

THE CULMINATION OF INTEREST INTO OVER-INDEBTEDNESS WITHIN THE SOUTH AFRICA CONTEXT: A REFLECTION OF ISLAMIC FINANCE AND BANKING

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ABSTRACT

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, an agreement for the loan of money, there is invariably an inequality between the credit lender and credit borrower. 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 has resulted 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 remains largely unregulated and malpractices are rife. This situation has generated an interest in Islamic

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economics and has fuelled a debate about the possibility of survival for a modern economy without interest. The elimination of interest under Islamic tools like zakāh, ṣadaqah, muḍārabah and mushārahah 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.

Keywords: *Over-indebtedness, in duplum rule, interest, South Africa, Islamic finance and banking.*

PROBLEM IDENTIFICATION

We live in a world that 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, a food crisis and poverty. There is a need to return to a harmonization of revelation and human reason in our economic thinking. Perhaps this is one of the only methods to attain economic justice, to attain a fairer distribution of wealth and greater poverty alleviation in our times.

RESEARCH METHODOLOGY AND FINDINGS

This paper is based on original research. There is a clear database that the author generated and from which he draws his findings. The author mainly relies on secondary data. This article is a serious inquiry into the subject matter. It presents a relevant theoretical framework within which the inquiry is located.

The gist of this research is that it presents new knowledge and the article purports to have a broader theoretical significance in the field of Islamic banking and finance in 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.²

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 the capitalist outlook. The capitalist simply cannot imagine 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 benefit of this loan, according to the account books may be non-existent, however, 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, it would be greater in value than the interest that 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 fore. The structure or remainder of the paper is as follows. The next section briefly describes the sentiments regarding interest. The third section elaborates upon 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. The fourth section deals with the Islamic solution to the problem of debt (interest). The fifth section treats the core problems and challenges facing the Islamic model. The final section provides a few concluding remarks.

INTEREST

- **The Meaning of the Word “Interest”**

Some time 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 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

² Siddiqi M.I., *Model of an Islamic Bank* (Lahore, Pakistan: Kazi Publications, Lahore, 1986).

that 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 the Eighth in England allowed the charging of interest up to a rate of 10 per cent. Anything more than 10 per cent was usury, anything less was permissible interest.³

• **The Evolution or Origin of Interest**

Modern discoveries have shown that the history of banking transactions harks back to a period of not less than two thousand years before Christ.⁴ As early as 2000 BCE, the Babylonians used clay tablets in their temples for transaction purposes, which would be referred to today as negotiable commercial instruments. Banking operations developed from religious institutions to private business institutions by 575 BCE.⁵

From the earliest 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 fifth-century private individuals began to receive money on deposit and lend it to merchants at interest rates varying from 12%-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

³ ‘Step by step you shall follow them’, <http://www.islamic-finance.com/item117f.htm>, 11 May 2007.

⁴ Usmani JMT. ‘The text of the historic judgement on interest given by the Supreme Court of Pakistan’: http://www.albalagh.net/Islamic_economics/riba_judgement.shtml#74-75, 25 September 2011.

⁵ Vessio M.L., ‘The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest’ (Dissertation Masters in Law, University Pretoria, 2005).

Justinian had to promulgate a law determining the rates of interest that could be charged for different types of borrowers. In his Code, Justinian allowed the rate of 4% to be charged as interest for illustrious people, 6% for the general public as ordinary rates of interest, 8% for the manufacturers and merchants and 12% for 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 both production and investment, various transactions were evolved in order to circumvent the prohibition of interest. During the sixteenth-century the Canonical prohibition had been abrogated by convention.⁶ This brief overview demonstrates that the practice of charging interest on loans has been a widely popular practice.⁷

- **Arguments in Favour of Interest**

Justinian's Code states 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.⁸ The first argument in favour of interest is that it was a 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.⁹ Interest is the price of the "time" that 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.¹⁰

⁶ Vessio M.L., 'The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest'.

⁷ Vessio M.L., 'The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest'.

⁸ Justinian, Institutes (3) (10) (9); Vessio M.L., 'The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest'.

⁹ Siddiqi M.I., *Model of an Islamic Bank*.

¹⁰ Siddiqi M.I., *Model of an Islamic Bank*.

- **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. However, 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 moneylender anxiously scrutinizes the financial hardships of society and then releases or withholds his funds from the money market for his personal gain.¹¹

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.¹²

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 that have resulted in their over-indebtedness. This has led to many social problems.¹³

- **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, the 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 led to reckless lending and many found themselves over-indebted

¹¹ Siddiqi M.I., *Model of an Islamic Bank*.

¹² Siddiqi M.I., *Model of an Islamic Bank*.

¹³ Siddiqi M.I., *Model of an Islamic Bank*.

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 were 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 was 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 that 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.¹⁴ 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.¹⁵

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, indicates 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”.*¹⁶

¹⁴ Kelly-Louw M., ‘The Prevention and Alleviation of Consumer Over-Indebtedness’, *20 SA Merc LJ* (2008): 200-226.

¹⁵ Gardner C., *The Complexity of Emolument Attachment Orders* (Solutions Team. HR Highway. Summit Financial Partners, 2007).

¹⁶ Kelly-Louw M., ‘The Prevention and Alleviation of Consumer Over-Indebtedness’.

- **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.¹⁷

An over-indebted employee is a high-risk employee for any organization. Over-indebtedness can result in the following behaviour: 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 that 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.¹⁸

- **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 indicates 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.¹⁹

In order to prevent consumers from abusing the reckless-lending provisions, section 81(1) 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

¹⁷ Gardner C., *The Complexity of Emolument Attachment Orders*.

¹⁸ Gardner C., *The Complexity of Emolument Attachment Orders*.

¹⁹ Kelly-Louw M., 'The Prevention and Alleviation of Consumer Over-Indebtedness'.

information made by the credit provider while the credit provider is assessing whether or not to grant the credit. Furthermore, section 81(4) provides that it is a complete defence 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.²⁰

Legislation protecting debtors and aimed at preventing the problems of overspending ensure 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 argue that consumer protection and credit legislation should be abolished, because they are ineffective. They believe that supply and demand alone should 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, though, 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.²¹ It is evident from the perception that an estimated 300 000 South African consumers find themselves in an extremely over-indebted position, while a further million or more are 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

²⁰ Kelly-Louw M., 'The Prevention and Alleviation of Consumer Over-Indebtedness'.

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

those who are already unable to repay their debts, but is prevention not always better than cure? The answer this study is offering is that interest seems be the problem. Therefore, the solution to the prevention of over-indebtedness lies in the prohibition of interest (*ribā*).

- **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.²² It provides 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 aim at resolving the over-indebtedness of South African consumers.²³

The Act lays the foundation for a regulated credit market. It contains several measures aimed at the prevention and resolution of the problem of indebtedness. These measures are aimed at the increase of levels of awareness, improvement of financial literacy and the ensurance of the disclosure of information. Measures like these remain the most effective protection for consumers. These measures can prevent further over-indebtedness and overspending because they address 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.²⁴

The National Credit Act seeks to promote and advance the social and economic welfare of South Africans. Does this mean all South Africans, Muslims 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.

²² Kelly-Louw M., 'The Prevention and Alleviation of Consumer Over-Indebtedness'.

²³ Stoop P.N., 'South African Consumer Credit Policy: Measures indirectly aimed at Preventing Consumer Over-Indebtedness'.

²⁴ Stoop P.N., 'South African Consumer Credit Policy: Measures indirectly aimed at Preventing Consumer Over-Indebtedness'.

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 have always been hotly debated topics. South Africa's teething problems in the area of credit consumer protection started with public demand for the control of interest rate charges. These controls developed both through the common law and legislative enactments. Although, at first, there was no statutory or common law control over finance charges, the position has changed.²⁵ It now gives the courts the power to decrease excessive interest rates and allow the contract to remain valid.

Therefore, the inclusion of the in duplum rule 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.²⁶ The National Credit Act 34 of 2005 has enacted the in duplum rule into legislation in section 103(5) of this Act.²⁷

- **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) 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 [...]*".²⁸ 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*".²⁹ 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*

²⁵ Vessio M.L., 'The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest'.

²⁶ Vessio M.L., 'The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest'.

²⁷ 'In Duplim Interest and the National Credit Act 2007': <http://www.creditmanagement.co.za/?p=165>, 18 February 2010.

²⁸ Justinian, Digest 12 6 26 1.

²⁹ Justinian, Digest 4 32 27 1.

usurae.³⁰ 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.³¹

Therefore, a creditor is not prevented by the rule from collecting 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 and 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)*);³² in the former source the plaintiff sued on a promissory note...). If, for example, you have borrowed R10 000 and do not make any repayments, interest can be added to the debt until it amounts to R20 000. If you pay off R1000, this will settle only part of the interest and a further R1000 of interest can be added. However, if you pay off R15 000, your original debt will be reduced to R5000 and the interest on this debt cannot take the total debt to more than R10 000.³³

³⁰ Vessio M.L., 'The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest'.

³¹ Vessio M.L., 'The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest'.

³² Vessio M.L., 'The Effects of the In Duplum Rule and Clause 103(5) of the National Credit Bill 2005 on Interest'.

³³ Du Preez L., *How Debt Counsellors Will Attempt To Put Your Financial House In Order* (Personal Finance: Online edition powered by IOL, 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.”³⁴

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.”³⁵

It is abundantly clear that this rule will only partially protect the over-indebted consumer. Therefore, the in duplum 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 debt 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.³⁶ The South African Banking Adjudicator, Neville Melville, said in a case where a bank is the lender for a student loan (notwithstanding 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.³⁷

³⁴ Lubbe G.F., ‘Die verbod op die oploop van rente ultra duplum – ‘n konkretisering van die norm van bona fides?’, 53 THRHR 193 (1990).

³⁵ Grové N.J., ‘Gemeenregtelike en Statutêre Beheer oor Woekerrente’ (Thesis RAU, 1989).

³⁶ Gardner C., *The Complexity of Emolument Attachment Orders*.

³⁷ ‘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): <http://www.obssa.co.za/news/280103.htm>, 18 February 2010.

As evident from the above, to prevent over-indebtedness, the National Credit Act and the in duplum rule mechanisms (discussed supra) cannot adequately promote the rehabilitation of consumers and cannot 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.³⁸

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.³⁹

The National Credit Act provides for debt-counsellors, resulting in further costs for the already over-indebted consumer.⁴⁰ Kelly-Louw also stressed that these costs ought to be increased in the near future.⁴¹ Debt counsellors charge one substantially for an initial review of one's debts, and they may also offer to review one's debts on an ongoing basis, for which they will also charge additional fees.⁴²

Notwithstanding the existence of the Act and the in duplum rule, the industry was and remains largely unregulated and malpractices are rife.⁴³ The credit provider and the consumer are not of equal standing and free competition will,

³⁸ 'Statement on global economic downturn and its impact on South African consumers'. National Consumer Forum. Placing Consumer issues on the Agenda: <http://www.ncf.org.za/main.php?include=docs/publications/consumerfair/vol5/creditlew>, 18/2/2010.

³⁹ Stoop P.N., 'South African Consumer Credit Policy: Measures indirectly aimed at Preventing Consumer Over-Indebtedness'.

⁴⁰ Du Preez L., *How Debt Counsellors will attempt to put your Financial House in order*.

⁴¹ Kelly-Louw M., 'The Prevention and Alleviation of Consumer Over-Indebtedness'.

⁴² Du Preez L., *How Debt Counsellors will attempt to put your Financial House in order*.

⁴³ Kelly-Louw M., 'The Prevention and Alleviation of Consumer Over-Indebtedness'.

unfortunately, not eliminate malpractices, simply because there are avaricious financiers in every society.⁴⁴

ISLAMIC SOLUTION TO THE PROBLEM OF DEBT

In the Qur'an, the charging of interest is considered an injustice. This view has been the cornerstone of Muslim writers' rationalizations of the prohibition of interest.⁴⁵ When a person lends money, the funds are either used to create a debt or an asset (i.e., through investment). In the first case, Islam considers that there is no justifiable reason why the lender should receive a return simply through the act of lending per se. Muslim writers like Iqbal and Mirakhor argue that Islam does not object to true profit as a return to entrepreneurial effort and to financial capital, they only denounce the justice of interest as a reward for money lent.⁴⁶ The lender who advances money for trade and production can contract to receive a share of the profit, because he becomes a part owner of the capital and shares in the risk of the enterprise. Iqbal and Mirakhor assert that the lender in this case is a partner in the enterprise and not a creditor. The latter claims interest regardless of the profit or loss position of the enterprise.⁴⁷

- **Is There Any Difference Between Interest And *Ribā*? A Moral And Ethical Discourse**

The spread of Western-style interest-based banks in predominantly Muslim countries has led Muslim scholars to debate whether or not interest is *ribā*. One trend of thought within Islam, the neo-Revivalists, maintain that interest is *ribā*, whereas an opposing group, the Modernists, argue that not all forms of interest are *ribā*. The neo-Revivalist group's interpretation of *ribā* as interest was given a major boost by the moral support of the Gulf rulers. Concurrently, Islamic governments embarked on eliminating interest from their banking and financial systems. This is a possible consequence that bank interest is *ribā*.

The people who think that modern day bank interest is not *ribā* usually present the argument that it is virtually impossible to have a *ribā*-free economy. Because of this notion, many writers attempt to differentiate between various

⁴⁴ Stoop P.N., 'South African Consumer Credit Policy: Measures indirectly aimed at Preventing Consumer Over-Indebtedness'.

⁴⁵ Iqbal, Z. and Mirakhor A., 'Islamic Banking', IMF Occasional Paper (Washington: IMF, 1987).

⁴⁶ Iqbal, Z. and Mirakhor A., 'Islamic Banking'.

⁴⁷ Iqbal, Z. and Mirakhor A., 'Islamic Banking'.

forms of interest practiced under the traditional banking system, advocating the lawfulness of some, while rejecting others.⁴⁸ Supporting this, Chibli Mallat made the following point in his discussion on the Egyptian Savings Funds scheme of the early twentieth century:

“Neither Muhammad Abduh nor Rashid Rida were comfortable about the interest yielded to the depositors on their monies, but they seem to have tolerated it if a scheme of mudaraba could be devised to legitimize the interest on the employee’s deposits.”

According to this paraphrase it is suggested that compound interest is to be prohibited.⁴⁹ By implication it accounts that simple interest would not be prohibited.⁵⁰ Critics assert that verse 3:130 “*ad’āfan muḍā’āfah*” (doubling and redoubling) does not mean that the interest charged would be lawful if the amount were not doubled.⁵¹ *Ribā*-related verses in the Quran (2:275-8) have clearly stated that any increase over and above the principal should be *ribā*, and, as such, prohibited. Saeed asserts that this applies to any form of interest whether it is simple, compound, fixed or variable.⁵²

In other words, it is not permitted under any circumstances for the creditor to receive interest that exceeds the amount of the principal. One of the leading Islamic banking theorists, M.N. Siddiqi, says:

*“Efforts of some pseudo-jurists to distinguish between ribā and bank interest and to legitimize the latter [have] met with universal rejection and contempt [...]”*⁵³

This paper adopts the view that any interest is *ribā*, and, as such, is prohibited. This notion is also buttressed by another Islamic banking theorist, Mohammad Uzair, who denotes that interest in all its forms is synonymous with *ribā*. He exclaims the existence of consensus on the issue:

⁴⁸ Saleh, N.A., *Unlawful Gain and Legitimate Profit in Islamic Law* (Cambridge: Cambridge University Press, 1986).

⁴⁹ Surah Āli-Imrān 3:130.

⁵⁰ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation* (Leiden: E.J. Brill, 1996), 43.

⁵¹ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 43.

⁵² Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 43.

⁵³ Siddiqi, M.N., *Issues in Islamic Banking* (Leicester: Islamic Foundation, 1983), 9-10.

“By this time, there is a complete consensus of all five schools of fiqh... and among Islamic economists, that interest in all forms, of all kinds, and for all purposes is completely prohibited in Islam. Gone are the days when people were apologetic about Islam, and contended that the interest for commercial and business purposes, as presently charged by banks, was not prohibited by Islam.”

However, the current economic system in South Africa and other parts of the Western world is a system invented by non-Muslims, and when designing this system they obviously failed to keep in consideration the prohibition of *ribā*. The current economic and financial system is based on *ribā* and will obviously collapse if *ribā* is removed therefrom.⁵⁴

Islam retorts by saying that 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. Thus, Islam has not denied the productivity of capital.⁵⁵

In a loan transaction, only the principal should be taken. The gist of this research echoes that there is no alternative but to interpret *ribā* or interest according to that wording. Whatever the circumstances are (production or consumption loans), the lender has no right to receive any increase over and above the principal.⁵⁶ Saeed mentions that *ẓulm* (injustice) is the reason why interest on loans has been disallowed.⁵⁷

This interpretation implies that any increase charged in a loan transaction over and above the principal is *ribā*. The prohibition of *ribā* is to be understood by Saeed as relating to the exploitation of the economically disadvantaged in the community by the relatively affluent.⁵⁸ This notion forms the gist of this

⁵⁴ Ahmed S.A., ‘Global Need for a New Economic Concept: Islamic Economics’, *International Journal of Islamic Financial Services*, 1/4 (2003).

⁵⁵ Ahmad K., *Inaugural Address. Elimination of Riba from the Economy* (Islamabad, Pakistan: Institute of Policy Studies, Shirkat Press, 1994).

⁵⁶ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 49.

⁵⁷ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 49.

⁵⁸ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 17.

research. It is believed by Saeed that this element of exploitation may or may not actually exist in modern bank interest.⁵⁹

It is evident from the protective nature of the Quran towards the poor and the needy that *ribā* is to cover all forms of interest and not only “excessive” interest. The 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 *ribā* is, notwithstanding the rate of interest or the use of borrowed funds.⁶⁰

Ahmad 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.⁶¹ 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 that is predetermined over the principal amount in a loan transaction will constitute *ribā* in all circumstances.⁶²

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 who are unable to afford even the immediate necessities of life. However, 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

⁵⁹ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 17.

⁶⁰ Ahmad K., *Inaugural Address: Elimination of Riba from the Economy*.

⁶¹ Ahmad K., *Inaugural Address: Elimination of Riba from the Economy*.

⁶² Ahmad K., *Inaugural Address: Elimination of Riba from the Economy*.

idle class of owners, who can still be sure of a decent income by acting as parasites.⁶³

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 poverty and unemployment in its wake.⁶⁴

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.⁶⁵ 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.⁶⁶ 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 particularly condemns the injustice of a lender being guaranteed a positive return without assuming a 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.⁶⁷ This is the harsh reality of capitalism. Although the in duplum rule prohibits this, the words of Neville Melville echoed that these preventative measures cannot be guaranteed. Grové also buttressed this perception in his doctoral thesis, where he asserted that exorbitant rates do

⁶³ Ahmad K., *Inaugural Address: Elimination of Riba from the Economy*.

⁶⁴ Ahmad K., *Inaugural Address: Elimination of Riba from the Economy*.

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

⁶⁶ Yousefi M. McCormick, K & Abizadeh, S., 'Islamic Banking and Friedman's Rule'.

⁶⁷ Swartz N.P., *Comparative Islamic Law Report* (Bloemfontein: SunMedia, 2009).

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 instalments of loans, reduces 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 leukaemia 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 alike.⁶⁸ 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.⁶⁹ 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?

Ribā, the Arabic word for the predetermined return on the use of money, can be translated as “increase,” “excesses”, or “usury”. *Ribā*, therefore, implies the “doubling of a sum (capital and interest) in money or in kind”.⁷⁰ The Qur’an therefore bans *ribā*, “an ancient Arabian practice of “doubling and redoubling

⁶⁸ Swartz N.P., *Comparative Islamic Law Report*.

⁶⁹ Khan MM & Bhatii I., ‘Development in Islamic Banking: A Financial Risk-Allocation Approach’, *The Journal of Risk Finance*, 9/1 (2008): 40-51.

⁷⁰ Yousefi M. McCormick, K & Abizadeh, S., ‘Islamic Banking and Friedman’s Rule’.

of (a) debt when the borrower fails to make restitution on time”.⁷¹ On the strength thereof, 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 that 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 (*ribā*) must be condemned.⁷²

The Islamic ban on interest is explicit and has to be taken as axiomatic. This position is 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 [...]”*⁷³

(Surah al-Baqarah, 2: 275)

“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.”

(Surah al-Baqarah, 2: 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 that 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 choose 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, have,

⁷¹ Yousefi M. McCormick, K & Abizadeh, S., ‘Islamic Banking and Friedman’s Rule’.

⁷² Yousefi M. McCormick, K & Abizadeh, S., ‘Islamic Banking and Friedman’s Rule’.

⁷³ Ali A. Y., *The Holy Qur’an. Text, translation and commentary. Commemorating the 1400th Anniversary of the Holy Qur’an* (Durban: Sartaj Company, 1387/1967).

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.⁷⁴ 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.

Friedman Rule stresses that the nominal rate of interest is equal to zero.⁷⁵ According to this rule, a zero nominal interest rate would be a good policy to follow for any economy. The best way for an Islamic economic system is the zero nominal interest rate buttressed by Friedman's rule.⁷⁶

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

⁷⁴ Yousefi M. McCormick, K & Abizadeh, S., 'Islamic Banking and Friedman's Rule'.

⁷⁵ Yousefi M. McCormick, K & Abizadeh, S., 'Islamic Banking and Friedman's Rule'.

⁷⁶ Yousefi M. McCormick, K & Abizadeh, S., 'Islamic Banking and Friedman's Rule'.

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.⁷⁷

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.⁷⁸

Zakāh and *ṣadaqah* 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. *Zakāh* and *ṣadaqah* 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 *zakāh* and *ṣadaqah* are earmarked for immediate distribution among those who are in need, without any obligation of loan repayment from the recipient.⁷⁹ 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 *ribā*, 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.⁸⁰

⁷⁷ Abdullah N., '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 (2008): 133-144.

⁷⁸ Abdullah N., 'Islamic Canon Law Encounters South African Financing and Banking Institutions'.

⁷⁹ Abdullah N., 'Islamic Canon Law Encounters South African Financing and Banking Institutions'.

⁸⁰ Abdullah N., 'Islamic Canon Law Encounters South African Financing and Banking Institutions'.

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 *muḍārabah* (joint venture) and *mushārahah* (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 beforehand, 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 *ribā* can be charged by the funding partner on the capital provided.⁸¹ 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 contribute 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.⁸²

CORE PROBLEMS AND CHALLENGES FACING ISLAMIC ECONOMICS

- ***Murābahah*: A Moral Dilemma for Islamic Finance and Banking?**

Murābahah, as deferred payment sale, allows for the sale of a commodity with the credit price being higher than the cash price.⁸³ It is argued by scholars that charging a higher price for a credit sale is the customary practice of merchants and on this basis jurists have permitted the higher price.⁸⁴ While conceding

⁸¹ Abdullah N., 'Islamic Canon Law Encounters South African Financing and Banking Institutions'.

⁸² Abdullah N., 'Islamic Canon Law Encounters South African Financing and Banking Institutions'.

⁸³ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 78.

⁸⁴ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 78.

that this increase represents interest on a loan, Rafiq al-Miṣrī contends that in a deferred payment sale, it is not possible to equate the seller with the usurer, even though the deferred payment sale in reality consists of a cash sale and a loan with interest. The seller in this case practices a commercial activity, which is productive and recognized as lawful and he is allowed to charge whatever price he may wish. Rafiq al-Miṣrī says: “*The seller, as a matter of principle, is free to determine prices for his goods. If these prices are very high, either the buyers would refuse to buy the goods or search for substitutes, or other sellers would enter the market to bring equilibrium to it*”.⁸⁵ The above arguments have been brought forward by Islamic banks to justify the increase in the deferred payment sale.

Another vindication for *murābaḥah* (deferred payment sale) is the argument that Islamic banks ensure that the client would know beforehand the total cost of the goods. This, it is argued, would not be known under interest-based financing, and interest rates could be fixed or variable. Islamic bank proponents would argue that whether the interest rate is fixed or variable is unimportant in short-term transactions. This is noteworthy since *murābaḥah* contracts are generally of a short-term nature. In the case of interest, the rate charged would depend on the bank’s need to earn a real return as well as inflation, uncertainty about future rates of inflation, liquidity preference and the demand for borrowing, monetary policy, and even interest rates abroad.⁸⁶ Other scholars of Islamic banking also argue that the *murābaḥah* mark-up would be lower than the current prevailing interest rate for similar advances. The reason given is that the Islamic bank, because of its ability to purchase goods in bulk, would be able to obtain discounts from suppliers.⁸⁷

However, these legal differences do not seem to make the profit margin in *murābaḥah* much different from the fixed interest on a loan. It can therefore be argued that the mark-up and profit-margin techniques in trade and rent are nothing other than interest by a different name. From an economic point of view (as envisaged by this research), there is indeed no substantial difference between mark-up and interest (or *ribā*). In economic terms, financing on the basis of mark-up in price (*murābaḥah*) has no significant economic merit over the interest-based system. Saeed quotes Zaidi:

⁸⁵ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 80.

⁸⁶ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 83.

⁸⁷ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 84.

“In my opinion the cost of credit in bank financing on the basis of murabaha or mark-up in price, is the same as in the case of financing on the basis of simple interest, except that in murabaha financing, the price agreed remains the same even if the payment is not made on the due date”.⁸⁸

The Council of Islamic Ideology in Pakistan also warned that *murābaḥah* would open a back door for dealing on the basis of interest. Saeed asserts that *murābaḥah*'s relevance remains basically in trade, and he opines that problems arise when this instrument is utilized in financing. Therefore, a change from an interest-based system to a mark-up based system is merely a change of name, leaving the substance intact. Siddiqi says: *“For all practical purposes this [the mark-up system] will be as good for the bank as lending on a fixed rate of interest”*.⁸⁹ Recognizing the same implication of the mark-up system, the Council of Islamic Ideology (CII) declares: *“There is a genuine fear among Islamic circles that if interest is largely substituted by ‘mark-up’ under the PLS operations, it would represent a change in name rather than in substance. PLS under the mark-up system was in fact the perpetuation of the old system of interest under a new name”*.⁹⁰ On the strength of these sentiments, Siddiqi argues in favour of excluding the instrument of *murābaḥah* from Islamic banking altogether and says:

“I would prefer that bay’ mu’ajjal [murabaha] is removed from the list of permissible methods altogether. Even if we concede its permissibility in legal form, we have the overriding legal maxim that anything leading to something prohibited stands prohibited. It will be advisable to apply this maxim to bay’ mu’ajjal in order to save interest-free banking from being sabotaged from within”.⁹¹

The research has established that *murābaḥah* is having a predetermined return on the banks' investments, much like the predetermined return of interest-based banks. It has substantiated that *murābaḥah* logically leads to the acceptance of interest. If Islamic law can allow *murābaḥah* financing as it is practiced under Islamic banking then the question is, “Is there any moral basis for not allowing fixed interest on loans and advances?”

⁸⁸ Saeed, A., *Islamic Banking and Interest: A Study of Prohibition of Riba and its Contemporary Interpretation*, 93; Zaidi, N.A., ‘Islamic Banking in Pakistan’, *Journal of Islamic Banking and Finance*, Summer (1988): 21-30.

⁸⁹ Siddiqi, M.N., *Issues in Islamic Banking*, 139.

⁹⁰ CII (Council of Islamic Ideology), *Consolidated Recommendations on the Islamic Economic System* (Islamabad: Council of Islamic Ideology, 1983), 97, 121.

⁹¹ Siddiqi, M.N., *Issues in Islamic Banking*, 139.

CONCLUSION

This study has shown that mechanisms, such as the New Credit Act 34/2005 and the in duplum rule, are 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. Although they succeed partially in protecting the consumer, it is woefully inadequate. The Islamic system, which prohibits interest, seems to be the effective mechanism to prevent over-indebtedness. Islamic mechanisms or instruments like *zakāh* and *ṣadaqah* assist the poor and these funds are earmarked for immediate distribution among those who are in need, without any obligation of loan repayment from the recipient. 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 *ribā*, as well as not having to bear all the risk associated with the entrepreneurial venture they intend to embark on, especially if the economic venture fails or does not yield the envisaged profits. Profit sharing financial or investment practices, such as *muḍārabah* (joint venture) and *mushārah* (partnerships/equity participation), can also serve as a viable existent Islamic Economic Empowerment tool available for all South Africans, and not to Muslims alone. These Islamic profit sharing economic empowerment strategies will enable the formerly historically disadvantaged to have direct access to finance, goods and services. These strategies 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. The 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. 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/*ribā*, 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 *ribā* 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.

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