



Access to Credits and Indebtedness: Islamic Perspective

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Abstract: The purpose of this paper is to describe, from Islamic perspective, Muslims' concern on loans and indebtedness. The paper intends to enlighten working class Muslims on the consequences of taking unnecessary loans. Due to increasing access to financial services, banks and other financial institutions are increasingly offering loans to their customers. Thus, increasing unnecessary borrowings at the expense of their future well-being. The paper concentrate on Islamic perspective of over borrowing and indebtedness. Muslims are expected to live a moderate life, free of embezzlement and misery. Therefore, are called upon to avoid unnecessary expenditure and improve savings. The study contributes to literature of borrowings, by considering loans as last alternative and by necessity.

Keywords: Access to Credits, Loans, Indebtedness, Muslim Consumers

1. Introduction

The financial system of developing world today is busy promoting the concept of financial inclusion of the poor. The essence of this programme is access to financial services at affordable, usable, and convenient manner and one of the most important parameters of access to financial services is access to credits. Easy and affordable access to credit, despite its importance to individual's welfare and national economic development, has a tendency of increasing accumulation of debt by poor borrowers, increased unsought consumption pattern and reduced saving's tendencies. Meanwhile, a society must look at not only a positive part of this development, but also its possible negative impact in the society. The negative impact is the tendency of accumulating debts and repayment default and bankruptcy, which may be resulted due to many reasons like lack of planning, negligence, or lack of self-restrain and natural or man-made disasters.

This paper intends to study Muslim consumers' consciousness to burden of debt, concern for loans repayment, default and indebtedness in relation to Maqasid al-Shari'ah. In this era of financial inclusion advancement, without proper entrepreneurial training, borrowers may accumulate only consumer related debts, which can only increase their burden of indebtedness. Without proper entrepreneurial training, borrowers will accumulate debts

only to increase their consumption, thus, burdened with indebtedness. Some borrowers may not be conscious enough to realise that these funds are loans and need to be refunded at the proper time, until they spend the money on unproductive consumables. Even though lending and borrowing is allowed in Islam, but, if one may consider its negative consequences, care and due-diligence must be taken before applying for loans.

Bank lending is globally increasing due to exploitative tendencies of profit seeking commercial financial institutions taking advantage of consumers' illiteracy. Both Islamic and conventional banks are willing to offer consumer credits and credit cards, which only increases the chances of unnecessary consumptions of unearned income among the middle and lower class individuals [19]. Individuals differ in relation to the feeling of being burdened with loans; some people see loans as a welcomed opportunity to increase consumption or investment while others are sceptical of loans due to fear of repayment inconveniences and burden of indebtedness. Thus, we consider Islamic point of view.

2. Current Debt Practice

Consumer loans are classified as necessary and desired like mortgage and consumption rationing, which are appropriate on one hand and undesired loans like fashionable expensive car or furniture on the other [10]. Even risk averse

individuals, can be motivated by current surge for access to credit version of inclusion and consumer protection incentives, to indulge in unnecessary borrowing. Both risk averse and risk taking individuals are likely to make mistakes in borrowing decision due to motivation by ease of access without adequate plan on investment opportunities.

In US, increasing cases of bankruptcy filing in post 2008 economic crisis has become a motivating factor for studying loans and default tendencies [33]. Relaxed debt collection procedures and regulations affects effectiveness of revolving credits, leads to lower recovery, high cost of recovery and less strict collection laws attract large and risky borrowers. Effective collection procedure is required to mitigate default [20]. The increasing trend of consumer credit has become a cause for concern even in the western world [35]. [16], linked increasing rate of personal bankruptcy to increasing credit supply by deregulated banks, which triggered lending and borrowing even among the previously excluded households. With availability of unsecured loans, credit cards, technologically advanced ways of monitoring borrowers and disappearance of fear and stigmatisation of indebtedness and bankruptcy, many spendthrift borrowers evolved and subsisted in the name of consumer protection [34] [16] [6].

Even in the western world, their ancestors were against the culture of debt on consumables, as in the words of Thomas Jefferson, in his "Cannons of conduct in life" advising his grand-daughter and indeed the future generation, around year 1811, that "Never spend your money before you have it", as he grasped that, "Banking institutions are more dangerous to peoples' liberty than standing armies" [41]. However, the modern capitalist has manipulated his advice of wisdom to a new motto of "Buy now, pay later" syndrome, which altered consumers' attitude to "wanting to have everything now, instead of patiently working to have something you need" [25] [21]. Meanwhile, since the institutions are greatly benefitting, they see the consumers as the one to blame themselves for indebtedness [52].

The possibility of timely repayment, defaulting, requesting for time extension and repeat loan request are not only dependent on financial strength, but also dependent on economic conditions and customer behaviour. According to [13], loan defaults were drawn from the economical, sociological, psychological and institutional perspectives. The literature of credit rationing shows that, credit market is different from other markets in such a way that high demand of credit cannot lead to high supply to borrowers. Default probability increases when credits are not appropriately utilised [9].

Other factors apart from project viability influences loan access like the analysis of the macroeconomic condition [4]. When credit market works well, lenders are matched to worthy borrowers the same way sellers are matched to buyers. But when the market shows the opposite, People often wonder why credit markets are so problematic. The challenge is beyond explanation of economic issues alone, behaviour of lenders and borrowers also plays a role, [15]. [11] observed that there is a point at which a borrower start thinking of defaulting even

if he can afford repayment. They made the observation on mortgage holders that lost their job while the mortgage property is not at their home towns. This shows that, even if a borrower has a good intention of repayment, eventualities may force him to think of defaulting. Ratio of periodical repayment amount to income of the borrower was also found to have a significant effect on his default decision [46] [49]. [32] found interest rate and high cost as factors affecting repayment of loans in rural Khorasan-Razavi of Iran in 2008. While [43], found high repayment rate was due to institutions' collaboration who help in monitoring loan repayment. [37] recommends outright sanctions as more appropriate measure for enforcing repayment of debt contracts. Stressing that human beings are more afraid of punishment than desire for reward and always willing to try if they can do away with it. [39], showed that information on the long-term consequences of repayment decisions affect level of repayment compliance. Disposable income, level of education, and perception of, and worry about, repayment difficulties had larger significant effects on repayment levels. [5] and [40] realised that, creditors extra effort for self-protection against moral hazard and credit supply regulation is more effective in default prevention than debtor punishment. [49] categorized micro credit repayment determinants as characteristics of the borrowers, project or business's characteristics and the characteristics of the loan itself. They showed that loan repayment default's probability is influenced by business activity type, borrower's gender and skills, as well as loan repayment period and loan. [36] identified individual's culture influencing bank loans and indebtedness.

3. Causes and Effects of Consumer Debts

3.1. Literacy Level

The increasing indebtedness may be because of poor literacy and financial discipline. Financial literacy and discipline remains inadequate even in developed world, which explains the reasons for high consumption level, poor savings habit, and unregulated borrowing and consumer bankruptcies [22]. Various research works in Muslim world proved lack of Islamic financial literacy as a cause of gap between consumer awareness and usage of credit financing in Islamic finance industry [24]. [18] found bank borrowers who receive counselling are unique on their behaviour, credit profile, creditworthiness, and a lesser delinquency experience. Sometimes borrowers' choice and subsequent demands for financing products, are influenced by formal and informal advice they received, wide consultation and various sources of information they have. Those borrowers who received advice from a credit counsellor fare well than those advised by only family and friends. Therefore, their loan outcome varies not only by whether they get consultation, but particularly whom they consulted [44].

3.2. Health Related Effects

Individuals differ in relation to the feeling of being

burdened with loans; some people are afraid of being indebted due to health-related reasons, as [55] demonstrated serious health effects related to indebtedness. A serious health effect was found related to indebtedness. There is positive correlation of household debt and health outcomes, while controlling all other variables in European countries. There are also many cases of anxiety and mood disorders found among indebted business failures during economic recession in western countries [14] [55] [23].

3.3. Effect on Household Welfare and Personality

Unwarranted borrowing to escalate consumption leads an individual to mortgage his household's future stability and peace. It may likely affect the future welfare of his children or even unborn generation. Easy access to credit increases propensity to consume, thereby, constraining his ability to save and possibly increase consumer debt. Increases vulnerability of an individual economy to be seriously exposed to systematic risk and credit crisis. Leads to deceptive rise in living standard of a borrower. Loans deprive debtor of his independence of choice, since his creditor has influence on his financial decisions as he is bounded to the creditor [3]. Debt is usually related to exploitation of available limited resources, and indebted person is likely to exploit other peoples' wealth. Indebted person usually present himself to public as doing well, likely to tell lies and living above his means. Majority of indebted persons "window-dress" to hide their deceptive image.

[29] try to study debt as human development indicator, from Islamic perspective. Having pointed out various indicators from Maqasid al-shari'ah, found out that, none of the previous researchers included debt due to its correlation with other variables like property ownership, education and faith. Meanwhile, he supports debt as an indicator of human development and suggest its inclusion as human development index. Client's concern about indebtedness may also be due on personality grounds, [12] explore a relationship of household or personal finance and personality traits, their findings show that personality traits like extroversion and openness to experience significantly influences level of debts and assets held by an individual or household. In some less educated societies the notion still exists that if you have a debt on you, is a sign that the wealth you held is not solely yours. [31] also studied the impact of attitudes towards borrowing on capital formation in Kenya, the study found that small businesses rely heavily on their personal savings to do business than accessing loans, even those accessing loans are too reserved about borrowing and they prefer to borrow from commercial banks than local microfinance institutions. [38] found that small scale entrepreneurs in rural Ghana uses perceived satisfaction, flexible terms and conditions and social influence as significant contributors to intention to collect future loans rather than usefulness and intensity of needs.

3.4. Institutional Effects

Over supply of credits attracts unnecessary borrowing to

improve consumption at the expense of the uncertain future. Many working-class households turned their lifestyle to debt based, by buying anything available on credit. It is realised that development of a country lead to increasing access to financial services, particularly credit. Therefore, country's development has correlation with consumer debt profile. [53] blamed interest based system of lending for over-indebtedness of borrowers and recommended Islamic system of banking, [51] recommends only participatory profit sharing business as a way human beings and business can prosper, not debt financing. While, unfortunately, [19] realised that even Islamic banks are disposed to debt-producing modes of financing than profit and loss sharing methods, which can lead to creating more debt and indebtedness as in conventional finance institutions

4. Other Religions' View of Debt

Although, this paper is central to Islamic perspective of credit, but, non-Muslims living in Muslim communities also supposed to understand that, other religions too, shuns lifestyles based on debt-taking behaviour, like in Christian's new testament "Owe no man anything, save to love one another" [20], and Judaism's "The rich rule over the poor, and the borrower is slave to the lender" [45], while buddhis emphasizes "*anana Suddha* (Happiness of indebtedness principles)" [30], and Hindu's maxim of "Juxtapose sin and debt" [54]. Therefore, this is a general call for all communities to avoid living a life of perpetual indebtedness.

5. Discussion: Islamic Perspective of Loans and Indebtedness

5.1. Loans and Indebtedness in Muslim Communities

Muslim, particularly the pious ones are likely to avoid unnecessary borrowing due to consciousness towards death, and what will happen to his soul thereafter, because of the saying of the holy Prophet (SAW):

Abu-Hurairah narrated that: The Messenger of Allah said: "The believer's soul is suspended by his debt until it is settled for him." (*Hasan*)

Jami' at-Tirmidhi, The Book on *Jana'iz* (Funerals) Book 10, *Hadith* 114. 6-in-1 (2013), free android version 1.06 e-Deen.com

In another related tradition of the Prophet (SAW) which shows the enormity of death while indebted as follows:

Salamah *bin* Al-Ak'wa narrated that: A *Janazah* was brought to the Prophet and they said: "O Prophet of Allah, pray for him." He said: "did he leave any debt behind?" They said: "yes". He said "Did he leave anything?" They said: "No". He (the Prophet) said; "pray for your companion". A man among the *Ansar* who was called Abu Qatadah said: "Pray for him and I will pay off his debt". So, he (Prophet) prayed for him. (*Sahih*)

Sunan an-Nasa'i, the Book of Funerals Book 21, *Hadith* 145 6-in-1 (2013), free android version 1.06 e-Deen.com

In another hadith, Narrated 'Aisha:

Allah's Apostle (SAW) used to invoke Allah in the prayer saying, "O Allah, I seek refuge with you from all sins, and from being in debt." Someone said, O Allah's Apostle! (I see you) very often you seek refuge with Allah from being in debt. He replied, "If a person is in debt, he tells lies when he speaks, and breaks his promises when he promises"

Sahih Bukhari, Loans, Freezing of Property, Bankruptcy Book 43, Hadith 13. 6-in-1 (2013), free android version 1.06 e-Deen.com

In the above *Hadith*, upon all calamities of life that befalls human beings, the Prophet (SAW) chose to ask Allah (SWA) protection against being indebted and sins. This shows that, for one to indulge himself in unnecessary borrowings, is calling for himself a calamity worth of daily invocation for protection. The *Hadith* also shows that; an indebted person is likely to be morally bankrupt by telling lies and breaking promises.

Therefore, accessibility to loans in Muslims' community is not only dependent on financial strength of the lender or borrower alone, but also on behaviour of borrower towards debt obligation. Unfortunately, there has been an increasing debt financing profile among Muslims and from Islamic banks [8] [48], to the extent of debt/loans overcoming consumers' income. The consequences of consumer debt persistently outweighing consumers' wealth and income is borrower to be highly indebted, leading him to bankruptcy. The implication of this from Islamic perspective is made clear, debtor remains indebted to the lender even in the hereafter. Another implication is that, lender is constraining investors' funds in unrecovered bad and doubtful debt [17]. While, conservative and introvert Muslims tend to avoid loans. Due to the persistent culture of indebtedness in our societies, even Islamic bank financiers are avoiding transactions like *Mudarabah* and prefer debt-related financing (fixed-return-based) due to risk and uncertainty factors, entrepreneurs as well prefer fixed-return-based financing than profit and loss sharing financing due to fear of losing control and loss of income. Meanwhile, profit and loss sharing financing attracts tax on profits while interest debt financing is tax exempted [27].

5.2. Avoiding Loans

Most of the time, man get indebted to buy flashy, beautiful, and unnecessary things or to fulfil unwarranted desire due to illusions, class competition, show-up or to enjoy unsustainable life style, while forgetting the warning and glad tidings of Allah (SWA) that:

Beautiful for men is the love of things they covet; women, children, much of gold and silver (wealth), branded beautiful horses, cattle, and well-tilled land. This is the pleasure of the present world's life; but Allah has the excellent return (Paradise with flowing rivers, etc.) with Him. (Qur'an: Aal-Emrana 3:14)

Over-indebtedness is a calamity man causes to himself by trying to live above his means or living on his future, uncertain and unearned income. While Allah (SWA) warned

Muslims in the Holy Qur'an that:

And whatever of misfortune befalls you, it is because of what your hands have earned. And He pardons much.

(Qur'an: Ash-Shura 42:30)

The best way to avoid unnecessary borrowing and indebtedness is to live a moderate lifestyle, moderation and honesty constitutes good behaviour in life. Muslim can live a moderate life by avoiding extravagant lifestyle, as Allah (SWA) commanded the faithful to avoid being extravagant or misers in their life, rather to remain moderate, as in the verse below:

And those, who, when they spend, are neither extravagant nor niggardly, but hold a medium (way) between those (extremes).

(Qur'an: Furqa'an 25: 67)

In the verse below, the consequence of being extravagant is stated as follows:

Verily, spendthrifts are brothers of the *Shayatin* (devils), and the *Shaitan* (Devil Satan) is ever ungrateful to his Lord.

(Qur'an: Isra'I 17:27)

In this *hadith*, as narrated Aisha:

Allah's Messenger (pbuh) used to invoke Allah in the prayer saying, "O Allah, I seek refuge with you from all sins, and from being in debt." Someone said, O Allah's Messenger (pbuh)! (I see you) very often you seek refuge with Allah from being in debt. He replied, "If a person is in debt, he tells lies when he speaks, and breaks his promises when he promises."

Sahih al-Bukhari, Loans, Freezing of Property, Bankruptcy Book 43, Hadith 13 free android version 1.06 e-Deen.com

5.3. Loan Repayment

A pious Muslim is expected to make loan repayment as his utmost priority in financial plans, because prompt loan repayment is an act that a pious man is to be careful about it. This is because, once you promise to repay on a certain date and time, it became a covenant on you. Allah (SWA) warned believers severally about covenants, in these verses:

And come not near to the orphan's property except to improve it, until he attains the age of full strength. And fulfil (every) covenants. Verily! The covenants, will be questioned about.

(Qur'an, Isra'I: 17:34).

Those who are faithfully true to their *Amanat* (all the duties which Allah has ordained, honesty, moral responsibility and trusts etc.) and to their covenants;

(Qur'an Al-Muminoon: 23:8).

A pious Muslim is expected to take only necessary and meaningful loans with good intention of prompt repayment as narrated Abu Huraira:

The Prophet (SAW) said, "Whoever takes the money of the people with the intention of repaying it, Allah will repay it on his behalf, and whoever takes it in order to spoil it, then Allah will spoil him."

Sahih al-Bukhari, Loans, Payment of Loans, Freezing of Property, Bankruptcy Book 43, Hadith 3 free android version 1.06 e-Deen.com

5.4. Death While Indebted

An indebted person is expected to update his will (obligatory will) regarding the property of others in his possession, every now and then [50]. This is to enable his next of kin to become aware and settle all obligations on his behalf, if eventually he died. The hadith below supports this:

“*Abd-Allah Ibn Umar* reported the Messenger of Allah, *PBUH* said: “It is not right for a Muslim who has property regarding which he must make a will that he should sleep for two nights save that his will should be written down with him” Muhammad bin Isma’ili (2005), *Bulūgh al-Marām min Adillat al-Ahkām*

“Jurists unanimously agreed on the interpretation of “two nights” above, as for Muslims to urgently make their wills because no one knows the suddenness of death over him [2].

5.5. Islamic Ethics on Loans and Indebtedness

Ethical issue is a well discussed phenomenon among scholars due to its utmost importance in organisations. Islam as a way of life, revealed by Allah (SWT) contains all aspects of moral code of conducts for its followers’ life. A business interaction is not an exception. In view of the above, all Shari’ah aspects of human life are categorised into obligatory, recommended, permitted, discouraged, and forbidden. In this perspective, credit transaction or borrowing is permitted, timely (as agreed) repayment is obligatory while proper contractual agreement is recommended. The core competence and unique feature of Islamic financial institutions is ethics, this is because ethical issues are grounded from Shari’ah perspective and therefore, the moral values considered in ethics are fundamentally the teaching of Islam [28]. Dealing with one’s emotions and temptations towards material world is a beginning of character building and good character is a driving force to improving interpersonal relationship skills [1].

What constitutes good behaviour in business, is defined by ethical code of conduct. Therefore, relationship of borrower with his bankers requires full disclosure, truthfulness, accountability, sincerity, and self-sense of belonging. It is against the teachings of Islam to do anything unethical at the expense of the other party no matter the benefits, as Allah (SWT) mentioned in the Holy Qur’an that:

“O! You who believe! Eat not up your property among yourselves unjustly; but let there be amongst you traffic and trade by mutual goodwill; and do not kill (or destroy) yourselves: for verily Allah hath been to you Most Merciful.”
(Qur’an Al-Nisa’i 4:29)

Therefore, bank-client lending relationship supposed to exhibit ethical conduct in Islamic banks’ practice and let borrowers ethically derive the impact of borrowing relationship.

6. Conclusion

By all indications, living a life free of debt is the best and stress-free form of life and if a Muslim can live according to

Shari’ah principles, he may do away with unnecessary borrowing to live a fancy life, as obtained in various Muslim communities. What is needed among Muslim consumers is not just financial literacy from conventional perspective, we need Islamic financial literacy, moderation, discipline, and fear of God. Islamic financial institutions should also be encouraged to reduce financial incentives to excessive consumer lending and critically scrutinise the essence of borrowing to avoid unnecessary spending and indebtedness as advised by [8].

Despite negative experiences on consumer demand for credit cards, there is rapid expansion of credit card usage in Muslim countries and Islamic banks. Financial institutions are benefitting at the borrowers’ expense, taking advantage of those lacking awareness of future implication of credit card borrowing on their income stream [26]. Therefore, Islamic finance scholars, should intensify calls for awareness on the negative effect of easy access to financial services, particularly credits.

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