

# CHAPTER ONE

## INTRODUCTION

### A. BACKGROUND OF STUDY

In the context of the conventional economy, there are many things we can compare the technique, means comparisons should be done from the Islamic perspective when the techniques and concepts we cannot find an adequate solution in the capitalist system. One of which is the time value of money concept.<sup>1</sup>

The fundamental idea in finance that money today is worth more than money to be received in the future. Because money can earn interest if invested. This concept applies to many contracts, for example, a trade in which payment is delayed will often require compensation for the time value of money.<sup>2</sup> And the concept that a certain amount of money, the more valuable the more readily accepted. Time value of money is not only dependent on the time interval under consideration, but also the discount rate used in calculating the present values or future.<sup>3</sup>

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<sup>1</sup>The concept, used as the basis for discounted cash flow calculations, that cash received earlier is worth more than a similar sum received later, because the sum received earlier can be invested to earn interest in the intervening period. For the same reasons, cash paid out later is worth less than a similar sum paid at earlier date. (in : Jonathan Law BA., Oxford Dictionary of Finance and Banking, 4<sup>th</sup> edition (Oxford University press, 2008). p. 440).

<sup>2</sup><http://www.commonsemmedia.org/> Farlex Financial Dictionary, 2012 farlex, Inc. All Rights Reserved.html, accessed on 12 may 2013.

<sup>3</sup>[http://books.google.co.id/Wall street words: An A to Z Guide to Investment terms for today Investor.html](http://books.google.co.id/Wall%20street%20words%3A%20An%20A%20to%20Z%20Guide%20to%20Investment%20terms%20for%20today%20Investor.html), accessed on 11 may 2013.

The time value of money concept has been claimed by most Islamic economists as a prohibited because of the element of *riba* inside. While understanding this concept tangible reflected in some contract. In which it is allowed under Islamic Sharia law, for example, the principle of buying and selling of *Salam*, *Ijarah*, and the concept of *Ujrah* (fee) in Islam. Where all things are not can regardless of the time dimension, that is inherently linked to the existing transaction.<sup>4</sup>

In the economics may appear risk-return<sup>5</sup>, thus reduced and increased results for a person if pursued appropriately is a normal.

In the Islamic economic system, the concept of time value of money is certainly not going to happen. Islam has no concept of time value of money. In the view of Islam is the time worth by itself, called the economic value of time.<sup>6</sup>

With regard to money, the Islamic economy is essentially crucial question is not on "how many" or "anytime". But more important is about "for what". The first question (how many and anytime), as if it was assumed that human beings all have the same preferences, that humans are consistent

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<sup>4</sup>Syafi'i Antonio, "Hukum Harga Tangguh Dalam Islam", an Articles not published, in : <http://jacksite.wordpress.com.html>, accessed on 9 June 2013.

<sup>5</sup>A Possibility of Financial Loss (whether in absolute terms or relative to expectation) that is inseparable from the opportunity for financial gain .(in : Jonathan Law BA., Oxford Dictionary of Finance... p. 440)

<sup>6</sup>Syafi'i Antonio, "Hukum Harga Tangguh....", accessed on 9 June 2013.

with the principles of economic rationality `` maximizing pleasure minimizing pain``.<sup>7</sup>

One trend of thought among western economics, made prominent by, and since, Bohm-Bawerk, assumes positive time preference to be a systematic or normal pattern of behavior. Negative (end zero) time preference is viewed as an aberration or at least a rare exception. Some economists have elevated positive time preference to the status of a principle of rationality in discounting.<sup>8</sup>

In the theory of cost-benefit analysis, the discount rate represents the return on investment required to justify the expenditure of scarce social resources. This in turn reflects decision maker impatience or time preference, the degree to which they prefer to receive benefits, in the present rather than the future.<sup>9</sup>

Islamic economic assumption, there is no amount of money will provide fixed income. Because it does not recognize to Islamic economics, as owned by the finance through the conventional concept of (interest-based income), with the ascertainment of profits above a certain amount of money. Surely, someone would tend to hold the money now than later or if the money was held later, there must give the compensation for the benefits he should get.

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<sup>7</sup>Jeremy Bentham, 178-1823, (in : Adiwarmar Karim, *Bank Islam: Analisis Fikih dan Keuangan*, (in the appendix 1 of Economic Value of Time), 3<sup>th</sup> edition (Jakarta: PT RajaGrafindo Persada, 2007) p. 374)

<sup>8</sup>D. Patikin, `` Interest``, in D.L Silss. *International Encyclopedia of Social Science*, Vol. 7, no Years (MacMillan).

<sup>9</sup>Richard B. Howarth, ``Discounting, Uncertainty, and Climate Change``, in *Dartmouth College for Economics for Equity and the Environment Network*, 1 April 2009. p. 3.

So to deny the validity of this concept there is a bid concept, namely economic value of time.<sup>10</sup>

In this regard, it has been mentioned in many articles and papers that conventional economic thinking arises according to the time value of money. The question now is whether the concept is there or justified in Islam?. Muslims Economists still debate on this theory, including the famous economist Muhammad Anas Zarqa and Muhammad Akram Khan, in this case they are criticizing on this theory. Thus, with regard researcher would like to discuss about the concept of time value of money on discounting, that builds upon capitalist system. And both are economists criticizing on this concept, as well as the similarities and differences of opinion that it would be more analysis continued.

## **B. PROBLEM FORMULATION**

In accordance with the above background, so that the problem can be formulated in this study are as follows:

1. How time value of money on discounting concept developed by the capitalist system?
2. What Muhammad Anas Zarqa and Muhammad Akram Khan views about the time value of money concept on discounting?

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<sup>10</sup>Adiwarman Karim, *Bank Islam: Analisis...*, p. 375

### **C. PURPOSE OF STUDY**

Based on those problems above, it can be concluded the purpose of this study are as follow:

1. Providing views on the concept of time value of money which developed by capitalist system.
2. Providing views on Muhammad Anas Zarqa and Muhammad Akram Khan is concept of time value of money on discounting.
3. Providing views on the similarities and difference of their opinion about time value of money on discounting.

### **D. THE SIGNIFICANCE OF STUDY**

This study is devided into theoretical and practical, as follow:

1. Theoretical Significance:
  - a. Providing views for researcher and reader on concept of time value of money on discounting which developed by capitalist system.
  - b. Providing views Muhammad Anas Zarqa and Muhammad Akram Khan is concept of time value of money on discounting that along with the development of the times and a lot of transactions carried out with a deferred payment it relates to time.
  - c. It can be used as additional useful information for the reader interested and made reference to the related fields.

## 2. Practical Significance:

- a. To increase knowledge of researcher and other readers about concept of time value of money on discounting.
- b. Can be used as additional reference, the results of research on this concept and the Muslims are expected to be able to apply in their lives to fellow Muslims in particular, and all people in general.

## E. LITERATURE REVIEW

In this study, researcher used several references as main reference, which all use the primary books, journals and extensive results of thesis.

The article entitled **An Islamic Perspective on the Economic of Discounting in Project Evaluation**<sup>11</sup>, written by Muhammad Anas Zarqa, This article aims to criticize the concept of time value of money on discounting which is developed by the capitalist system. result of this paper is legitimate economic activities within islamic economy generate rates of return, not interest rates. to keep on thinking on islamic economy in terms of interest rate, much like counting on one`s fingers is just bad habit. So, discounting is acceptable islamically, even desirable to the extent that it promotes investment efficiency. In this case the researchers disagree with the opinion of Anas Zarqa, which declared with discounting as objectives efficiency of investment acceptable in Islam, because it legitimized usury.

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<sup>11</sup>Muhammad Anas Zarqa, "An Islamic Perspective on the Economic of Discounting in Project Evaluation", in Sheikh Ghazali, Sheikh Abod, Syed Omar, Syed Aqil Aidit, Hj. Ghazali, *An Introduction to Islamic Finance*, (Malaysia: CERT Publication (Revised Edition), 2008). p. 119-160.

Article on **Time Value of Money**<sup>12</sup>, Written by Muhammad Akram Khan, the main conclusion this article is that the time value of money is unsound concept on rational grounds. He said, acceptance of this concept leads to legitimation of interest (riba). In this case the researchers agree with Akram Khan that discounting is a container legitimize usury by using interest rate.

Thesis, entitled: **Implikasi Time Value of money dalam sistem tempo pembelian hand phone ditinjau dari hukum islam**<sup>13</sup>, written by Fatimatuz Zuhro, the student of UIN Sunan Kalijaga Yogyakarta. the results of this study that there are no losses on both sides agree on the determination of profits. delay payment system provides additional advantages, it's a real business to appreciation of the time, so macell can provide more benefits. in this case the researchers saw that the system used is bai `mu` ajjal with murabaha system, not profit-based interest but an agreement with both parties so that there are no losers.

So, the Paper, **Pemakaian Maslahah Terhadap Konsep Nilai Masa Wang Dalam Sistem Perbankan Islam di Malaysia**<sup>14</sup>, Written by Ridzwan Ahmad and Azizi Che Seman. In This paper is analyzes the concept of time value of money in the light of maslahah which serves as the backbone for the

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<sup>12</sup>Muhammad Akram Khan, "Time Value of Money", in Sheikh Ghazali, Sheikh Abod, Syed Omar, Syed Aqil Aidit, Hj. Ghazali, *An introduction to Islamic Finance*, (Malaysia: CERT Publication (Revised Edition), 2008). p. 127-142

<sup>13</sup>Fatimatuz Zuhro, *Implikasi Time Value of Money dalam Sistem Tempo Pembelian Hand Phone Ditinjau dari Hukum Islam*, undergraduate thesis not published, Islamic State University Yogyakarta, Digital Library of UIN Yogyakarta, 2008.

<sup>14</sup>Ridzwan Ahmad and Azizi Che Seman, "Pemakaian Maslahah Terhadap Konsep Nilai Masa Wang Dalam Sistem Perbankan Islam di Malaysia", Paper in *Journal of Fiqh*, No. 6 (2009) 87-106.

exercise of many deferred contracts of exchange. It also emphasizes on some aspects of ambiguity in the operation of Islamic finance particularly in Malaysia. Researcher concluded, applying isti'na selling very rapidly in Malaysia, this transaction so bloom in use and in accordance with the maqasid shari'ah because there is no injured party.

So, the book entitled, **Manajemen Keuangan Perusahaan (Teori dan Praktek)**<sup>15</sup>, the book written by I Made Sudana, this book describes the importance, application and various concepts of time value of money. Which in this case, the researcher concluded that the author of this book, makes the reader want to understand the concept with clearly illustrates the theories of the time value of money.

References above strongly support the researchers in this study, as the basis for reference and additional information, about the data to be processed, so this research is important to discuss.

## **F. THE THEORITICAL FRAMEWORK**

In this research, the researcher used ideational approach which used to select the Islamic economists writing related to time value of money and analyze it.<sup>16</sup> This approach is benefit to find the idea of Islamic economists are

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<sup>15</sup> I Made Sudana, *Manajemen Keuangan Perusahaan Teori dan Praktik*, (Jakarta: Erlangga Publisher, 2011).

<sup>16</sup> This approach is used by Dr. Fauzan Saleh for writing his doctoral thesis in McGill University Canada entitled "Modern Trends in Islamic Theological Discourse in Twentieth Century Indonesia: A Critical Survey", which is published in Indonesia entitled *Teologi Pembaruan, Pergeseran Wacana Islam Sunni di Indonesia Abad XX*. (Jakarta: Serambi, 2001).



Muhammad Anas Zarqa and Muhammad Akram Khan of time value of money on discounting, even if their thought on it are explicit and then analyze and criticize it. However, the researcher will use the economic theories as his theoretical framework and more specifically the time value of money on discounting theories.

Money as a medium of exchange is a very sacred and means in the growth of the economy in both the micro and macro scale, because the money can be paid at any time without having first exchanged with other objects, and without having to wait for other people's willingness to accept.<sup>17</sup>In economics developed at this time arose view time value of money concepts is a development of the theory of interest, from the views of capitalist economists of all time.<sup>18</sup>

A dollar on hand today is worth more than a dollar to be received in the future because the dollar on hand today can be invested to earn interest to yield more than a dollar in the future. The Time Value of Money mathematics quantify the value of a dollar through time. This, of course, depends upon the rate of return or interest rate which can be earned on the investment.<sup>19</sup>

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<sup>17</sup>Suherman Rosyidi, *Pengantar Teori Ekonomi: Pendekatan Kepada Teori Ekonomi Mikro dan Makro*, (Jakarta: PT RajaGrafindo Persada, 2006), p. 28

<sup>18</sup>Syafi'i Antonio, "Hukum Harga Tangguh...", accessed on 9 June 2013.

<sup>19</sup>Bruce, J., Sherrick, Paul N, Ellinger, David A, Lins., "Time Value of Money and Investment Analysis". *The Center for Farm and Rural Business Finance*, Department of Agricultural and Consumer Economics and Department of Finance, University of Illinois, Urbana-Champaign, V 1.2, September 2000.

The time value of money has applications in many areas of Corporate Finance including Capital Budgeting<sup>20</sup>, Bond<sup>21</sup> Valuation, and Stock Valuation. For example, a bond typically pays interest periodically until maturity at which time the face value of the bond is also repaid. The value of the bond today, thus, depends upon what these future cash flows are worth in today's dollars.

The Time Value of Money concepts will be grouped into two areas: Future Value and Present Value. Future Value describes the process of finding what an investment today will grow to in the future. Present Value describes the process of determining what a cash flow to be received in the future is worth in today's dollars.<sup>22</sup>

Time value of money is an important concept for consideration and applied in decision-making in finance, especially long-term decisions. This is because the use of funds at the time the results are not always immediately available to whole moment, but recently acquired a few and then gradually.<sup>23</sup>

Money is not a commodity but as a medium of exchange, in this case related to money by the time the money is not the object but the time, the factors that determine the value of time is how people take advantage of the

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<sup>20</sup>The process by which an organization appraises a range of different investment projects with a view to determining which is likely to give the highest financial return. The approaches adopted include net present value, the internal rate of return, the profitability index, and the payback period method. (in: Jonathan Law BA., Oxford dictionary of Finance..., p. 65).

<sup>21</sup>An IOU issued by a borrower to a lender. Bonds usually take the form of Fixed-interest securities issued by governments, local authorities, or companies. (in : Jonathan Law BA., Oxford dictionary of Finance..., p. 50)

<sup>22</sup><http://www.zenwealth.com/BusinessFinanceOnline/TVM/timevalueofmoney.html>, accessed on 15 June 2013.

<sup>23</sup>I Made Sudana, *Manajemen Perusahaan...*, p. 68.

time, the more effective and efficient (right way)<sup>24</sup>, the higher the value of time and it will be profitable in the world for those who carry it out.<sup>25</sup>

Investment is a defer consumption to get a value greater consumption in the future. To maximize utility, a person will only invest, if the expected benefits of the delay is greater than if the money is being spent now. Before analyzing decision making under conditions of uncertainty we have to do the analysis of investment under conditions of certainty.<sup>26</sup>

Discounting, the usual procedure to give a present value to financial flows occurring in the future, seems to give outrageously low values to future damages, and thus, to "play against" the environment and future generations. On the other hand, low discount rates would imply more sacrifices for present generations, although future generations may be richer. And using various discount rates would lead to inefficiencies in selecting investment policies.<sup>27</sup>

Professor Muhammad Anas Al-Zarqa, Senior Advisor, Shura Shari'ah Consultancy Education: L.L.B (Hon.,1960), Damascus University, Syria. Ph.D. (Economy 1969), University of Pennsylvania, USA. Was tutored in fiqh by his

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<sup>24</sup> "Effective is doing the right things. In efficient is doing the things right" (in Adiwarman Karim, *Bank Islam: Analisis...*, p. 375).

<sup>25</sup> Adiwarman Karim, *Bank Islam: Analisis...*, p. 376.

<sup>26</sup> Zaenal Arifin, *Teori Keuangan dan Pasar Modal*, 1<sup>st</sup> Edition (Yogyakarta: CV. Adipura, 2005). p. 21.

<sup>27</sup> Cedric Philibert, "Discounting The Future", in *International Energy Agency, Energy and Environment Division*, June 2003. p. 1.

late father Sheikh Mustafa A. Al-Zarqa, a renowned Shari`ah Scholar. His career began 1970 - 1976 in the State Planning Commission Syria.

Between 1977-2000, Professor Al-Zarqa taught and supervised MA and Ph.D. theses at the Islamic Economics Research Centre (now the Islamic Economics Institute) and the Department of Economics at King Abdul Aziz University in Jeddah.

Then he moved to The International Investor, Kuwait where he was appointed as the Advisor in Sharia Compliance between the period 2001- 2008. At present and since 2009, he joined Shura for Shari`ah Consultation, as Senior Advisor.

He published many academic papers, in both Arabic and English connecting economics, fiqh and Islamic finance, particularly in macroeconomics, project evaluation, distribution, mythology, zakat, financial contracts and insurance.

Anas Zarqa has been awarded IDB Prize, in Islamic Economics, 1990. Moreover, he is a member at the, Shari`ah Standards Committee, AAOIFI Bahrain, and the International Association for Islamic Economics - London, the American Economic Association. Furthermore, he is an Advisory Board Members for several Islamic economic journals.<sup>28</sup>

Muhammad Akram Khan, a pioneer in the effective use of Performance Auditing, is an Audit Professional with over 30 years experience. He developed the Performance Auditing Methodology used by the Department of

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<sup>28</sup><http://www.zoominfo.com/p/Muhammad-Zarka/html>.

the Auditor General, Pakistan. For years he served as the Director General of Performance Auditing in the Department of the Auditor General of Pakistan.

His previous experience includes the delivery of numerous training courses and workshops for auditors in Pakistan, Saudi Arabia, Malaysia and China. Responsible for training auditors of all levels in the Department of the Auditor General of Pakistan, he trained hundreds of auditors in scores of professional courses, developed training material for various programs, and wrote a training manual for the department.

Additionally, he was a visiting professor on Performance Auditing in the International Islamic University Malaysia. He has been a regular speaker on Performance Auditing for training programs of senior executives and middle managers in the National Institutes of Public Administration, Lahore and Pakistan Administrative Staff College.<sup>29</sup>

## **G. REASERCH METHOD**

In analyzing the study, the researcher also had to use a methodology in order to get accurate results with analysis of existing materials. The method used by the researcher is:

### **1. Research format**

Applied research by researcher in the study is Inductive of Comparative Analitative is qualitative.

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<sup>29</sup> <http://www.pleier.com/pacd.html>.

## 2. Data Source

In these data sources, researcher used primary and secondary sources:

- a. Primary source is taken from the book, entitled: An Introduction to Islamic Finance, Edited by: Sheikh Ghazali, Sheikh Abod, Syed Omar Syed Aqil Aidit, Hj. Ghazali, Oxford University, Quill Publisher. In this book there is a article about An Islamic Vendor's Perspective on the Economic Evaluation of Discounting in Project written by Muhammad Anas Zarqa and articles about the Time Value of Money, written by Muhammad Akram Khan.
- b. Secondary data sources which are collected from the books, papers, magazines, newspaper, website etc written by another person besides the persons mentioned above whereas discussed a related topic to Time Value of Money Concept.

## 3. The Method of Collecting Data

To collect the data from the sources, the researcher shall uses at least a primary method, it is:

### a. Documentation Method

Documentation method is a method to look for any data from expert writings, transcripts, decisions, newspaper, magazines etc. This method used for collecting the ideas and the thought of Islamic economist to be a fundamental of this research.

#### 4. Method of Data Analysis

To support the researcher in writing this thesis, uses a number of analysis method, they are as follow:

##### a. Inductive Method

This method based at special principles and arranged in general formulation<sup>30</sup>.

The writer uses this method to explain about the concept of Time Value of Money generally.

##### b. Deductive Method

This method is done by a thinking process from the main declaration to special declaration<sup>31</sup>, or in another word, thus particular instances are deduced from general inferences<sup>32</sup>. The writer uses this method to descript the general concept of Time Value of Money.

##### c. Analysis Descriptive Comparative Method

This method is to solve the gathered essence of research, and to look for the scientific research which follows the role of writing and analyzing it with the comparison between two opinions or more.<sup>33</sup> The researcher uses this method to compare and know the

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<sup>30</sup>Sutrisno Hadi, *Metodologi Riset*, (Yogyakarta: Yayasan Penelitian Fakultas Psikologi UGM, 1987), p. 42.

<sup>31</sup>Sartono Kardiharjo, *Pengantar Penelitian Ilmiah*, (Bandung: Tarsito, 1990), p. 24.

<sup>32</sup>Jill Hussey and Roger Hussey, *Business Research*. (New York: Palgrave, 1997), p. 13.

<sup>33</sup>Sartono Kardiharjo, *Pengantar Penelitian...*, p. 64.

concept of Time Value of Money on discounting According to Muhammad Anas Zarqa and Muhammad Akram Khan.

## 5. SYSTEM OF STUDY

Researcher can classify this research into five chapters, with each chapter consist of:

Chapter one consists of an introduction, background of study, problem formulation, purpose of study, significance of study, literature review, theoretical framework, research methods and system of study.

Chapter two will explain the general overview of the concept of time value of money consisting of: understanding and importance of the concept of time value of money, the kinds of concepts, concept applications, as well as comments on the concept of time value of money on discounting according to Muhammad Anas Zarqa and Muhammad Akram Khan and them bibliography.

Chapter three will explain the comparative analysis is divided into two discussion points, the first: the concept of time value of money on discounting by Muhammad Anas Zarqa, this chapter consists of two sub-chapter, first linked to The Economic Rational, Second related to An Islamic Perspective on Discounting.

Discussion of the second point, namely: analysis of the concept of time value of money on discounting by Muhammad Akram Khan composed of sub chapter discussion, first linked to The Economic Rational, Second related to An Islamic Perspective on Discounting. And Third Point is the Similarities



and differences of opinion the concept of time value of money on discounting between Muhammad Anas Zarqa And Muhammad Akram Khan.

Chapter Four, this is a result of the data analysis are divided in the conclusions and suggestions made by the researcher in order to be developed for further research.