutions. Such features include the fact that, *murabahah* is not a loan given on interest; it is a sale of commodity for a deferred price which includes any agreed profit added to the cost; and that being a sale and not a loan, *murabahah* must fulfil all the conditions of sale laid down in Islamic law⁵⁴ and once this is done it would be contrary to the Islamic commercial principle to equate such commercial transaction with trading in interest.⁵⁵ The paper can go on and on to demonstrate the favour of Islamic financial principle which *murabahah* enjoys and showcase the weakness of the criticism against its operation. But, it seems the point has been properly made.

IV. CONCLUSION

In any Islamic financial transaction, all norms of commercial ethics enunciated by Islamic law must be observed. All new modes of financial transactions brought about by the emergence of Islamic banking system have been concerned with compliance with the Islamic financial norms. Out of those numerous newly introduced financial systems, *murabahah* (cost-plus-sale) has been rejected by some scholars as being unable to fulfil the required norms on the ground that it has proximity to bank interest. This paper has examined the arguments canvassed within the terrain of that line of criticism. The criticism has been critically analysed. The paper has disclosed that, giving a proper understanding of the operation of *murabahah*, the criticism against its operation by Islamic financial institution is misconceived and cannot be grounded. The demand of the contemporary Islamic market will not favour the criticism.

⁵³ Al-Baraka Release, above note 10.

⁵⁴ Al-Baraka Release, above note 10

⁵⁵ Just as Allah refuted justification of interest trade by those who engage in it on the ground of its similitude with lawful transaction where profits are made, it would be legally unacceptable to equate a lawful transaction like *Murabahah* with interest trade no matter how closely they may look alike. In Quran 2,verse 275,Allah says: That is because they say: “Trading is only like *Riba*(usury)”,whereas Allah has permitted trading and forbidden *Riba*(usury).

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