



The Controversy over Time Value of Money among Contemporary Muslim Economists

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ABSTRACT

This paper looks at the issue of time value of money in general and its relevance to Islamic economics and finance in particular. After a brief overview of some of the key ideas related to this concept in conventional economics, the paper attempts to investigate the basic reality of time value of money. It suggests that, in general, people do not prefer present consumption over future consumption. Instead, there are some other factors which influence their decision to receive, if possible, present income (and not present consumption) sooner than later. It is then argued that, from an Islamic point of view, neither a positive time preference nor a preference for realizing an income sooner than later, justifies a reward for consumption loan. It is emphasized that although the case of loans for consumer durables appears to be different from those given for necessities, the severe condemnation of the later requires a very careful look at the permissibility of sale on deferred payments. The paper concludes that devising a solution to sale and purchase of consumer durables without involving *riba* in any form will be a unique contribution of Islamic finance.

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1) BACKGROUND

M. Fahim Khan (1991) raises the issue of time preference and the time value of money and their relevance not only to discounting but also to wage, rent, bay muajjal and bay salam. He attempted to explain the apparent contradiction in prohibition of interest which can be considered as a denial of time value of money, and permissibility of bay muajjal and bay salam which, in his opinion, seem to be based on the concept of positive time value of money. He also observed that rent (which is generally higher than depreciation) and wages are also permissible even though, like interest, they are predetermined and fixed implying a time value of money.¹ By using an example of a machine that could be rented, he concluded that there is nothing against realizing time value of money as long as it is not claimed as a predetermined value.² Referring to the issue of bay muajjal, he claimed

¹ M. Fahim Khan (1991), p.35.

² At this stage he did not raise the issue of wage or house rent.

³ M. Fahim Khan (1991), p.37.

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that although Islamic jurists have allowed a difference between cash and credit price of a commodity, the same couldn't legitimize a predetermined time value of money. The jurists, in his opinion, could have allowed the difference in the cash and credit price because they recognized that supply and demand forces could be different at different times. He further claimed that the same demand and supply consideration led the jurists to allow the future price in a bay muajjal transaction to be higher, lower or equal to the present price.³ According to him, the same is the case of bay salam. The permission for the difference in the price of a commodity to be delivered in future is likely to be simply a recognition of the forces of supply and demand that may cause prices to be different at different points in time.⁴

Several points made by M. Fahim Khan were critically reviewed by Kahf (1994) who questioned the notion that time preference is derived purely from consumption preferences. Like Zarqa, he claimed that the prohibition of interest in Islam is not a sine qua non to denial or recognition of time value of money.⁵ He refuted the idea that payment of wage and rent tantamount to recognition of time value of money. Finally, refuting the idea that demand and supply in the future must have been considered to legalize bay muajjal, he argued that the legitimacy of bay muajjal and bay salam can be rationalized along the lines of musharakah, mudarabah and leasing on the basis of ownership and distinction between anticipated and realized time value of money⁶ (an issue that will be critically looked at later in this paper).

There are two main purpose of this chapter. First, to have a further look at the link between time preference and the institution of interest and their relevance to bay muajjal and bay salam. Second, to have a critical look at the presumed permissibility of bay muajjal and bay salam in light of the arguments put forward by Monzer Kahf, a leading and influential Islamic economist.

The organization of the chapter is as follows. In section two we present a brief discussion of the very basic link between time preference and interest. Section three extends this discussion and looks at important ideas presented on these concepts in a chronological order. In section four an attempt is made to get some further insights about the nature of time preference. Section five takes up the issue of bay muajjal and bay salam. Finally, in section six we make some concluding comments.

2) TIME PREFERENCE RATE AND INTEREST RATE

In his pioneer work on discounting in project evaluation under an Islamic economic system, Zarqa (1983) rigorously dealt with the issue of time value of money and concluded that a positive time preference is neither a principle of rationality nor an empirically established predominant tendency among consumers. It is simply one of the three tendencies among consumers, the other being zero and negative time preference each of which is rational and observable under its own conditions.⁷

⁴ M. Fahim Khan agreed with Zarqa's proposal that the rate of return on projects with comparable risk could be used as the discount rates for private projects. However, he argued that the same could not be appropriate for public projects. As the risk on public projects are distributed among a very large number of tax payers, he suggested that for public projects that rate of discount should be used which represent the pure time value of money (ibid, p.43) According to him, there are two types of risk; time related risk and risks that are not related to time. He asserted that rate of return on risky projects include remuneration for both types of risks. These rates must be decomposed into two and only that part of it should be used in discounting for public projects that is related to time. He calls this the 'pure time value of money'. He also argued that the value of time preference increases with the increase in length of time. He pointed out that Islamic banks finance many (diverse) projects at a time, eliminating risks not related to time, and also have deposits of different maturity. He, therefore, suggested that their expected rates of return on deposits of different maturity should be taken as the discount rates for projects of different maturity (ibid., p. 43).

⁵ Kahf (1994), pp. 33-34.

⁶ ibid., pp. 36-37.

⁷ Zarqa (1983), p. 209. He further argued that as time preference need not always be positive, it couldn't provide a valid base for discounting. He, however, claimed that discounting is one of the definite requirements for efficiency in investment in both the private and the public sectors. He suggested that, for private projects, rate of return on projects with similar risks should be an appropriate rate of discounting. Zarqa (1983), p. 219. For public projects the discount rate should be adjusted downward to reflect the common view that such projects are less risky and the objectives are more complex. Zarqa (1983), pp. 230-31.

Zarqa (1983) provides a good survey of the issue of time preference in western economic tradition. He claimed that the overemphasis on positive time preference among some western economists could be ideologically explained by its presumed suitability as defense of the institution of interest against Marxist attacks. However, he points out that even western scholars such as Patinkin and Samuelson have admitted that existence of positive interest rate does not validate the positivity of time preference.⁸ On the other hand, Sugden and Williams (1978) have emphasized that a marginal time preference rate is independent of the institution of interest rate. Time preference, in their view, is about preference, which exists, independent of any system by which trade takes place. Even Robinson Crusoe, they assert, would have had a marginal time preference rate who had no opportunity to borrow or lend. The presence of an interest rate regime, however, according to them, facilitates to identify the time preference of an individual.⁹ If a person can freely borrow and lend at a particular interest rate, he would, rationally, attempt to make himself as well off as possible by having a consumption pattern commensurate with his time preference. He would continue to borrow or lend until his time preference rate coincides with the interest rate.¹⁰ The interest rate would thus represent the time preference rate of the individual. If all individuals in a society can borrow and lend freely at the same interest rate, they will all share the same time preference rate after they have made their decision to borrow or lend at that rate.¹¹ In reality, however, there is no such rate at which one can borrow or lend freely. The borrowing and the lending rates for the same individual are different, and different for different individuals depending upon their credit worthiness and other characteristics. One should also observe that interest rates are normally defined in nominal terms whereas rational people are mainly interested in the real rate of interest. Similarly, individuals have to pay a tax on their interest income at different rates depending on their respective tax brackets. Furthermore, part of the interest rate represents the payment for risk undertaken by the lender, and hence it does not wholly represent the lender's time preference.¹² All these considerations make the relation between interest rate and the time preference rate rather weak.

3) TIME PREFERENCE AND? THEORIES OF INTEREST: A BRIEF CHRONOLOGICAL REVIEW.

In 1834 John Rae pointed out that uncertainty of human life and excitement produced by the prospect of immediate consumption determine time preference (have negative effects on desire for accumulation). On the other hand bequest motive coupled with propensity to exercise self-restraint determine the degree of desire for accumulation.¹³

In 1836 N.W. Senior (1790-1864) attributed the over weighting of present consumption to the miseries produced by the self-denial required to delay gratification.¹⁴ He also thought that interest was a necessary payment to capitalists who provided investible funds by sacrificing and abstaining from present consumption.¹⁵ This position was, however, severely criticized and ridiculed by Marx and other socialist philosophers. They vigorously contested the argument that capitalists of their time made any sacrifice to abstain from consumption and provide funds for investment. Later Alfred Marshal suggested that instead of abstinence and sacrifice it would be more appropriate to claim that interest was a reward to capitalists for waiting.¹⁶

⁸ Zarqa (1983), p. 205.

⁹ Sugden and Williams (1978), p. 15.

¹⁰ As he borrows more and more and increases his current consumption, his marginal time preference rate decreases and vice versa.

¹¹ Sugden and Williams (1978), p16.

¹² *ibid.*, pp. 42-45.

¹³ Frederic et al (2002) p. 353.

¹⁴ *ibid.*

¹⁵ Brue (2000) pp. 146-47.

¹⁶ *ibid.* pp. 310-11.

It is worth mentioning that apart from Senior, starting from Adam Smith and David Ricardo, almost all classical economists treated interest as a part of business profits. They were implicitly implying that interest was justified as it was paid out business profits. As the framework of their economic analysis was deterministic, they never asked the question what would happen if no profits were made or there were business losses.

In 1888 William S. Jevons and later his son Herbert S. Jevons in 1905, claimed that people only care about their present utility and would postpone their current consumption only if the prospect of future consumption produces "anticipal" utility that more than compensates for the decrease in immediate consumption utility. Like John Rae, Jevons did not relate time preference to interest.

In 1889, the Austrian economist Bohm Bawerk added another reason for time preference. According to him people have defective imagination. They generally fail to visualize their future wants.¹⁷ People underestimate future needs because they have defective imaginations, because they have limited will power and cannot resist present extravagance even when they are aware of future needs, and because they know the life is short and uncertain and therefore wish to enjoy life today rather than sacrifice for tomorrow. He claimed that this is the only irrationality he had generally found among otherwise rational people. He regarded this as one of the reasons for payment of interest to those who give loans.¹⁸

According to Bohm Bawerk, apart from time preference, there are two more reasons for payment of interest. One other reason for payment of interest, that is also subjective like time preference, is the prospect of increasing income for borrowers in the future. As many people expect that their income would be increasing in future, they are ready to borrow and pay interest that allows them to consume something earlier. For Bohm Bawerk the only objective justification for payment of interest was that the saved money could be utilized in round about production method that generally produces a profit.¹⁹ The providers of the fund are thus entitled to get additional payment in the form of interest. People could invest in expectation to get more in the future. But more income in the future also means more consumption opportunities in the future. In this sense, there is no difference between treating time value as an investment or consumption phenomenon. It is, therefore, immaterial to argue whether time value of money is only a consumption phenomenon.

Bohm Bawerk had admitted that the notion that the expected future income (and hence the future consumption) would be higher, or that people prefer current goods to future goods, is subjective. The only objective element in his theory of interest is the possibility of more production in the future using the current funds. However, to validate interest charge on consumption, the other two elements of his theory are indispensable. As interpreted by Brue, in Bohm Bawerk's scheme, interest must be paid because of the first two elements whereas interest could be paid because of the roundabout method of production.²⁰ If we agree with Brue, then time preference does have an effect on interest.

In his Theory of Interest published in 1930, Irving Fisher argued that people are generally impatient to consume. However, as they set aside more and more resources for present consumption, their impatience rate decreases. At a given level of present consumption, some consumption could be delayed only if the increasing rate of impatience is compensated by an increasing rate of interest. On the other hand, the rate of interest that could be paid to them by the users of the saved funds depends on the investment opportunity rate in the economy.²¹

¹⁷ Fredrick et al, p. 354.

¹⁸ Brue (2000), pp. 266-67.

¹⁹ Ibid.

²⁰ Brue (2000) p. 267.

²¹ Ibid, pp. 329-30.

4) LOOKING DEEPER INTO TIME PREFERENCE!

Bohm Bawerk had suggested that people are irrational when they put more weight to the current goods compared to the future goods. He found this the only irrational act on part of, otherwise, rational consumers. It could be, however, disputed whether people, in general, are really irrational about their future needs. In order to contemplate and investigate the actual nature of time preference, we look at the following situation.

Zaid who hopes to live for three periods works for someone under the following situation:

- 1) No uncertainty about the payment of his remuneration.
 - 2) No chance of theft if the money is kept at home
 - 3) No inflation or deflation
 - 4) No difference in needs in the three periods he lives
 - 5) Zaid is certain that he will be working in the first and the second period and will be earning certain income of \$900 in each of these two periods. He is also sure that he will not be earning any income in the third period.
 - 6) There is no other source of income or endowment.
 - 7) No avenues for investment with certain or uncertain income through his saving.
- Zaid has three options for the payment mechanism
- (a) He gets \$ 1800 in the beginning of period one.
 - (b) He gets \$900 in the beginning of period one and another \$900 at the beginning of period two.
 - (c) He gets three installments of \$600 at the beginning of each of the three periods.

Given assumption 1-7 and three payment options, I would like to suggest that Zaid being a normal²² person would be indifferent to these three payment options. He knows his needs in the different time periods and he would act accordingly. He gives equal weight to all the periods he believes / expects to live. If Zaid is not a normal person, he may give much higher weight to the first or the third period. Zaid, however, might prefer one payment arrangement to other under different scenarios.

Relaxing the Assumptions

1) Uncertainty about payment:

If Zaid thinks that his employer may not keep his words and may not pay as promised or delay payments, he would prefer arrangement (a) over (b) and/or (c). If he cannot get option (a), he would prefer (b) over (c). In both cases, he may even agree to accept a lower amount if the payment could be made earlier. If all other assumptions (i.e., assumptions 2 to 6) remain intact, he may prefer to get a little less, for example \$ 860 in each of the first and second periods, rather than \$900 in the beginning of the first period and a promise to be paid \$1000 in the beginning of the second period. A promise of higher pay in the second and third period may not attract Zaid under the circumstances.

2) Possibility of Theft

If there were a possibility of theft, all other assumptions (i.e., 1 and 3 to 7 remain effective), he would prefer option (c) even if it were available at some cost.

3) Inflation

If Zaid expects a positive rate of inflation (all other assumptions i.e., 1,2, & 4 to 7 intact), he would be indifferent among the three options but he may spend a bit less in the first two periods to have a uniform level of consumption during the three periods he expect to live. He can alternately, ask for a gradual increase in the payment starting with some thing less than \$600 in the first period and gradually increasing to leave the real income unchanged. Indeed if he has an option to put some of his saved money where he can get a certain return, he would prefer arrangement (a) or (b). If he can also have an opportunity to get even a higher return with some risk, he may choose a portfolio with some of the savings

²²By normal I mean an average person. Some people may care too much about future and may be called misers. Others may be too careless about future. But I assume that the behavior of most lies somewhere in between.

going to certain and the rest to the uncertain or risky investment. The actual dispersion of the portfolio would depend on his attitude towards risk.

4) Difference in needs during different periods

Suppose Zaid thinks that he would not need \$600 in the third period. In that case he would like to get more in the first and the second period and hence he would not opt for option (c). This, however, is not a reflection of time preference. His expenditure is higher in the first two periods, so he would like to be paid more during these two periods. Suppose his expenditure is higher than \$900 in the first period (the maximum he can get in that period) but he thinks that his total requirements for the second and the third period would be less than \$900. He may be willing to borrow in the first period and pay back later. Depending upon his intensity of the requirement in the first period, he may even agree to pay more than what he actually borrowed (ignoring the religious restriction on such extra payment for the moment). Similarly, if Zaid's requirement in the first period is less than what he can be paid during the period, he may not mind to lend some amount to someone to be paid later provided there are no uncertainties about getting back the loaned amount and there is no inflation. He would not mind if the borrower, under the same assumptions, gives him an extra amount as a reward (again ignoring the religious restriction on such extra payment for the moment). Zaid may be a miser by nature and he would save more than what he thinks he would need in future, and vice versa.

5) Uncertainty about the ability to earn in the future

If Zaid thinks that he may or may not be able to work in the second period, he would rather save a proper amount in the first period. On the other hand if he thinks that later in his life, he would get some help from his children or the government, he may spend more during the first period.

6) Other sources of income and endowment

If Zaid has some other sources of income in the three periods, his preference may be then different. For example, if he believes that his children are going to support him in the third period, then he would prefer arrangement a or b over c.

7) Possibility of investment

If some avenues of investment are available with sure return, he would prefer the payment arrangement (a) or (b) and definitely put his savings there. But even if only risky investment opportunities were available he would put some of his savings in the first or the second period earning. The level of investment would partly depend on his degree of risk aversion. But this act again has nothing to do with pure time preference. This shows that Zaid will prefer to get income in the early periods that it can be invested and thus used to make more income (and hence more consumption) in the future. In this way he will be able to buy more and more is preferred. So it is not the time preference but preference for more consumption that could be available in the future! Also, it is not preference for present consumption but preference for more consumption (in future), which is reasonable and rational. There is also nothing immoral about this.

It should be clear from the above analysis that preference to get income earlier is only indirectly related to time: to avoid uncertainty of payment or to avail an investment opportunity in the future. It is not that people prefer present consumption to future consumption in general. But there are some other factors which influence their decision to receive, if possible present income (not necessarily present consumption) sooner than later. My intuitive assertion is in conformity with a recent survey article on time preference. Frederick et al (2002) have also argued that what is being labeled as discounting of future payments and time preference could actually be a reflection of avoidance of uncertainty or impact of inflation or missing an investment opportunity or a combination of these and more factors.²³

²³Frederic et al (2002), pp. 381-83.

5) ISLAMIC POSITION ON INTEREST AND TIME PREFERENCE

Both Anas Zarqa and Monzer Kahf are correct in their assertion that the prohibition of interest in Islam is not a sine qua non to denial or recognition of time value of money. Our analysis of the previous section shows that the desire to receive nominal payments earlier than later is not necessarily related to time preference. It has also been argued earlier in this paper that, for some economists, pure time preference could be one justification for a lender or provider of funds to ask for an extra payment or interest. Similarly, one can also ask for an extra payment on loan for other reasons such as anxiety caused by giving a loan (the uncertainty problem), inflation, missing a profitable opportunity etc. However, according to my understanding of Islamic teachings, while these concerns are not unrealistic, they do not allow the borrowers to charge extra payment on consumption loans except for a compensation for inflation. Islam encourages its followers to give consumption loans to those who are in need. It further recommends them to give more time if the borrowers are facing difficulties. However, the lender has an option to refuse to give loans. But in no circumstances Muslims are allowed to give loans and then ask for an additional amount (except, in my opinion as a compensation for inflation). In case of business loans, an extra payment should be related to any profit made by using the funds.

Time Preference, Interest, Bai Muajjal and Bai Salam

It should be admitted that people would not invest or lend money for business if they do not expect to get a positive return. This is an important point that has been emphasized by Kahf. One should also be ready to admit that people would like to pay a premium if they can consume some thing earlier than later. This is not equivalent to comparing an apple today to an apple tomorrow. It is a choice between not consuming an apple today and consuming an apple today, Similarly, it is not equivalent to commuting by a car today and commuting by a car tomorrow. It is a choice between travelling by a bus today and travelling by a car today. If Zaid can borrow today which enables him to buy and commute by a car today (which he prefers to commuting by a bus), he may be willing to pay more tomorrow than what he borrows today (assuming a zero rate of inflation for simplicity)²⁴ This may be because he expects to earn more tomorrow and / or because he thinks he can save the required money (principal plus interest) over a period of time or he can pay back the principal and an additional amount, through installments.

Thus, one should admit that there seems to be a justification for payment of interest as it allows a consumer to buy and use (and get utility) a consumer durable earlier than he is able to do otherwise. However, one should also admit at this point that when a person is having difficulties in meeting his immediate needs (food, clothing and shelter, etc.), he will be willing to borrow on interest. But the lender is categorically prohibited to lend money on interest in this situation. The difference in the two situations is the severity of the borrower's needs. But for the lender both situations provide an opportunity to increase his wealth without contributing to a productive activity (and perhaps this is the Islamic reason for prohibition of interest in both situations; it implants seeds of greed for more wealth without consideration of social responsibility). While one can understand the difference between the two situations, the severity of the condemnation of the second transaction warrants a very careful look at the first situation. Devising a mechanism that allows the sale of consumer durables on installment without involving interest is perhaps

²⁴During a recent seminar at University of Brunei Darussalam Roger Neil Lawrey of Department of economics asked me if this is not an evidence of positive time preference that people are generally ready to pay a higher price for deferred payment purchase? My answer to this question is no! People who buy a car today on a deferred payment basis are not implying that they prefer to use a car today and use a bus tomorrow. They are implying that they prefer to use a car today than using a bus today. This is a preference for a car over a bus and they are ready to pay a higher than the cash price on deferred basis. From the social point of view it is undesirable because the relatively lower income people end up paying a high price for the same commodity under deferred payment arrangement. It is claimed that in many parts of Pakistan the implied interest rate on deferred payment sale can go substantially higher than the interest rates charged by the commercial banks

the best solution for the situation. This will be a unique contribution of Islamic finance. It would help many people who may not be very poor but who are relatively less fortunate than others.

An appropriate and practicable mechanism of different payment sale without any increase to cash price would require the following:

1. A very low level of inflation
2. An understanding on the part of seller or lender of durable goods that charging an extra amount would tantamount to or close to interest condemned by the Holy Book whereas an avoidance of that would mean blessings of the Creator
3. An understanding / realization on the part of Muslim economists that further sale or opportunity of profit may be possible only if the seller agrees to sell on installments. No seller would be willing to sell on credit without interest if he can find buyers ready to pay full cash payment for all the units of the goods he has to sell. Sale on credit would make sense only if, (a) all the units available for sale could not be sold on cash or (b) the "implied" rate of interest earned on deferred sale is significantly higher than the interest rate that can be earned by putting an equivalent investment in a suitable deposit scheme of a bank. One also has to remember that even at the cash price of a good a normal profit is earned. So only extra amount that could be charged with a moral justification should not exceed the rate of inflation.
4. The amount involved should be minimum possible so that it is easier for the buyer to pay back in time. That means consumers should be discouraged to buy unnecessarily expensive brands.
5. Down payment should be maximum possible so that the consumers are encouraged to save maximum possible before buying a consumer durable.

Financing of consumer durable is an important issue. However, allowing bay muajjal and murabaha as it is currently practiced, is not the solution. The effect is similar to that of interest. The prophet would have not allowed it looking at its exploitative nature. The people with relatively less income and wealth end up paying more for the same commodity even if we give allowance for inflation.

On several points Monzer Kahf's criticism of Fahim Khan is convincing. He correctly claims that, although wages and rent are fixed payments that are settled in advance, they are not like interest. The rent of a structure could be higher than the depreciation cost and any tax paid on it. The difference could be justifiably regarded as a profit to the person who invested his resources to build the structure. Just because it is a fixed payment, rent cannot be regarded as interest. An entrepreneur who decides to run a business may employ the services of labor and land on a fixed payment basis or through a profit and loss sharing arrangement.²⁵

While Monzer Kahf points raised against Fahim Khan are quiet convincing, his own case for acceptance of murabaha and bay muajjal payments are very weak. He takes pain to justify the way murabaha is being practiced today.

Monzer Kahf's point is not convincing. Just because a good (instead of money) is involved in a murabaha transaction is not a sufficient argument for its justification. The effect is similar to that of interest. According to Monzer Kahf:

"Trade has the same characteristic, that other production processes have, of ownership of goods with the intention of selling at a higher price than their cost. In Bay Muajjal and in Salam, the owner of investible funds incorporates his/her expected time value of money in the investment process he/she pursues. The fact that once a contract is concluded in a Bay Muajjal, we reach the ex-post evaluation of time preference does

²⁵ For a detailed discussion of factors of production and their remuneration in Islamic economic context, please see Siddiqui (1996).

not change the nature of the process. In Bay Muajjal one begins by the mental operation of formulating an anticipated time value of money, then transforming funds into goods, owning them and then taking responsibility of one's ownership, then concluding a deferred payment sale which transform his/her expectation into an actual and final reality although this actual time value of money needs not be the same as the anticipated one. This process is essentially the same as Musharakah, Mudarabah and leasing.²⁶

It seems that Kahf is confusing two different things. The issue is not about the validity of production and trade for profit motive. The issue is deferred sale on higher than present price. A manufacturer can also be involved in selling his product on deferred sale with higher than cash price. All producers and traders do anticipate a possible sale price for their product that may or may not realize. There is nothing special about that. The problem is that when a consumer borrows from a bank on interest to buy some consumer durable, he and the bank are supposed to be committing a great sin. However, if the same person purchases the same good from a trader or producer on a deferred payment basis, both are said to be involved in doing something similar to Mudarabah, a form of business practiced by the Prophet (PBUH) himself.

There does not seem to be any evidence that Prophet (peace be upon him), in his life time, had ever allowed a bay muajjal or deferred payment transaction involving a higher than the current price of a good. He could have realized what avenues of riba would be opened if differed payments sales were legalized. After discussing the relevant Ahadith on riba at length, Chapra (1985) has correctly pointed out that Riba Al Fadl was disallowed by the Prophet to remove all the injustices in the economic system.²⁷ It is hard to believe that the Prophet would have allowed the bay muajjal and murabaha transactions the way they are being used today. But unfortunately, Chapra himself does not come to categorically disallowing bay muajjal transaction involving a higher than the cash price.

The case against ijarah wal iqtina could be made the same way. In this case it is not consumer durable but a machine or equipment. The party purchasing the machine or equipment may be a well to do businessman. But he / she could also be a business entrant without sufficient wealth and capacity to absorb huge losses. When machine or equipment is rented through operational leasing or ijarah, both parties involved are sharing the risk of the business. In ijarah wal iqtina, the lesser does have an exposure to risk. In case of non-payment of the rent, he can confiscate the machine or the equipment, but could still incur a loss if sufficient amount has not already been recovered through (a) installments paid by that time and (b) any amount recovered through court settlement. However, this is not the norm and in most cases the lesser do get a significant amount of earnings through this mode of finance. The real question is that why the person or business that agrees to have a transaction based on ijara wal iqtina could not arrange the required amount through equity finance?

One may be tempted to put the case of bay salam to justify the murabaha transaction with a higher than the current price. However, in case of bay salam the payment is made in advance to the farmers to provide them necessary cash either to facilitate production or to enable them to consume earlier. But there is no evidence that the merchants who bought the farm produce in advance used to pay lower than the normal price of the product. The Prophet would have never allowed bay salam if the buyers in his time were indulged in paying a lower than the normal price and thus harming the farmers who were in need of cash. Furthermore, by paying a normal price in advance, the buyers (who must had been the traders or middlemen) were although assured of procurement were exposed to a risk of price fluctuation.

²⁶ Kahf (1992), p. 36.

²⁷ Please see Chapra (1985), Chapter 2.

6) CONCLUDING REMARKS

It is hoped that a successful attempt has been made in this paper to show that people may not generally have a pure positive time preference. Moreover, what may appear as pure time preference may not be a preference for present consumption over future consumption. People are generally not irrational or unmindful of future needs. But rather than a preference for present consumption they may actually have a preference for a currently realized income to a promised future income. However, in the context of Islamic economics and finance none of the above two reasons justifies a reward for consumption loan. It is argued that, although the case of consumer durables seems to be different from goods that are regarded as necessities, it would be a unique contribution of Islamic finance if a mechanism of interest free loans for such goods could be devised. It is finally argued that Monzer Kahf's defense of bay muajjal is weak. Unlike his assertion, bay muajjal is neither similar to mudarabah or musharakah nor its permissibility could be linked to bay salam.

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