TIME VALUE OF MONEY IN ISLAMIC BANKING:

Many people question whether Islamic finance differs meaningfully from conventional finance. The present day operating environment is a conventional one in terms of market structuring and dynamics. However, the two differ as night and day with respect to their core defining parameters and fundamental perspectives.

There are several basic principles in Islamic banking. Conventional banking operates on interest-based money lending while the Islamic banking operates like a trading house. What allows this difference? Two core principles are at the centre; elimination of riba (interest) and gharar (uncertainty or chance).

Keeping in mind the definition given in Hadith ("Every loan that draws a gain is riba"), one can discuss time value of money and the workings of present day Islamic banks. For this, we would have to look at the different ways in which modern capitalist theory views "Money" and "commodity" and compare with the principle as defined by Islam.

According to capitalist theory, there is no difference between money and commodity in so far as commercial transactions are concerned. Both are treated at par and can be sold at whatever price parties agree upon. For them selling $100 for $110 is the same as selling a bag of rice costing $100 for $110.

Islamic principles differ from the capitalist theory as money and commodity have different characteristics, for instance money has no intrinsic value but is only a measure of value or a medium of exchange, it is not capable of fulfilling human needs by itself, unless converted into a commodity.

A commodity can fulfil human needs directly, and two, can be of different quality while money has no differential quality in the sense that a new note of $1,000 is exactly equal in value and quality to an old note of $1,000 Also, commodities are transacted or sold by pinpointing the commodity in question or at least by giving certain specifications.

Money however, cannot be pinpointed in a transaction of exchange. Even if it is, it would be of no use since the different denominations of money summing into equal amount are exactly the same.

It follows then that one would agree that exchanging $1,000 with $1,100 in a spot transaction would make no sense since the money in itself has no intrinsic utility or a specified quality and thus the excess of amount on either side is without consideration and hence not allowed under Shari'ah.

The same would hold true if we were to exchange this $1,000 with $1,100 to be delivered after a period of one month, since the excess of $100 would be without any consideration of either any utility or quality but only against time.

The same is not true when commodities are involved. Since a commodity is known to possess an intrinsic value and quality, the owner of such a commodity is allowed to sell it at whatever price the buyer and himself mutually agree on, provided the seller does not commit a fraud but is subjected to the forces of demand and supply. This would hold true even if the price that is mutually agreed upon is higher than the prevailing market price.

Therefore, any excess amount charged against deferred payment is riba (interest) only where money is exchanged for money, since the excess charged is against nothing but time.

Due to the dynamics in the current banking industry, the use of T Bill as a benchmark by Islamic banks in calculating the selling price of their commodities in Murabaha sale transactions is not only justified but necessary.

Outlawing its use will lead to Islamic banks losing their competitiveness coupled with their low market share in the banking industry.

T Bill as a benchmark to determine the profit is only for indicative purposes and this does not make the transaction impermissible, provided that all the conditions of a valid sale are fulfilled.

If one looks at a normal market situation, every trader whether a large multinational trading corporation or a roadside store, decides on their profit margin rates based on various factors in the competitive environment in which they operate in.

Similar is the case with Islamic banks when they arrive at the selling price of the commodities using any known bench mark. In contrast conventional banks price their loans based on the T Bill, which does result in riba since it is an exchange between money and money and not a sale transaction in which commodities are changed with money.

Questions are being asked whether Islamic banks could price their commodities by applying some other benchmark rate. The rationale behind using a known benchmark is that the banking environment is dominated by conventional banks.

However, as more and more Islamic banks come into the operation, an inter-bank market between Islamic banks will be created and a new benchmark for the Islamic banking industry can be developed.

Reference: Najmul Hassan, CEO, Gulf African Bank