African Journal of Business Management Vol.6 (37), pp. 10099-10108, 19 September, 2012
Available online at http://www.academicjournals.org/AJBM
DOI: 10.5897/AJBM12.740
ISSN 1993-8233 ©2012 Academic Journals

Review

The prevention of over-indebtedness: The problem of interest and the Islamic response

Nico P. Swartz

Department of Law, University of Botswana, Private Bag UB 00705, Gaborone, Botswana. E-mail: nico.swartz@mopipi.ub.bw.

Accepted 20 February, 2012

The current system of lending and borrowing on interest is to a large extent responsible for the present economic woes of the Western capitalist world. In a credit agreement, there is invariably an inequality between the credit lender and credit borrower in an agreement for the loan of money. Given the considerable imbalance, many South African consumers have concluded unaffordable credit contracts, which have resulted in their over-indebtedness. As stated in this study, mechanisms such as the National Credit Act 34/2005 and the *in duplum* rule are not able to prevent over-indebtedness, because over-indebtedness is the result of borrowing at interest. The provisioning of debt counsellors by the National Credit Act results in additional cost for the already over-indebted consumer. Notwithstanding the existence of the National Credit Act and the *in duplum* rule, the industry was and remain largely unregulated and malpractices are rife. This situation has generated an interest in Islamic economics and has fuelled a debate about the possibility of survival for a modern economy without interest. The elimination of interest will act as a countervailing force against the cumulative debt problem facing all nations. The Islamic economy could make a useful contribution to the prevention of over-indebtedness. The practice of doing business on a non-interest basis has finally come of age.

Key words: National Credit Act, In duplum rule, Mudarabah, Musharakah, Islamic Economic Empowerment, Interest, Black Economic Empowerment, South Africa.

INTRODUCTION

The rule of Islam is clear and simple: if you advance a loan, you are entitled to receive your capital only and nothing more. However, if you wish to secure profit, you should enter into a partnership and become a shareholder. This is what justice demands and this is the way in which mankind can prosper (Siddiqi, 1986).

Lending out on interest results in the concentration of wealth in the hands of a few individuals. The outlook developed by Islam is quite different from that of the capitalist. The capitalist simply cannot imagine at all that somebody can advance his money without interest to anyone.

In Islam, it is the duty of every citizen to lend money to his needy fellow citizen. The profit of this loan according to the account books may be non-existent, but it is abundantly clear to an enlightened mind that for the society as a whole and every financier individually, as well as, every economic and political institution, its benefit would be greater in value than interest which is being exacted under the present materialistic system.

This paper explores the handling of interest in terms of the capitalist and Islamic model. It seeks to effect methods to prevent over-indebtedness. In doing so, the treatment of interest by the South African and the Islamic model has to come to the forefront. The structure or remainder of the paper is as follows. Subsequently, the study describes the sentiments regarding interest, after which it elaborates the methods employed by the conventional model to curb over-indebtedness, for example, the *Credit Bill* 34 of 2005 and the consumer protection under the *in duplum* rule. This was followed by proffering of an Islamic solution to the problem of debt (interest). Furthermore, the study treats the core problems and challenges facing the Islamic model, before finally providing a few concluding remarks.

Problem identification

We live in a world which has, for all practical purposes,

abandoned religious foundations in its economic systems. In our troubled world – some of the gravest problems we face are global warming, food crisis and poverty. There is a need to return to harmonization of revelation and human reasoning in our economic thinking. Perhaps this is one of the only methods to attain economic justice, a fairer distribution of wealth and greater poverty alleviation in our times.

RESEARCH METHODOLOGY AND FINDINGS

The paper is based on original research. There is a clear database which the author generated and on which he draws his findings. The author mainly relies on secondary data. This article is a serious inquiry on the subject matter and it presents a relevant theoretical framework within which the inquiry is located. The general idea of this research is that, it presents new knowledge and the article purport to have a broader theoretical significance in the field of Islamic banking and finance.

INTEREST

The meaning of the word "interest"

Sometime before 1220 CE, the Christian scholar Hispanus described a form of loan which did not contain usury, but which was not free of financial gain to the lender either as "*interesse*." This is in the Latin for "that which is in between." The principle underlying *interesse* was that if a borrower of money was late in repaying a loan, then the lender could be compensated for losing the benefit of that money during the period in between the date on which repayment should have been made and the date on which repayment was actually made. Over a period of some three hundred years, there arose an innovation which provided that a compensation for the loss of use of money could be charged from the conclusion of a loan, and not simply where a borrower was late in making repayment. The word *interesse* gradually fell from usage, to be replaced by the now familiar term "interest." By the 1540's CE, King Henry 8th in England allowed the charging of interest up to a rate of 10%. Anything more than 10% was usury, anything less was permissible interest (http://www.islamic-finance.com/item117f.htm (11/5/2007).

The evolution or origin of interest

Modern discoveries have shown that the history of banking transactions harks back to a period not less than two thousand years before Christ- (http://www.albalagh.net/Islamic_economics/riba_judgement.shtml#74-75). As early as 2000 BCE, the Babylonians used clay tablets in their temples for transaction purposes. That would be referred to today as negotiable commercial instruments. Banking operations developed from religious institutions to private business institutions until in 575 BCE (Vessio, 2005).

From the early times in the Republic of Rome, lending and borrowing was a common feature of the commercial society. While Roman law emphasized the autonomy of contracting parties, the one area where the state intervened was in the control of interest rates. A ceiling rate was contained in the *XII Tables*. In case of a contravention, the usurer would incur criminal liability. Towards the end of the republic, fixed interest rates were set at 12 and 6% for senators. When Justinian came into power, he lowered the rate to 6 and 4% respectively. Compound interest was forbidden and therefore simple interest was charged.

In the 5th century, private individuals began to receive money on deposit and lend it to merchants at interest rates varying from 12 to 30% according to the risk involved. These individuals became private bankers. These early private bankers were Greeks, who took their methods from the near East, improved on them, and passed them on to Rome, which handed them down to modern Europe. The practice of commercial, industrial and agricultural loans advanced on the basis of interest were so prevalent in the Roman Empire that Justinian had to promulgate a law determining the rates of interest which could be charged from different types of borrowers. In his *Codex*, Justinian allowed the rate of 4% charged as interest from illustrious people, 6% from the general public as ordinary rates of interest, 8% from the manufacturers and merchants and 12% from insurers in the shipping industry.

Canon law forbade the charging of interest altogether, but the economic realities were more forceful than religious injunctions. As finance was required for production and investment, various transactions were evolved in order to circumvent the prohibition of interest. During the 16th century the Canonical prohibition had been abrogated by convention (Vessio, 2005). This brief overview demonstrated that the practice of charging interest on loans has been a widely popular practice (Vessio, 2005).

Arguments in favour of interest

Justinian's *Codex* stated that the charging of interest is not unlawful. Both Van der Linden and Grotius look to reasons why the borrower required the money: if the borrower made the loan in order to obtain necessities, the loan ought to be granted according to Grotius, without any expectation of a return. If however, the borrower required the loan in order to make a profit, or for his convenience, it would only be natural to require a return from the loan (Justinian Codex 3 10 9; Vessio, 2005).

The first argument in favour of interest is that it was compensation to the money-lender for his risk and

sacrifice. After all, if the borrower is earning profit on the lender's money, it is only reasonable that the lender should share in the profits. If the loan is invested by the borrower in a business venture, the lender has every right to demand a share in the profit of the borrower (Siddiqi, 1986). Interest is the price of the "time" which the lender grants to the borrower for making use of the capital. This "time" has an independent value and as its duration extends, a progressive increase in its price has to take place (Siddiqi, 1986).

Rate of interest: causes for imbalances

In a Western capitalist system, the entire problem pivots on the point that the rate of interest should be reasonable. But the rate of interest is determined by the supply and demand in the money market. When money supply exceeds the demand, the rate of interest declines. When the rate of interest falls to an exceptionally low level, the demand for loans rises. This vicious circle continues indefinitely. In this way, the current system of lending and borrowing on interest is to a large extent responsible for the present economic woes of the Western capitalist world. Nothing but human cupidity is the cause of determining the rate of interest. The money-lender anxiously scrutinizes the financial hardships of society and then releases or withholds his funds from the money market for his personal gains (Siddiqi, 1986).

In a credit agreement, that is, an agreement for the loan of money, there is invariably an inequality between credit lender and credit borrower. While the debtor is in need of the money or credit, the purchaser is not in the same position of need; nor is the seller for that matter. While a purchaser has the value that he has paid for in the form of the asset, the debtor has less value for the credit he has "paid" for – in the form of credit or a loan. Credit, due to its fragmentary nature, makes it difficult for consumers to assess the cost thereof (Vessio, 2005).

Given the considerable imbalance of power between credit providers and consumer, low education levels, poorly informed consumers, weak disclosure and deceptive market practices, many South African consumers have concluded unaffordable credit contracts which have resulted in their over-indebtedness. This has led to many social problems (Stoop, 2009).

Methods (*Credit Bill* 34/2005 and the *in duplum* rule) employed by the South African conventional model to curb over-indebtedness

Over the past few years, levels of over-indebtedness have increased dramatically. There are many reasons for this. It is a well-known fact that since 1994, historically disadvantaged consumers, who never had access to credit, suddenly obtained this facility. This went hand-in-hand with the transformation of the civil service, affirmative action and aspiration borrowing. This again leads to reckless lending and many found themselves over-indebted or with no income. The number of administration orders that were granted also rocketed sky high and became an industry in itself. Another reason for the high level of over-indebtedness appeared to be the fact that a large portion of the historically disadvantaged group of consumers was still excluded from the formal financial market. This forced them to access their finance, particularly their credit, through the informal financial market (micro-lenders and loan sharks) where credit was expensive and legal regulation at a low level.

The financial credit market that had developed was clearly unsuitable for the present and future political, economic and social context of South Africa. It was also a market of high cost of credit and limited consumer protection. The mechanisms (Credit Bill 34/2005 and the *in duplum* rule) to prevent over-indebtedness which were in place (at that time), could not adequately promote the rehabilitation of consumers and the available debt relief could also not assist already over-indebted consumers to deal with their debt (Kelly-Louw, 2008). This resulted in the situation where lower-income, over-indebted employees in South Africa, are indebted to retailers, micro-lenders and other financial institutions as a result of consumption expenditure on for example, furniture and clothing. These types of debt attract high interest rates, administration fees and collection costs (Gardner, 2007).

OVER-INDEBTEDNESS: DEFINITION

Over-indebtedness is defined as follows: "A consumer is over-indebted if the preponderance of available information at the time a determination is made, indicated that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's: (a) financial means, prospects and obligations; and (b) probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment" (Kelly-Louw, 2008).

Reasons for Over-Indebtedness and the implications thereof

Employees become over-indebted as a result of the following: irresponsible borrowing; predatory and reckless lending; excessive finance and collection charges; uneducated and ignorant borrowers; abusive collector and lender practices that over-deduct and/or overcharge already distressed borrowers (Gardner, 2007).

An over-indebted employee is a high-risk employee for

any organization. Over-indebtedness can result in the following behavior: employees resigning to gain access to retirement funds in order to pay for living costs and outstanding debt; employees resigning to escape from garnishee deductions which cause them to go home with insufficient pay; employees resorting to desperation theft at the workplace to pay for living costs; increased employee stress, resulting in increased mental and physical absenteeism and reduced productivity levels (Gardner, 2007).

Reckless lending

Over-indebtedness results from reckless lending and borrowing at interest. It invariably occurs when a borrower can no longer service all his or her debts or where the level of debt servicing is depleting the household funds.

Credit is lent recklessly if either the credit provider took no steps to assess the proposed consumer's general understanding and appreciation of the risks and the costs of the proposed credit agreement, and his or her rights and obligations under the agreement; debt re-payment history for credit agreements or his or her existing financial means, prospects and obligations. Or, after having conducted such an assessment, the credit provider still enters into the credit agreement with the consumer despite the fact that the preponderance of information available to the credit provider indicated that the consumer does not generally understand or fully appreciate his risks, costs or obligations under the proposed credit agreement, or that entering into that credit agreement would make the consumer over-indebted (Kelly-Louw, 2008).

In order to prevent consumers from abusing the reckless-lending provisions, section 81(1) of the National Credit Act 2007 requires that when a consumer applies for a credit agreement, and while that application is being considered by the credit provider, the prospective consumer must fully and truthfully answer any requests for information made by the credit provider while the credit provider is assessing whether or not to grant the credit. Furthermore, section 81(4) provided a complete defense to an allegation that a credit agreement is reckless if the credit provider establishes that the consumer failed to fully and truthfully answer any requests for information made by the credit provider as part of the assessment required by section 81, and if a court determines that the consumer's failure to do so materially affected the ability of the credit provider to make a proper assessment. From this, it is clear that a consumer will not be able to benefit from the reckless-lending provisions if he or she did not disclose all financial obligations when concluding the credit agreement. It is therefore simple, if the consumer failed to disclose all the relevant information to the credit provider when he or she applies for the credit, that credit agreement will not be deemed a reckless grant, provided, of course, that the credit provider did a proper assessment as required by the National Credit Act (Kelly-Louw, 2008).

Legislation protecting debtors is aimed at preventing the problems of overspending and ensured that consumer abuses are minimized. Consumer credit legislation is essential in a market-oriented and capitalist economy, like South Africa. However, some writers, merchants and financiers argued that consumer protection and credit legislation should be abolished, because they are ineffective. They believed that supply and demand alone can regulate the credit industry. This may be interpreted as implying that the prohibition of interest is a last resort where legislation fails. One should keep in mind, that the credit provider and the consumer are not of equal standing and that legislation alone will not eliminate malpractices, simply because there are greedy financiers in every society (Stoop, 2009). It is evident from the perception that an estimated 300 000 South African consumers found themselves in an extremely over-indebted position, while a further million or more were potentially debt-stressed. Mechanisms to prevent and penalize reckless lending in the National Credit Act (and the *in duplum* rule), should have the effect of further reducing the practice of credit being offered to consumers who are already over-indebted. The question arises whether these methods are justified by the end for which they have been devised. It may also be hoped that the debt relief provided for in the National Credit Act will assist those who are already unable to repay their debts. If these hopes fall on rocky soil, what will be the solution for the over-indebted consumer? The National Credit Act will assist those who are already unable to repay their debts, but is prevention not always better than cure? The solution to the prevention of over-indebtedness therefore lies in the prohibition of interest (*riba*).

Objective of the National Credit Act

The National Credit Act seeks to promote and advance the social and economic welfare of South Africans, Muslim and non-Muslim alike. A further objective is to encourage responsible borrowing and the avoidance of reckless lending (Kelly-Louw, 2008). It provided the foundation for a regulated credit market, while at the same time minimizing the social and economic costs of credit and also introducing regulatory measures that aimed at resolving the over-indebtedness of South African consumers (Stoop, 2009).

The Act lays the foundation for a regulated credit market. It contained several measures aimed at the prevention and resolution of the problem of indebtedness. These measures were aimed at the increase of levels of awareness, improvement of financial literacy and the ensurance of the disclosure of information. Measures like

these remained the most effective protection for consumers. These measures can prevent further over-indebtedness and overspending because they addressed the basic issues of a lack of information, education and low levels of awareness. Although, these regulatory measures have their merit, the solution for over-indebtedness and overspending rather lies in a totally different sphere, where the root cause of over-indebtedness, namely interest, is prohibited. The application of the prohibition of interest can largely prevent overspending and over- indebtedness (Stoop, 2009). The National Credit Act seeks to promote and advance the social and economic welfare of South Africans. Does this mean all South Africans and Muslims are included? Apparently, this is not the case, because provisions are made for interest in this Act. The National Credit Act is therefore exclusive to other groups, especially the Muslims.

The in duplum rule

Consumer protection is a relatively recent development in the legal sphere. Charging of interest is of pristine origin. Throughout human history, lending and lending rates had always been hotly debated topics. South Africa's teething problems in the area of credit consumer protection started with a public demand for the control of interest rate charges. These controls developed both through the common law and legislative enactments. At first, there was no statutory or common law control over finance charges but the position has changed (Vessio, 2005). It now gives the courts the power to decrease excessive interest rates and allow the contract to remain valid.

Therefore, the *in duplum* rule, being included in the National Credit Bill 34 of 2005, is potentially a very workable consumer protection device, with the prospect of saving the consumer from becoming overextended and forcing the lender to take timely action against a defaulting debtor. The rule has, as recently as 2001, been accepted as "part of our law" by the Supreme Court (Vessio, 2005). The National Credit Act 34 of 2005 has enacted the *in duplum* rule into legislation in section 103(5) of this Act (http://www.creditmanagement.co.za/?p=165 (2/18/2010).

Origination of the in duplum rule

The rule is traced back, in Commercial Bank of Zimbabwe v MM Builders (Pty) Ltd 1997 2 285 SA (Z) (Isaacs I (ed) 1997) to the Digest where it is stated as follows: "*Supra duplum autem usurae, et usurarum, nec in stipulatum deduci nec exigi possunt: et solutae repetuntur* […]" (Justinian *Digest* 12 6 26 1). In *Union Government v Jordaan's Executor* 1916 TPD 413 De Villiers JP stated that our law is based on the Roman law and quotes the Digest: "*Cursum insuper usurarum ultra duplum minime procedere concedimus*" (Justinian *Digest* 4 32 27 1). Many of the authorities are *ad idem* on this matter. Groenewegen says: "*Usurae non currunt ultra duplum*" (interest does not run beyond the capital amount) and Voet: "*Sortem excedere non potuerunt usurae*" (Vessio, 2005). No interest runs after the amount is equivalent to the amount of capital. Under the circumstances, we must follow what appears to be the unanimous opinion based upon the Roman law, that the right is extinguished and that the interest does not run after it has reached the capital amount.

Rationale of the in duplum rule

The rule limits interest recoverable in terms of loan or credit transactions. It prevents unpaid interest from accruing further, once it reaches the unpaid capital amount. According to the rule, arrear interest that is legally claimable (in terms of the agreement between the parties and within the legal limits set by the statute) may not exceed the capital amount on which interest is due; and in this calculation, what has already been paid by way of interest will not be taken into account (Vessio, 2005).

A creditor is not therefore prevented by the rule to collect more than double the unpaid (or paid) capital amount in interest (Sanlam Life Insurance Ltd v South African Breweries Ltd 2000 2 SA 647 652H-J), provided that, at no time he allows unpaid arrear interest to reach the unpaid capital amount. Should this augmentation occur, interest would then cease to run (Sanlam Life Insurance Ltd 652H-J).

When the debtor again pays part of his debt, his payment has the effect of decreasing the interest amount thereby, reviving the running of interest. Interest will run again until such time as it (arrear interest) again reaches the unpaid capital amount (Van Coppenhagen v Van Coppenhagen 1947 1 SA 576 (T); Vessio, 2005 – in the former source the plaintiff sued on a promissory note…). If, for example, you have borrowed R 10 000 and do not make any repayments, interest can be added to the debt until it amounts to R 20 000. If you pay off R 1000, this will settle only part of the interest and a further R 1000 of interest can be added. However, if you pay off R 15 000, your original debt will be reduced to R 5000 and the interest on this debt cannot take the total debt to more than R 10 000 (Du, 2007).

The purpose of the rule is to ensure that debtors are not "endlessly consumed by charges" and that those debtors whose affairs are declining should not entirely be "drained dry." Lubbe examines the rule and concludes: "Die oogmerk van die klassieke reëling was dus om 'n spesifieke vorm van benadeling, naamlik die uitbuiting van 'n skuldenaar se onvermoë om reëlmatig te betaal, teen te werk." (The aim of the classic ruling was to counter a specific form of prejudice, namely the debtor's inability to pay regularly) (Lubbe, 1990).

Although this rule entails protection to the consumer,

there exists however, a flaw in its paraphernalia. This is brought about by a court of law as can be seen in a phrase utilized by Grové: “Buitensporige koerse het egter nie nietigheid van ‘n kontrak tot gevolg nie. ‘n Hof is bevoeg om ‘n beding met betrekking tot finansieringskoste slegs gedeeltelik af te dwing. Hierdie benadering is in ooreenstemming met die uitspraak van die appélhof in Magna Alloys and Research (SA) (Pty) Ltd v Ellis.” (Exorbitant rates do not nullify a contract. A court is capable to enforce a stipulation with regard to finance costs only partially. This approach is in conjunction with the decision of the Appeal Court in Magna Alloys and Research (SA) (Pty) Ltd v Ellis) (Grove, 1989).

It is abundantly clear that this rule will only partially protect the over-indebted consumer. The *in duplum* therefore, would leave abuses unchecked.

Inadequacy of existing measures

Many lower-income, over-indebted employees are indebted to retailers, micro-lenders and other financial institutions as a result of consumption expenditure on for example, furniture and clothing as opposed to asset purchases such as property. These types of debts attract high interest rates. South Africa’s laws and legal system do not sufficiently protect these employees when they default on their payments and some charges contain irregularities or are inflated (Gardner, 2007). South African Banking Adjudicator, Neville Melville, said in a case where a bank is the lender for a student loan nonwithstanding the fact that interest on a debt cannot exceed the outstanding capital component of the debt), the *in duplum* rule does not prevent the bank from demanding interest that exceeds the original capital (The Sowetan, 2003; http://www.obssa.co.za/news/280103.htm (2/18/2010).

As evident from the above, *The National Credit Act*- and the *in duplum* rule mechanisms (discussed *supra*) to prevent over-indebtedness, could not adequately promote the rehabilitation of consumers and could not assist already over-indebted consumers to deal with their debt. Traditionally, many of the people who are in this business for profit give consumers a poor service – with expensive charges, a lack of regulation, a lack of consumer understanding and a general perception that the over-indebted have no rights and are at their mercy (http://www.ncf.org.za/main.php?include=docs/publications/consumerfair/vol5/creditlaw (2/18/2010).

The consumer public argues that credit providers do not comply with the *National Credit Act*’s measure, due to the lack of pre-agreement control of compliance with those measures. These credit providers take the risk of not complying with those measures because there is a likelihood that, during the span of the credit agreement, the consumer will not raise over-indebtedness or reckless credit as direct measures for debt relief (Stoop, 2009).

The *National Credit Act* provides for debt-counsellors, resulting in further costs for the already over-indebted consumer (Du Preez, 2007). Kelly-Louw (2008) also stressed that these costs ought to be increased in the near future. Debt counsellors charge one substantially for an initial review of your debts, and they may also offer to review your debts on an ongoing basis, for which they will also charge additional fees (Du Preez, 2007).

Notwithstanding the existence of the Act and the *in duplum* rule, the industry was and remains largely unregulated and malpractices are rife (Kelly-Louw, 2008). The credit provider and the consumer are not of equal standing and free competition will unfortunately not eliminate malpractices, simply because there are avaricious financiers in every society (Stoop, 2009).

ISLAMIC SOLUTION TO THE PROBLEM OF DEBT

The difference between profit and interest

In the past, there has been dispute about whether *riba* refers to interest or usury but there is now consensus amongst Muslim scholars that the term covers all forms of interest and not only “excessive” interest. The term *riba* and interest will be used interchangeably, and an Islamic system will be one in which a payment or receipt of interest is forbidden. Interest is essentially measured by the difference between the amount the borrower repays and the amount he originally received from the lender. This disparity between the amount received by the borrower and the amount paid by him is interest. And that is exactly what *riba* is, notwithstanding the rate of interest or the use of borrowed funds (Ahmad, 1994).

Ahmad (1994) opines the notion that interest being moderate, and usury being exorbitant and oppressive, is irrelevant. It makes no difference whether the loan is for a consumption purpose or for a commercial purpose. Similarly, it is irrelevant whether the rate of interest is low or high, simple or compound or for a short- or a long term, between two Muslims or between a Muslim and a non-Muslim or between a citizen and a state or between two states. Any excess which is predetermined over the principal amount in a loan transaction will constitute *riba* in all circumstances (Ahmad, 1994).

Interest as the reason for over-indebtedness

Interest means to take a reward for your surplus money irrespective of what the debtor might do with it. The creditor refuses to share his profit and loss, but simply burdens the debtor with the yoke of interest. Human brotherhood and sympathy evaporates when interest is charged for loans on money. The result is that a people who accept interest as the basis of their economic system come to have two classes: excessively rich who lend and the indigent, unable to afford even the

immediate necessities of life. But Islam excludes the possibility by the abolition of interest. What is more, Islam taxes the enormously rich, and makes it incumbent on the State to provide for the poor. Interest negatively influences the brotherhood of man and creates an idle class of owners, who can still be sure of decent income by acting as parasites (Ahmad, 1952).

The greatest problem in the capitalist economy is that of interest. Interest plays an important role in bringing about over-indebtedness. Large amounts of money on interest are employed in the productive processes. The wages however, lag behind. The abolition of interest can avoid this scourge bringing in poverty and unemployment in its wake (Ahmad, 1952).

The abolition of interest in Islam: An ethical discourse

The abolition of interest-based transactions in Islamic society is only one component of a broader system which has been described as the Islamic economic system. The primary objective of this system is social justice and specific patterns of income and wealth distribution (Yousefi et al., 1995). The economic system envisaged by Islamic economics, allows individuals the freedom to produce and trade for profit. However, in the exercise of this freedom, they have to refrain from both causing harm to others and earning more than normal profits.

The principle ingredient to these norms is altruism, i.e. the idea that individuals should place the welfare of society above their own personal interests (Yousefi et al., 1995). According to Islamic principles, unlike that of the conventional system or model, a financial transaction should not lead to the exploitation of any party subject to the transaction. Islam condemns particularly the injustice of a lender being guaranteed a positive return without assuming the share of risk with the borrower. It is unlike the capitalist system, where if a loan is not paid on time, a penalty is levied to the extent that the borrower could end up paying double the principle debt (Swartz, 2009). This is the harsh reality of capitalism. Although the *in duplum* rule prohibits this, the words of Neville Melvin echoed that these preventative measures cannot be guaranteed. Grové also buttressed this perception in his doctoral thesis, where he asserted that exorbitant rates do not invalidate a contract. Case law, *Megan Alloys Research*, underpinned this. Islam is at pains to stress that interest charges render the full adjustment of loans almost impossible and the poor borrower continues taking one loan after the other to escape from the vicious circle without any success. Although, he has already paid much more than the original amount, the outstanding amount continues to rise inexorably due to the application of interest. The result will be that the payment of installments of loans, reduce a substantial portion of their income and the miserable debtors are unable to meet even their basic needs and that of their families. This will lead to poor health, sub-standard living conditions and no education. This sad state of affairs is highlighted by the British media in the case of David Taylor, who was a leukemia patient. He had taken a loan from a major Western bank. The bank overdraft was growing at an alarming rate due to the bank's high interest rate. The poor and ailing man was worried that the longer he lived, the more his life insurance money would be gobbled up by the bank, leaving nothing or little for his family. Every additional day of his life meant less money for his wife and children. He lost all interest in life. This explains the misery caused by charging interest on personal consumption loans. This ethical principle of Islam evokes respect from Muslim and non-Muslim (Swartz, 2009). It is a unique feature of Islamic banking that it does business with weaker groups and the poor. It embraces the social and religious responsibility to mobilize charitable funds and donations from its shareholders, clients and others to help the needy and disadvantaged groups in the community. Islamic banking does not indulge in unethical activities based on interest (Khan and Bhatti, 2008). It is therefore evident that this model would be more acceptable by the consumer public. It will certainly prevent over-indebtedness.

Islam: a zero interest society?

Riba, the Arabic word for the predetermined return on the use of money, can be translated as "increase," "excesses," or "usury." *Riba*, therefore implies the "doubling of a sum (capital and interest) in money or in kind." (Yousefi et al., 1995). The *Qur'an* therefore bans *riba*, "an ancient Arabian practice of "doubling and redoubling of (a) debt when the borrower fails to make restitution on time." (Yousefi et al., 1995). On the strength hereof, Muhammad Baqir Sadr, a Shi'i Mujtahid (a Mujtahid is a scholar in Islamic jurisprudence), views any return on a loan as illegitimate. In this view, Islam condemns any transaction which brings a party anything beyond the "fair exchange" value. This position may appear similar to Aquinas's "just price." According to Aquinas, there is no just price for the use of money. Consequently, usury (*riba*) must be condemned (Yousefi et al., 1995).

The Islamic ban on interest is explicit and has to be taken as axiomatic. This position is to be based on two verses in the *Qur'an*: "Those who devour usury will not stand except as stands one whom the evil one by his touch […}" (Ali, 1387 AH-1967 C.E.; Holy Qur'an, Sura ii, 275) and "O ye who believe fear God, and give up what remains of your demand for usury, if ye are indeed believers. If ye do not, take notice of war from God and his apostles." (Holy Qur'an, Sura ii, 278-279).

The Islamic ban on interest-based transactions is a reflection of religious beliefs, a desire to attain social

justice. The collection of interest is tantamount to the exploitation of one's fellow man because it is undeserved income which transfers wealth from the poor to the rich. This is contrary to the Islamic notion of social justice which requires no more than a "fair exchange" of value in a transaction. Therefore, while returns for labour and for physical capital are allowed, returns for money are not. In Islamic economic sentiment there should be no fixed return for money, i.e. the nominal interest rate is fixed at zero.

If a society chooses to have a zero interest rate, one method is to impose a zero price ceiling in the credit market, and the second is to conduct monetary policy in such a manner that the markets chooses a zero interest rate. These are two ways in which a society can achieve a zero interest rate, but one of these ways is likely to damage the economy while the other one is not. Islamic economics have focused on imposing a zero nominal interest rate and has as a result thereof experienced significant positive rates of inflation and hence negative real interest rates, with all of the associated negative economic consequences. They have chosen to employ the more damaging of the two methods available for having a zero nominal interest rate. (Yousefi et al., 1995). The less damaging approach would be to conduct monetary policy along the lines suggested by what has come to be known as *Friedman's* Rule.

The *Friedman* Rule stresses that the nominal rate of interest is equal to zero (Yousefi et al., 1995). According to this rule, a zero nominal interest rate would be a good policy to follow for any economy. The best way for an Islam economic system is the zero nominal interest rate buttressed by *Friedman's* rule (Yousefi et al., 1995).

The impetus behind the creation of interest-free economy in Islam has come from religious beliefs and a desire to eliminate the "exploitation" of one individual by another.

The revival of Islamic economics: the Southern African context

The emergence of strong Islamic movements in recent years has generated a renewed interest in "Islamic" economics. Islamic economics has revived the ancient controversy concerning the legitimacy of interest payments. It has also fuelled a debate about the possibility of survival for a modern economy without any interest.

The Islamic Economic Empowerment, which is founded upon *Shari'ah* law, could act as a catalyst for promoting accelerated and shared economic growth for all South Africans. The teachings and practices of socio-economic justice and equitable distribution of accumulated income and wealth should be regarded as an important cornerstone in Islamic ethical and economic philosophy. Islamic Economic Empowerment is founded upon the idea that humanity is regarded as a trustee who must strive to realize the ideals of socio-economic justice and general well-being in the world for all people and not just Muslims. The Islamic Economic Empowerment cannot then be implemented in isolation or to the exclusion of the rest of humanity. The Islamic Economic Empowerment should be aimed at the total satisfaction of the essential human needs and development, in order to attain a state of general well-being for all peoples who inhabit the world. The Islamic Economic Empowerment should then be aimed at the overall improvement of humanity's plight through the re-distribution of scarce economic resources which have been unevenly distributed (under the capitalist system), especially to those who are still caught up in the daily life and death struggle against poverty, disease, crime and underdevelopment (Abdullah, 2008). In the South African context, the immediate goal of the Islamic Economic Empowerment would be to eradicate poverty, economic stagnation and unemployment. The Islamic Economic Empowerment aiming at the promotion and circulation of wealth so that it does not become stagnant on account of unjust hoarding by a privileged or economically advantaged elite. Economic empowerment and development has to permeate to all levels of society (Abdullah, 2008).

Zakah and *Sadaqah* serve as the first level of economic empowerment strategies that can be implemented to help those who are in dire need of capital resources. Recipients from the historically disadvantaged ranks, have no immediate security or collateral to secure the necessary loan from a bank or financial institution. *Zakah* and *Sadaqah* would be utilized to assist the poor, destitute, orphaned, widowed, refugees, students, pilgrims, veteran soldiers, sick, exiled and anybody in society who is in an economically disempowered state. The funds acquired by *Zakah* and *Sadaqah* are earmarked for immediate distribution among those who are in need, without any obligation of loan repayment from the recipient (Abdullah, 2008). Now the poor can have a way of attaining the much needed financial and investment capital assistance without the onus of having to repay exorbitant amounts of interest or *riba*, as well as not having to bear all the risk associated with the entrepreneurial venture they intend to embark upon, especially if the economic venture fails or does not yield the envisaged profits (Abdullah, 2008).

Profit sharing financial or investment practices can also serve as a viable existent Islamic Economic Empowerment tool available to all South Africans, and not to Muslims alone. Profit sharing economic empowerment strategies enable the formerly historically disadvantaged to have direct access to finance, goods and services. Islamic economic empowerment strategies, such as *mudarabah* (joint venture) and *musharakah* (partnerships/equity participation) can be used to smooth the path for prospective entrepreneurs who would not qualify for financial and loan services, because of a lack of security or collateral. Under these strategies, the

financier and the borrower share in the profits as agreed before-hand, as well as the associative risks that might accompany the intended business venture. In this way, no partner can be exploited. These two strategies entail that no interest or *riba* can be charged by the funding partner on the capital provided (Abdullah, 2008). The Islamic model relies on these two instruments to eliminate interest which causes over-indebtedness, from the economy.

These Islamic economic empowerment tools will not only be contributing to the South African government's broad-based Black Economic Empowerment programme, but also to the ongoing development of the country's stability and prosperity through nurturing a culture of economic development and investment via Islamic Economic Empowerment strategies, within the course and scope of Black Economic Empowerment (Abdullah, 2008).

CORE PROBLEMS AND CHALLENGES FACING ISLAMIC ECONOMICS

One of the major hurdles in eliminating interest/*riba* from the economy is the fact that there are divisions in the Muslim world wondering whether or not modern day bank interest is *riba.* The people who think that modern day bank interest is not *riba* usually present the argument that it is virtually impossible to have a *riba*-free economy. The current economic system is a system invented by non-Muslims. While designing this system, they obviously failed to keep in consideration the prohibition of *riba*. The current economic and financial system is based on *riba* and will obviously collapse if *riba* is removed from it (Ahmed, 2003).

The elimination of interest does not mean zero-return on capital. What Islam has forbidden is a fixed predetermined return for a certain factor of production – one party having assured return and the whole risk of entrepreneurship to be shared by others. Islam has not denied the productivity of capital (Ahmad, 1994).

Conclusion

This study has shown that mechanisms such as the *New Credit Act* 34/2005 and the *in duplum* rule is inappropriate to curb the high cost of credit and provide the necessary consumer protection. It is therefore clear that over-indebtedness will thrive under these measures. They succeed only partially to protect the consumer. But it is woefully inadequate. The Islamic system which prohibits interest seems to be the effective mechanism to prevent over-indebtedness.

Islam therefore proposes an interest-free economic model for Muslim and non-Muslim alike. The elimination of interest does not mean zero-return on capital. What Islam has forbidden is a fixed predetermined return for a certain factor of production – one party having assured return and the whole risk of entrepreneurship to be shared by others.

The elimination of interest/*riba*, which is the cause for over-indebtedness, does not mean that credit transactions will altogether disappear but it will result in financial responsibility. The elimination of *riba* will act as a countervailing force against the cumulative debt problem facing all nations. Islamic banks could make a useful contribution to economic growth and development, particularly in a situation of recession. The practice of doing banking on a non-interest basis has finally come of age.

REFERENCES

Abdullah N (2008). Islamic Canon Law Encounters South African Financing and Banking Institutions: Prospects and Possibilities for Islamic Economic Empowerment and Black Economic Empowerment in a Democratic South Africa. Law, Democracy & Development, 12(1):133-144.

Ahmad K (1994). Inaugural Address. Elimination of Riba from the Economy. Institute of Policy Studies. Shirkat Press, Islamabad, Pakistan.

Ahmad S (1952). Economics of Islam (A Comparative Study). Institute of Islamic Culture. Kashmiri Bazar, Lahore.

Ahmed SA (2003). Global Need for a New Economic Concept: Islamic Economics. Int. J. Islam. Financ. Serv.,1 (4).

Ali AY (1387 A.H. – 1967 C.E.). The Holy Qur'an. Text, translation and commentary. Commemorating the 1400th Anniversary of the Holy Qur'an. Sartaj Company, Durban.

Du Preez L (2007). How Debt Counsellors will attempt to put your Financial House in order. Personal Finance: Online edition powered by IOL.

Gardner C (2007). The Complexity of Emolument Attachment Orders. Solutions Team. HR Highway. Summit Financial Partners.

Grové NJ (1989). Gemeenregtelike en Statutêre Beheer oor Woekerrente (thesis RAU 1989).

http://www.persfin.co.za/index.php?fSectionId=5888&fArticleId=4067515 Accessed on (2/18/2010).

In Duplim Interesst and the National Credit Act 2007, accessed at http://www.creditmanagement.co.za/?p=165 (2/18/2010).

Isaacs I (ed) (1997). Commercial Bank of Zimbabwe v MM Builders (Pty) Ltd 1997 (2) 285 SA (Z). Justinianus, Institutes. Justinianus, Digest.

Kelly-Louw M (2008). The Prevention and Alleviation of Consumer Over-Indebtedness, 20 SA Merc LJ 200-226.

Khan MM, Bhatii I (2008). Development in Islamic Banking: A Financial Risk-Allocation Approach, J. Risk Financ. 9(1):2008:40-51.

Lubbe GF (1990). "Die verbod op die oploop van rente ultra duplum – 'n konkretisering van die norm van bona fides?", 53 THRHR 193.

National Credit Act 34/2005. Debt Councelling Regulation (Gazette No. 32229 – Notice 503) at http://www.polity.org.za/article/national-credit-act-342005 (18/06/2010).

Siddiqi MI (1986). Model of an Islamic Bank, Kazi Publications. Lahore, Pakistan.

Statement on global economic downturn and its impact on South African consumers. 2009. National Consumer Forum. Placing Consumer issues on the Agenda at http://www.ncf.org.za/main.php?include=docs/publications/consumerfair/vol5/credit_law (2/18/2010).

Step by step you shall follow them. 2002. At http://www.islamic-finance.com/item117f.htm (11/5/2007).

Stoop PN (2009). South African Consumer Credit Policy: Measures indirectly aimed at Preventing Consumer Over-Indebtedness, Cite as (2009) 21 SA Merc LJ 365-386.

Swartz NP (2009). Comparative Islamic Law Report. SunMedia, Bloemfontein. Sanlam Life Insurance Ltd v South African Breweries Ltd 2000 2 SA 647.

The Sowetan**.** 28 January 2003. The Supreme Court of Appeal of South Africa, Case no. 205/96. Leech and Others v ABSA Limited 1997 3 SA 308 (W) at http://www.obssa.co.za/news/280103.htm (2/18/2010).

Usmani JMT. Nd. The text of the historic judgement on interest given by the Supreme Court of Pakistan, at http://www.albalagh.net/Islamic_economics/riba_judgement.shtml#74-75.

Vessio ML (2005). The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest. Submitted in partial fulfillment of the requirements for the degree Masters in Law, University Pretoria.

Yousefi M, McCormick K, Abizadeh S (1995). Islamic Banking and Friedman's Rule. Review of Social Economy, Association for Social Economics. Catholic Econ. Associat. 53:65-87.