

Interest, Mark up and Time Value of Money
By Muhammad Ayub

In his article "The debate over 'mark-up'" Dr Aqdas Ali Kazmi raises a question: "Does the Islamic Shariah regard mark-up, or a similar system, consistent with its basic precepts and principles?"

He has discussed stance of Islamic jurists on mark-up during the past two to three decades and drawn the conclusion: "In its operations, structure and use, mark-up resembles interest.... if the Shariah accepts mark-up as valid, it is left with no basis to reject interest.... Shariah jurists cannot reject interest if they accept 'mark-up'".

He has quoted from the Report of Pakistan's Council of Islamic Ideology (June 1980) that the mark-up mode should not be used as a back door for allowing interest into the banking and financial system. The main thrust of this article is to explain Shariah position of the difference between cash and credit prices of a commodity and the possible modus operandi of time valuation according to the precepts of the Shariah. The steps taken by the State Bank of Pakistan for maintaining the purity of Bai Murabaha are also given in the end.

With regard to the credit trade, there had been some difference of opinion among the jurists on the Shariah position of the difference in cash and credit prices of a commodity. Notwithstanding this difference, there is almost a consensus among the Shariah scholars that credit price of a commodity can genuinely be more than its cash price provided one price is settled before separation of the parties.

Accordingly, the Islamic Fiqh Academy of the OIC and Shariah Boards of all Islamic banks approve the legality of this difference. This is tantamount to the acceptance of time value in the pricing of goods. What is prohibited is any addition to the price once mutually agreed because of any delay in its payment. This is because the commodity once sold, even on credit, belongs to the purchaser on a permanent basis and the seller has no right to re-price a commodity that he has sold and which does not belong to him.

According to many jurists this aspect is approved by the Nass (clear text of the Shariah). The Holy Quran has reported non-believers saying, "The sale is very similar to Riba." Their objection was that they increase the price of commodity in the original transaction of sale because of its being based on deferred payment and it is treated as a valid sale. But if they add to the due amount after the maturity date and the debtor is not able to pay, it is termed as Riba, while the increase in both cases is similar. This argument has been specifically mentioned by the famous exegetist Ibn-Abi-Hatim (d. 327 AH) (Tafseer, 1999, Vol. 2, p. 545).

The Holy Quran's reply to the above thinking of the non-believers is that "Allah has permitted trading, and prohibited Riba". Allamah Sayyuti and Ibne Jarir Tabari have reported the similar situation of Riba involvement in which a person sold any commodity on credit; when the payment was due and the purchaser could not repay that, the price was enhanced and the time for payment extended (Sayyuti, Lubaab al Nuqool: 1423 and Tabari, Jami al Bayan, Vol. 6, p. 8).

The great Muhaddith Tirmidhi has reported that the Holy Prophet (pbuh) forbade two sales in one contract. Jurists have explained it to mean that a person asks someone, 'I sell this cloth on cash for ten and on credit for 20 (dirhams)' and at separation, one price is not settled. If one of the two prices is settled, it is not prohibited (Tirmidhi, 1988, No. 1254). Tohfatul Ahwazi, Sharah Jam'i al Tirmidhi, explains that if a seller says that he sells the cloth for 10 on cash and 20 on credit and the buyer accepts any of the two prices; or if a buyer says that he purchases for 20 on credit or the parties separate on any of the prices, the sale will be valid (vol. 2, p. 236).

Shukani explains the above Hadith of the Holy Prophet by concluding that if the purchaser in such a situation says, "I accepted for 1000 on cash", or "for 2000 on credit", it would be all right. He adds that 'Illah (effective cause) for the prohibition of two sales in one is non-fixity of the price (Nail al Awtar, Vol. 5, p. 12).

Shah Waliullah in Muaswwa, Sharah Al Muwatta, writes that if the parties separate after settlement on one price, the contract is valid and there is no difference of opinion in this regard (Al-Musawwa, vol. 2, Pp. 28, 29). Among the scholars of the present age, the late Shaikh Abdullah ibn Baz, who was the most honoured Grand Mufti of Saudi Arabia, permitted the installments sale wherein the credit price could be higher than the cash price (Abdullah ibn Baz, Fatawa, Urdu translation, KSA, 1995, P.142).

Jurists allow the difference between cash and credit prices of a commodity considering it a genuine market practice. It is quite natural that in the market credit price of a commodity is more than its cash price at a point of time while in contracts like Salam (the mode of future trade allowed by the Holy Prophet) the future price will be less than the cash price.

In the words of eminent Hanafi jurist Sarakhsi, "Selling on credit is an absolute feature of trade.... We hold that selling for credit is part of the practice of merchants, and that it is the most conducive means for the achievement of the investor's goal, which is profit. And in most cases, profit can only be achieved by selling for credit and not selling for cash. He further observes, "A thing is sold on credit for a larger sum than it would be sold for cash" (Al Mabsut, Vol.22, P. 45).

The comments of Abraham L. Udovitch on the views expressed by Sarakhsi are worth mentioning, "This statement makes clear as to why there was a greater profit to be derived from credit transactions..." The difference in price between a credit and cash sale also helps explain why the prohibition against usury, to the extent that it was observed, did not exercise any crippling restriction on the conduct of commerce... (Udovitch, 1970,p.80).

Islamic economics has the genuine provision of converting money into assets on the basis of which one can measure its utility. While it concedes the concept of time value of money to the extent of pricing in credit sale, it does not uphold generating rent to the capital as interest does in credits and advances leading to a rentier class in society.

As per rules of the Shariah, the aspect which matters is the conversion of Rs 1000, for example, into an asset in which case that Rs 1000 asset may be worth more or less in

future leading to profit or loss. This conversion into assets is subject to well articulated rules governing profit/loss sharing, trading and leasing.

The concept of time value of money in the context of Shariah is also established from the fact that Shariah prohibits mutual exchange of gold, silver or monetary values except when it is done simultaneously. This is because a person can take benefit by use of a currency which he has received while he has not given its counter value from which the other party could take the benefit.

It further transpires that time valuation is possible only in business and trade of goods and not in exchange of monetary values and loans or debts. Loaning is considered in Shariah as a virtuous act from which one cannot take any benefit. Therefore, no time value can be added to the principal of a loan, or a debt after it is created or the liability of the purchaser stipulated.

There should be no confusion in this regard about interest vis-a-vis the concept of rent in Ijarah (leasing). It might be argued, for example, that as per approved Shariah principles, predetermined rent includes a time-value of money, therefore, a predetermined time value of money in loans/debts should also be permitted by analogy. This argument does not have any substantive basis. The rent in leasing is calculated on the basis of capacity of the asset to give usufruct, which is in principle uncertain. Hence, it remains uncertain how much time-value of money is actually realized until the asset has completed its economic life. Lessor, as owner of the leased assets, is also the owner of risk and reward of that asset. Further, anything which cannot be used without consuming its corpus cannot be leased out like money, eatables, fuel, etc.

The above discussion leads to an important conclusion that while time-value of money is acceptable in respect of the pricing of assets and their usufruct, it is not acceptable with regard to any addition to the principal of loans or debts. Valuation of credit period based on value of the goods or their usufruct is different from the conventional concepts of 'opportunity cost' or the 'time value'. As such, "mark-up" is permissible provided Shariah rules relating to trade or leasing are adhered to, but interest is prohibited due to being increase over any loan or debt.

On the basis of the above rationale, an overwhelming majority of the Islamic economists believe that economic agents in an Islamic economy will have positive time preference and there will be indicators available in the economy to approximate the rates of their time preferences generally determined by the forces of demand and supply. There is no justification to assume zero rate of time preference in an Islamic economy as is done in a number of studies on investment behavior in Islamic perspective.

Having said that, the permission of charging 'mark-up' in Murabaha is subject to fulfillment of trading rules and conditions set out by the Shariah for such transactions. It goes without saying that the mark-up technique, or for that matter any Islamic modes, should not be used as a back door for allowing interest. The State Bank as a regulator is in the process of designing a framework to ensure compliance of Shariah principles relating to Islamic modes of financing.

State Bank of Pakistan has received comments from bankers, Shariah scholars,

economists, educational institutions, business community, etc on guidelines containing Shariah Essentials and Model Agreements of various modes of financing. As and when these guidelines are finalized and approved by the Shariah Board, the same would serve as the basis of the regulatory framework of Islamic banking in the country.

Similarly, the State Bank of Pakistan is the only central bank in the world that has so far planned Shariah compliance audit of Islamic banks/branches. Let's hope that with these steps Islamic banks in Pakistan would be doing Murabaha in line with its true spirit.

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