

"Mourabaha" Contract and Basis of Islamic Finance

Gharsellaoui Dalel*
Taamalli Bessem**

Abstract

Among Islamic financial products most frequently used by Islamic banks, we found "Mourabaha" contract. However, careful analysis shows that the "Mourabaha" contract does not respect the foundation of Islamic finance and this product is just another means of conventional financing.

Keywords : Islamic finance, "Mourabaha" Contract.

Introduction

As noted by Sami A. Aldeeb Abu Sahlie, Muslims today represent about 20% of the world population. They are mainly grouped in 57 countries forming the Organization of the Islamic Conference founded in 1969. Muslim countries have probably the largest oilfields in the world. Oil is matched to petrodollars which, in the absence of adequate investment in the concerned countries, are found in banks, including banks in occidental countries regulated by standards set by these countries.

Taking advantage of the religious sentiment of their co-religionist, Muslims have created banks called Islamic banks which have attracted huge amounts estimated at \$ 1,000 billion in 2010, which represents a shortfall to conventional banks in Muslim and non-Muslim countries. Occidental countries have also begun to authorize the establishment of Islamic banks on their territory, and occidental-style conventional banks in Muslim countries and in occidental countries have opened special counters offering banking supposed to be conform to Islamic law. One of the basic principles of Islamic finance is the prohibition of interest. Alternative techniques of financing based on interest were developed by Islamic banks and monetary authorities in several countries. Among Islamic financial products most frequently used by Islamic banks, we find the "Murabaha" contract.

But in what does the "Murabaha" contract differ from conventional contracts to respect the foundation of Islamic finance, a difference that is an argument for attracting Muslim's money?

To answer this question, we will present first the principles of Islamic finance, second the contract of "Murabaha" and third the "Murabaha" contract and the foundation of Islamic finance.

1- The principles of Islamic finance :

According to Sami A. Aldeeb Abu Sahlie, "Islam is a legalistic religion that claims to solve not only the relationship of man with God, but also human relationships between them. God, for Muslims, is the best legislator (musharri') who expresses his will through the system of Islamic law (shari'ah), man can intervene only where God was silent. This law has two main sources : the Qur'an, the word of God, and the Sunnah, tradition of the Prophet Muhammad (peace and blessing be upon him). "

* Assistant at the Faculty of Economics and Management of Sousse, Tunisia.

** Assistant at the Faculty of Economics and Management of Sousse, Tunisia.

Based on the principles of Shari'ah that impose justice, fairness and transparency, the Islamic finance emphasizes ethics and morality and has its roots in divine revelation, Sunnah and Islamic law. For commercial behavior, the Muslim is required to maintain some basic principles⁴:

1.1. Prohibition of Riba :

Ar-Riba, etymologically means surplus, usufruct. It is translated under the Islamic law as interest : it is Haram (forbidden) in Islam by the Qur'an and Sunnah : In Islam, the investor behaves as an entrepreneur and shares the risks and returns.

The number of verses that refer to Riba is 7 (Surah 2: Verse: 275, 276, 278, 279 and 280; Surah 3: Verse 130 and Surah 30: Verse 39).

Some scholars distinguish two types of Riba :

- **Riba an-Nasiah (term)** : the sum paid for the use of borrowed capital or for a rescheduling of the payment of a debt. It means you give credit to someone, he reimburses to you the amount later with a surplus: it means that the deadline for the payment of credit is charged.
- **Riba al Fadl** : sale or exchange of asset against another of the same kind with a surplus.

1.2. Prohibition of Maysir and Qimar :

The Qimar and Maysir are defined as any form of contract in which the right of contracting parties depends on a random event. This is particularly the principle found in games of chance and pariages.

Etymologically, the Maysir was a game of chance, Maysir comes from the arab adjective Yasir: which means easy: before the advent of Islam, Arabs believed that these games are an easy way to earn money...

1.3. Prohibition of Gharar :

This term means uncertainty, randomness. The Gharar is defined as any transaction in which there is deception or ignorance (Jahala) on the contract. "Gharar" sale is the one that you do not know if the subject exists or not, or you do not know what is the amount or whether it will be possible to deliver or not. Al-Gharar also means any transaction involving a blur or a hazard. As interest, Islam condemns any speculation, betting on the future, and prohibits transactions involving gambling and extreme uncertainty.

1.4. Tangibility of assets:

Tangibility of assets means that any operation must be based on a tangible asset, real, material and especially held.

1.5. We do not invest in illicit :

In Islam, we cannot sell or buy the illicit.

2- The "Murabaha" Contract :

According to Sofia Bennamara, "Murabaha" contract is a contract of sale with profit. The customer gives the order to an Islamic bank to purchase an asset, on its behalf, in cash. He then undertakes to take this asset through a deferred payment with a margin paid to the bank. This payment can be done once or over several deadlines.

To respect the Shari'ah, the bank must buy the asset first and then resells it later. It is also necessary that the asset is tangible, that the client is informed and that he agrees to buy with the new price (purchase price plus profit margin).

When all these conditions are fulfilled, the parties (bank and client) sign a contract of "Murabaha" in which, all terms and conditions are specified.

⁴ See the website www.doctrine-malikite.fr

3- "Murabaha" contract does not comply with the foundation of Islamic finance :

Warde (2000) defines Islamic finance as all financial practices which "are based, in their objectives and activities, on the Qur'anic principles". According to this definition, in order that a financial contract be admitted by Islamic finance, it must comply both the form and content of Qur'anic principles, a condition not satisfied by the contract of "Murabaha" for several reasons :

3.1- With a contract of "Murabaha", the bank practices interest :

We can show, for two reasons, that the "Murabaha" contract is assimilated to a loan with interest :

3.1.1- In a contract of "Murabaha", there is no risk, no work and a certain return :

According to the Islamic Development Bank, liberal economic theory distinguishes between interest and usury, it considers usury as an excessive rate of interest. The Islamic conception rejects this distinction, both are considered as Riba. It does not prohibit the interest rate but the interest principle itself.

Interest is defined in a broad sense as the rent of money. Interest combines two characteristics that lead to its prohibition : the absence of the lender's work, and especially the absence of risk to him. The interest is a form of Riba, but Islam prohibits all transactions of Riba, that is to say, all operations in which there is no work and no risk.

In banking practice of "Murabaha", the client undertakes to purchase the asset before the bank buys it and resells it to him thereafter. In this operation, there is no risk and no work with a certain gain for the bank. Here, the bank lends money in return for a determined benefit, thus the contract of "Murabaha" is none other than a loan with interest.

3.1.2- Profit margin is rather an interest :

If we visit the official website of Zitouna bank, which is supposed an Islamic bank, we find a simulator which determines the profit margin required by the bank. According to this simulator :

$$PM = f(TAP, OC, MGI, D, MOF)$$

With :

PM : Profit margin;

TAP : Total Acquisition Price;

OC : Own Contribution;

MGI : Monthly Gross Income;

D : Duration;

MOF : Monthly Other Financing.

It is clear that this margin does not depend on the project neither its quality, this margin depends only on own contribution and time factor, these two variables determine interest.

3.2- In a contract of "Murabaha", we find the "Gharar" :

In banking practice of "Murabaha", the client undertakes to purchase the asset before the bank buys it and resells it to him later, in other words, the bank will sell something that is not its property. The "Murabaha" contract contains uncertainty and consequently the "Gharar", element which is not conform to the principles of Shari'a.

3.3 - In a contract of "Murabaha", there is a vice of the client consent and a dol by the bank :

According to François Guéranger, the main vice of consent, in Islamic law, is violence, assessment subjectively determined, we find then, alternatively, dol and error, both based on objective factors.

Violence is an action against somebody, affecting his consent, vitiates his freewill. It is subjectively estimated : it should be illegal, may be exercised and really effective.

Violence is exerted on the client because he agrees to buy at the new price which is equal to the purchase price plus a profit margin without knowing the counterparty of this margin.

Dol is exerted by the bank, because it declares that the "Murabaha" contract is a contract that respects the foundation of Islamic finance, but in reality the "Murabaha" contract is rather a loan with interest.

Conclusion :

Islamic economy is an alternative to the existing economic relations. It is based on a set of moral values established by the Muslim religion.

For commercial behavior, the Muslim is required to maintain certain basic principles that arise among other major Islamic principles of justice, equity, transparency and mutual consent of the contracting parties.

Islam is thus interested in trading behavior, he imposed the fulfillment of some basic principles : the prohibition of Riba, the prohibition of Gharar and the prohibition of Maysir and Qimar.

Alternative financial products were developed by Islamic banks. Among this Islamic financial products most frequently used, we find the contract of "Murabaha". A question to which we tried to answer: does the "Murabaha" contract respect the foundation of Islamic finance?

In the operations of "Murabaha" implemented by organizations that offer funding supposed to be conform to Islamic law, the client usually signs a unilateral promise of purchase even before the bank purchases the financed asset.

This unilateral promise of the client has as effect :

- Eliminate completely the risk of the financial institution: it guarantees to resell the purchased asset whatever happens, as it may apply to the court, the execution of the promise made by the client. Thus, the whole operation would not really be a commercial transaction but would be a simple loan with interest.
- The financial institution agrees to sell an asset he does not own and therefore falls into the Gharar which is prohibited by Shariah.
- The two elements that are not consistent with the principles of Sharia, Riba and Gharar constitute a defect of consent for the client and a dol by the bank.

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