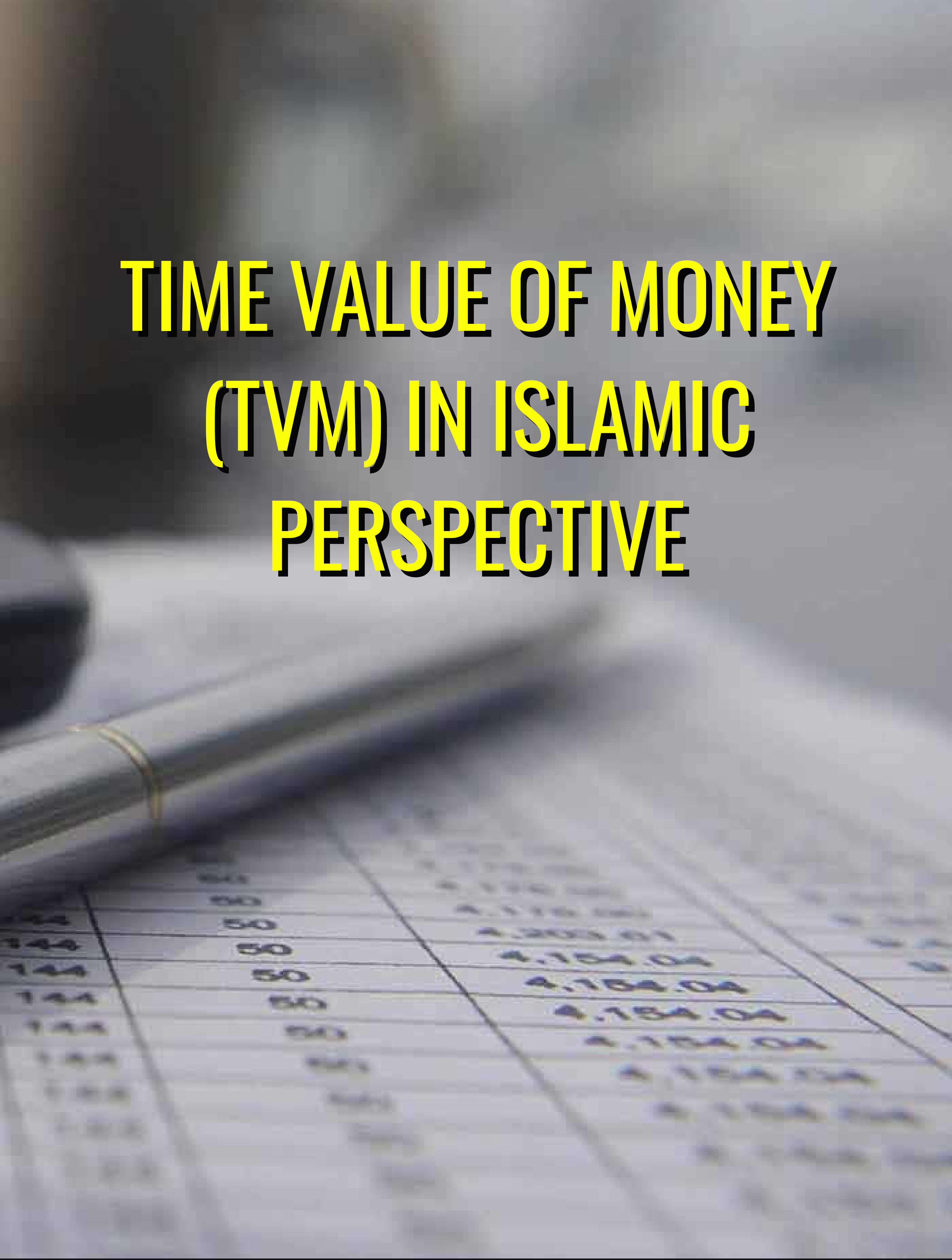
TIME VALUE OF MONEY (TVM) IN ISLAMIC PERSPECTIVE



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INTRODUCTION

Time Value of Money (TVM) is the foundation for all other notions in finance. It impacts consumer finance, business finance, and government finance. The conventional Time Value of Money (TVM) results from the concept of interest that prohibited in Islamic principle. There are several basic principles that caused the conventional theory views money and commodity differs with the principle as defined by Islam.

The interest-based system (*riba'*) was practiced on conventional system. From Shariah point of view, this system has been declared as Non-Shariah compliant (haram) as clearly mentioned in Al Quran, 3: 130.

"O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful"

Islamic banking and finance institution has introduced several interest-free systems, based on trade that accommodate the banking and financing needs of the Muslim population like *Murabahah*, *Bai-Inah* and *Bai' Bi Thaman Ajil* (BBA) of the sales contracts; *Mudharabah, Musharakah* and *Musyarakah Mutanakisah* (MM) of the partnership contract; *Ijarah* and *Ijarah Muntahiah Bi Tamlik* of the leasing contract.

However, the Time Value of Money (TVM) is not rule out in Islamic legal financial theory and practice, as long as it is not part of lending relationship in which it is claimed as a predetermined value. We shall look into the concept of Time Value of Money (TVM) in Islamic perspective and able:

1. To distinguish the Concept of Time Value of Money (TVM) between Islamic and conventional perspectives
2. To enlighten the advantages of Time Value of Money (TVM) in Islamic perspective.

THE DEFINITION OF MONEY FROM CONVENTIONAL AND ISLAMIC PERSPECTIVES

In order to understand more on Time value of money relationship with *riba'*, it is crucial to develop a basic understanding on money.

CONVENTIONAL PERSPECTIVE

From the conventional perspective, money can be seen as:

1. Money is a commodity and is used to obtain other goods.
2. Widely marketable as it is highly in demand and valued good. Thus, it is sure that it can be used anytime and anywhere
3. It can be transport easily. Money is made to make human life easier therefore to make sure that it is convenience is important.
4. Relatively scarce as it is high in demand and high in value, which means it holds a high value in small quantities.
5. Money is relatively imperishable. It is durable and can be used for future purchases.
6. Easy to store
7. Easily divisible
8. Money lasts forever.
9. All units of money are similar, meaning to say that it is easy to distinguish and estimate the value of the money.

Time Value of Money (TVM) in Islamic Perspective

ISLAMIC PERSPECTIVE

As for the Islamic perspective:

1. Money has no intrinsic value, which means it cannot be utilized in direct fulfillment of human needs. Money to Islam can only be used to acquire goods or services. It is not a commodity which can be utilized directly without exchanging it for some other things.
2. All units of money of the same denomination are equal to each other.
3. In commodity, the transactions of sale and purchase are affected on an identified and specific commodity.
4. Money is a medium of exchange. It is a way to define a value of a thing, but not to itself.
5. Money has standard of value which measures the relative different goods and services

THE CONCEPT OF TIME VALUE OF MONEY IN ISLAMIC PERSPECTIVE

The time valuation of money in Islamic perspective is totally different from the conventional since Islam defined money that differs from conventional system. Firstly, the concept of money itself from the Islamic perspective is not similar to conventional. Islam defines money as the medium of exchange. No function at all that money can perform by itself unless when it is exchanged with asset or to buy services that makes money become useful. Secondly, money has worthless in itself due to money unable to produce by itself and it will be productive only when it is jointed with other resources.

In Islam, money is considered as a capital only when it combines with other resources to carry out the productive activity like *Mudharabah* and *Musharakah* that lenders do not share only profit but also loss. In addition, to increase more money by lending out (which is due to it) is prohibited in Islam as it leads to element of interest (*riba'*)

The important function of money is to serve and facilitate the exchange transactions and it is not an objective in itself. Treating money as a commodity like trading money contradicts the Shariah principle and brings more harm than benefit i.e. promotes inflation and creates injustice to the society. In addition, when money can create more money via lending by the concept of interest, it leads the society to greed, speculation and immorality.

For the concept of Time Value of Money (TVM) in Islamic perspective, Islam recognized the concept of Positive Time Preference (PTP). Time is considered as a valuable economic resource that can be explain into two main position:

1. Opportunity cost of postponing current consumption current consumption brings more satisfaction than future consumption.
2. Opportunity cost of not being able to invest funds in productive activity. Owner of funds gives up possibility of earning a positive return on funds

Time Value of Money (TVM) in Islamic Perspective

The concept of Positive Time Preferences (PTP) in Islam is supported by majority of jurists. They agreed that prices for cash sale and credit sale can be varied, wherein the credit price could be higher than the cash price. In Islam view, both time and place have impact on Time Value of Money (TVM) as we can see from the contract of *Bai' Salam* that support Positive Time Preference (PTP) whereby price paid in advance for future delivery of goods is less than cash and carry price.

Therefore, the idea of Islamic Time Value of Money (TVM) is providing of funds should be compensated for foregoing current consumption or opportunity to earn a positive return on investments. **However, this compensation cannot be contractually predetermined because there is no certainty in any outcome**. For example, in profit loss sharing concept or *Mudharabah* transaction that capital provider (*Rabb-mal*) has to a share of venture's profits because he has given up current consumption or ability to invest funds elsewhere. In short, the Shariah principles concept of Positive Time Preference (PTP) is based on real sector that is on business and trade of goods, not in exchange of monetary values and loans or debts.

FUNDAMENTAL ANALYSIS OF TIME VALUE OF MONEY: COMPARISON BETWEEN CONVENTIONAL AND ISLAMIC PERSPECTIVE

Unlike conventional banking based on interest-bearing loans, funds invested in an Islamic bank are used essentially for trade. There is no room for ambiguity in Islam;

"every loan that draws a gain is *riba'*."

Many people question whether Islamic finance differs meaningfully from conventional finance. Outwardly, in form, many structures do bear a similarity in various respects. However, the way these two types of finances function with respect to core defining parameters is very different. Many things look the same but are in essence differ in fundamental perspectives.

We begin with basic principles. One is interest-based money lending while the other operates like a trading house. There are two core principles that make the difference; Elimination of *Riba'* and *Gharar*. Any Islamic transaction needs to assess these two things first. For this, we would have to look at the differences in ways in which modern capitalist theory views money and commodity from the principles defined by Islam.

CONVENTIONAL PERSPECTIVES	ISLAMIC PERSPECTIVES
Money is a commodity besides medium of exchange and store of value. Therefore, it can be sold at a price higher than its face value and it can also be rented out	Money is not a commodity though it is used as a medium of exchange and store of value. Therefore, it cannot be sold at a price higher than its face value or rented out.
Time value is the basis for charging interest on capital.	Profit on trade of goods or charging on providing service is the basis for earning profit
Interest is charged even in case the organization suffers losses by using bank's funds. Therefore, it is not based on profit and loss sharing	Islamic bank operates based on profit and loss sharing. In case, the businessperson has suffered losses, the bank will share these losses based on the mode of finance used like *Mudharabah* and *Musharakah.*
While disbursing cash finance, running finance or working capital finance, no agreement for exchange of goods & services is made.	The execution of agreements for the exchange of goods & services is necessary, while disbursing funds under Murabaha, Salam &Istisnaa contracts.
Conventional banks use money as a commodity, which leads to inflation	Islamic banking tends to create link with the real sectors of the economic system by using trade related activities. Since, the money is linked with the real assets therefore it contributes directly in the economic development.

As the concept of time valuation is possible only in business and trade of goods not in exchange of monetary values and loans or debts. 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. The important conclusion view in Islam is 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 value of the goods or their usufruct is different from the conventional concepts of opportunity cost or the time value.

Thus, the Time Value of Money (TVM) in Islamic view represents the advantages to the economy and society which are:

Fulfill the human need directly

The time valuation of money in Islamic principle differs from the conventional theory as money and commodities have different characteristics, i.e. money has no intrinsic value but it is only a unit of value or medium of exchange so it is unable to fulfill the human needs by itself unless convert to the commodity. Thus, commodity can fulfill human needs directly and can be different quality while money has no differential quality in the sense of the new note of RM 100 is exactly equal in value and quality to an old note of RM 100. Also, commodities are transacted or sold by pinpointing the commodity in questions or at least by giving certain specifications. 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. Therefore, the Islamic view that based on the concept of real price of commodity and usufruct can fulfill the need of human due to it is according to the real situation in the practice.

Enhance the economic productivity

Since its concept based on the real sector of the economic activities, it encourages people for working and trading. This leads the improvement and enhances the ability in competition. Moreover, these economics activities increase the level of real productivity of the system and develop the national economy for achieving the high level of economic growth and the standard of living.

The stability of National economy and society

Furthermore, it leads to the stability to the country's economy because when all economics activities mainly from real sector, it prevents the effect of fluctuation and recession that originates from the greed and speculation. It also reduces the socio-economic problems that happened when applying the conventional time value of money to the system such as the collapse of the system, the default of loan payment, economic crisis and injustice.

CONCLUSION

The Time Value of Money (TVM) in Islamic perspective is totally different from the conventional. The return is not related to *riba'*-based transaction. The fact that Islam forbids *riba'* does not mean that it is against the concept of Positive-Time Preference (PTP). Furthermore, time valuation is possible only when goods are traded, not when exchanging monetary values and loans or debts. The important conclusion view in Islam is 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.