Examining the Dominance of Islamic Debt-based Products in the Economy

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Abstract
Islamic financing products have provided easy availability of funds for the people, especially to its Muslim society. The ruling on that law of products is mainly derived from the classical legal opinions of particular schools of law in Islamic jurisprudence. The purpose of this paper is then to extend the examination of shariah stand on the current Islamic financial practice dominated by debt-based products. The study is conducted within the ambit of two sacred revelations and the rest of reasoning principles in usul fiqh as well as Islamic legal maxims. The findings show that the basic tenet of financing system itself, fractional reserve banking, has to be terminated or at least upgraded to certain level, in order to minimize credit creation from which various adverse implications have ever since arisen. The researcher suggests that the reserve requirement must be converted to a full reserve banking system that guarantees the full deposits of depositors in banking, with Islamic financing activities channelled more towards investment. The equity-based products are now easily offered in the market by the Islamic financial institutions locally and internationally. The activities of Islamic financial institutions do not necessarily have to be parallel with what is the norm in the conventional system.

Keywords: Debt, Fractional reserve, Full reserve, Equity

1. Introduction

During the time of the establishment of the modern Islamic banking system, more than 90 percent of the overall number of Islamic products were debt-based, although these had been modified from that conventional to make them appear *shari`a*-compliant on the advice of *shari`a* jurists.[1] When Islamic banking products came onto the market, by offering mountain of debt-based products as the conventional, they thus widened and increased the room and magnitude for debt products in financing, compared to those based on equity or partnership. Thus conventional debt-dominant products plus Islamic debt-dominant ones contribute to an excessiveness of debt in the economy. This may create a mountain of debt in the whole economy, where cash is only a minuscule portion of the total money in the system, becoming a top-up element of the mainly debt-based financial system.

Henceforth, the Islamic banking and finance have been moving towards becoming the main stream of the financing system rather than the conventional competitor in a number of countries, in particular, countries that are dominated by Muslim residents. As the conventional system has been established ever since, followed by the Islamic system few years ago, has been well received in particular Islamic debt-based products which have provided easy availability of funds demanded by people. Banking and financing practices in Islam are subject to the guidance of Allah the Almighty in safeguarding socio-economic fields in all areas of human activity as one to fulfil the objectives of *shariah* (*maqasid al-shariah*). As it is seen there is a need for *shariah*-compliant activities, the dynamic changes have occurred in the banking system today, in the sense of the development of Islamic debt-based financing products, to provide an alternative financial mode that is based on the conventional models and which is in accordance to the comments by El-Gamal (2006): 'Islamic finance as practiced today serves a primary goal of replicating conventional financial products and services, as efficiently as possible, utilizing classical contract forms'. Various contracts might be used by bankers and financial practitioners, but the most common debt contracts used in banking and financing today are then based on the concept of so-called Islamic devices. The ruling on that law of contract is mainly derived from the classical legal opinions of particular schools of law in Islamic jurisprudence.

In addition to the Islamic debt-based contracts being a means of providing alternative solutions to the financial needs of a modern society, the debt contracts might also be perceived as contributing to economic growth particularly in emerging economies like Malaysia and the Middle East where Islamic financing such as in infrastructure contributes toward economics. Therefore, it is not strange to hear some experts claim that debt-based financing is the backbone of the Islamic financing system (Homud, 1987). Haque (2006) emphasizes: 'it is expected that these (Islamic debt-based financing products) are likely to serve the varied credit needs of the rural mass, dislodge the money lenders, stabilize prices, improve production and ensure recycling of bank funds'.

Today, however, problems may arise when the increasing use of debts, credits and loans raises various issues; firstly from that of their relation to the pursuit of economic growth and socio-economic interest. Debt expansion might, among others, be triggered by the excessive or dominant use of those products. People all over the world have seen economic disorder and destruction that are likely to have originated from over dependence on debt-based products. Islamic banking and finance are a part of the system that also contributes to the expansion of the use of debt. Muslim economist worry if the said type of product may stunt economic growth by constraining entrepreneurs from investing in new projects. Secondly,

[1] Based on the Statistics of the Monthly Statistical Bulletin of the Central Bank of Malaysia, March 2009.

the principle of taking debt according to the *shariah* law as perceived by Muslim scholars among them Sheikh al-Zuhaily (1991) that the debts or loans are only permissible for those who are looking for needs as saying: 'A person should not be asking for debt unless he is facing a crucial requirement for debt and in dire need condition'.

The excessive use of debts, credits and loans are unanimously seen amongst classical and contemporary scholars as not fulfilling the purposes and principles of *shariah*; for socio-economic prosperity and sustainability (Khan, 1995). If the entire system is based on the ideal Islamic principles, debt based products would not have been a mode of financing that is believed to promote socio-economic growth (Usmani, 2005). Iqbal and Mirakhor (2007) emphasize, 'an economist cannot solve all theoretical issues without understanding the principles of *shariah* or without working closely with a *shariah* scholar. Therefore it is essential that serious research efforts be made collectively to address the theoretical foundation of the system upon which a more sophisticated set of instruments can be built'.

Despite the huge benefits of debt-based financial activities today for a certain group of individuals, high levels of consuming credits at the macroeconomic or the global level that is beyond the ability to service those debts might not be considered *shariah*-compliant and can lead to financial instability and crisis.

Hence, there is a pressing need to examine the critical issue of debt-led market and its alternatives that would fulfil the needs of people in particular Muslims and at the same time meeting the requirement of the *shariah* principles. Based on these grounds, the current study is conducted to address the following research question:

How is the expansion of Islamic debt products?

How the debt is exploited by the market players in the system?

How to fulfil the ideal use of debt according to the Islamic philosophy/principles?

The next section addresses the relevant methodology to the research topic, which has measured the issue to be researched.

2. Methodology

Discussion of debt-based financial system from the perspective of the *shariah* law would require the use of the *shariah* principles, mainly of the Quran and *sunnah* (Prophetic traditions), and the rest of Islamic jurisprudence principles, *interalia*, *maqasid al-shariah* (objectives of *shariah*), *maslahah* (public interest), *sadd al-zarai'* (blocking the means) and its general principles namely *al-qawaid al-fiqhiyyah* (Islamic legal maxims) as supporting tools. In addition to that, the research also applies the concept of fractional reserve banking system to get clearer picture of the debt-based and money supply system.

Maqasid al-shariah (objectives of *shariah*) is, according to Al-Ghazali (1971), divided into two types; *dini* (objectives of the hereafter) and *dunyawi* (objectives pertaining to this world). Each of these is divisible into *tahsil* (securing of the interest) and *ibqa'* (preservation of interest). *Tahsil* is the securing of benefit and *ibqa'* is the repelling of harm. The phrase *ri'ayah al-maqasid* (preservation of the *maqasid*) is used to indicate both *tahsil* and *ibqa'*. The worldly objectives are further divided into four types; the protection of *nafs* (life), *nasl* (progeny), *'aql* (intellect) and *mal* (wealth). Each worldly objective is meant to serve the single *dini* (protection of religion). When all types are taken together, we have five ultimate objectives of the law; protection of religion, life, progeny, intellect and wealth. These five objectives are designated as *darurah* (necessities). These are followed by the *hajat* (needs), which are additional objectives required by the primary objectives even though the primary objectives would not be lost without them. The third category is that of objectives that seek to establish ease and facility (*tawassu'* and *taysir*) in the law; these are called the *tahsiniyyat* (complementary values) (Nyazee, 2000).

Nyazee and Kamali have quoted a number of *maslahah* definitions given by different scholars by which it is concluded as a consideration of public interest that would fit the objectives of the Lawgiver, securing benefits and preventing harm; the texts, the Quran and *Sunnah* have never mentioned as to its validity or otherwise (Kamali, 2003; Nyazee, 2000). While s*add al-zarai'* implies blocking the means to an expected end that is likely to materialize if the means towards it is not obstructed. Blocking the means must necessarily be understood to imply blocking the means to evil, not to something good (Kamali, 2003).

Whereas *al-qawaid al-fiqhiyyah* (Islamic legal maxims) according to Mustafa al-Zarqa as translated by Laldin is the 'general fiqh principles which are presented in a simple format consisting of the general rules of *shariah* in a particular field related to it' (Laldin, 2006; Ismail, Habibur Rahman, 2013). The majority of these general principles of *fiqh* consist of a few words but at the same time would be able to cover the comprehensive meanings that can be applied to various issues of *fiqh,* among them '*al-dharar yuzal* (harm must be eliminated)' and '*dar' al-mafasid awla min jalb al-masalih* (averting harm takes precedence over achieving benefit)'.

3. Discussion and Findings

This paper contributes to the existing body of knowledge in terms of narrowing the research gap by examining the use of credit and its dominance in the market. The novelty of this study is that it provides a holistic perspective of the critical view from the *shariah* standpoint.

3.1 Maximizing satisfaction and luxury

Fractional Reserve Banking is a system that creates credit within the market through financial institutions (including Islamic ones) for the purpose of economic sector. The system starts from the small portion of notes and cash deposited, giving birth to multiple credit, as the initial sum is used as the basis for more and more loans or debts. The creation of money in turn depends on the willingness of a bank to offer credit and the willingness of a customer to take on debt. Hence this is the real means by which credit or debt-based financing might be expanded from the very small amount of fiat money to the multiple amount of digital or virtual money.

Islamic debt-based financing is a form of financial facilities that is perceived to fulfil people's necessities, needs, desires and requirement for luxuries without dealing with a load of unlawful tools denounced by the *shariah*. Various types of that products and services are provided by Islamic banks, all of which are comparable and competitive with conventional products; as Mansor (2004) observed that 'about 50 innovative and competitive types of

Islamic products and services are provided by Islamic banks by which their functions, operations, instruments and benefits such as Islamic credit cards, are comparable to their counterpart, the conventional'.

It is a privilege and usefulness of such a financing where the proper integration between lender and borrower could be achieved, based on the Islamic law of contract and limited to the permissible subject matters as guided by *shariah*. By using this Islamic financing product in any quantity and amount either for the sake of consumption or investment, or due to fulfilling necessities, needs and luxuries is perceived acceptable and to be encouraged, provided that no wastage takes place, as suggested by Chouldry (1986):

> Consumption of and investment in the production of essentials, comforts and luxury are encouraged in this order of preference, subject to the condition that it does not create wasteful consumption.

People have their own privilege to fulfil their higher level of consumption and investment as allowed by the Islamic law. In the view of Choudhury, it is perhaps permissible for Islamic banks to provide debt financing beyond necessities and needs fulfilment, that to maximize people's satisfaction of desires, wants and luxuries within the framework of the *shariah* law of contract. Insofar as people might have individual rights to secure financings to fulfil spending activities so as to maximize their satisfaction of wants (Pindyck, 2005), as might have been meant by the pronouncement on 'adornment' in the Holy Qur'an:

> O Children of Adam! Take your adornment to every Masjid, and eat and drink, but waste not by extravagance, certainly He (Allah) likes not the wasteful.[2]

And again, Allah continues that He has permitted 'beauty' to be accepted by all His servants:

> Say, who is there to forbid the beauty which God has produced for His servants, and the whole-some means of sustenance? Say, they are (lawful) in the life of this world, to all who believe, to be theirs alone on the Day of Resurrection (...). [3]

The existence of credit is to be believed to be a foundation of wealth-generation process, but it might also be the cause of socio-financial instability (Cooper, 2009). Islam has allowed its believers to cater for all levels of benefits and interest for the betterment of the life-style. However, Islam has imposed limitations and constraints into certain extent concerning the use of debts for the acquisition of luxury and the maximization of satisfaction. The financing behaviour in Malaysia is today moving more towards debt or credit becoming the contract underlying each transaction, and a huge percentage of this financing is to finance luxury spending. A study of preferred modes of payment conducted by Ramasamy et al. (2006) involving a distribution of 2000 questionnaires in Malaysia, producing a 27.15 percent response rate or 543 usable questionnaires. The table below shows the findings of the study.

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[2] Surah al-`Araf, 7: 31.

[3] Surah al-`Araf, 7: 32.

Table: Preferred modes of payment

Payment Mode	Mean Rank	Overall Rank
Cash	1.46	2
Cheques	2.80	5
Credit cards	3.06	6
Smart cards/MEPS cash	1.64	3
Debit card	1.23	1
Charge card	2.38	4

1 = least preferred, 2 = next preferred, …, 6 = most preferred

The table shows that debt is the most preferred mode of payment, credit card in particular dominating all other methods of payment, and the least preferred being cash and debit card. Islamic debt is not far behind in peoples' preference over other methods of payment, as has been confirmed by Mansor. Economic indicators show then that Malaysian households are the highest indebted, compared to other countries in Asia, achieving 77 percent on average of their monthly income only for the servicing of debts (TV3, 2010). Meaning to say that the Islamic debt-based financing is a significant share of the Malaysia's massive overall debts, and the Malaysian people are the highest debtors in terms of percentage of their income earned. This situation happens, perhaps, Malaysia has become, globally, one of the top three hubs of the Islamic financial system, with its growth having developed significantly in recent times

A) Debt for people in-need

The objectives of *shariah* in finance and economics are to provide individuals with their welfare protection. Muslim scholars apply the principle of *maslaha* (public interest) to describe the objectives of *shariah*. Human beings living in this world are required by *shariah* to seek the *maslaha*. Financial and economic activities that entail *maslaha,* as defined by *shariah,* must be pursued as religious duty due to fulfilling one's betterment in this temporary world and the permanent world of hereafter. All those activities then having the aim of achieving the objectives of *shariah* are called needs (Bashir, 2009).

'Fulfilling needs' with debt when no wealth in hand rather than' maximizing the satisfaction of wants with debt', inter alia, is the objective of financial and economic activities, and the pursuit of this objective is a religious duty; either in the context of consumers or financiers. As Gabriel (*Jibril*) answered, speaking of greater rewards to the great Prophet (peace be upon him) upon providing loan for those who seek to fulfil their needs by saying:

> While travelling in upper realms, I saw the following written on the doors of heaven (*Janna*): by giving charity, a person receives tenfold reward and the reward for giving a loan is eighteen times. I asked Gabriel (*Jibril* – peace be upon him) why the lender was given more virtue than the one who gave charity. Gabriel (peace be upon him) replied that a beggar begs when he has something by him while the person asking for loan, only asks when he is in dire need. [4]

The hadith shows that 'fulfilling needs' with debts or loans in order to meet the objectives of *shariah* is a religious duty, as Gabriel confirmed the great rewards for lenders. Hence, it is this that the Islamic finance and economic activities. However, the problem in financial and economic activities to 'fulfil needs' with the available resources is which most of the time might switch over to be scarce relative to needs. These discrepancies and inconsistencies that have been pointed out in the concept of 'maximizing satisfaction of wants, desires and luxuries' are not present in the concept of 'fulfilling human needs'. If the resource constraint is relaxed, the human needs can be fulfilled as they are objectively defined, but not for the other (Bashir, 2009). The concept of 'satisfaction of wants' is then a value-free concept. Thus *shariah* discourages human beings to satisfy wants, desires and luxuries with loans and debts, since no value added or created in the socio-economy.

Hence, Islamic debts provided by Islamic banks are perceived inconsistent with what is stipulated in the *shariah* requirement. They have, in fact, comparable functions with the conventional as confirmed by Mansor herself, implying that their functions are then proven to be equivalent to the objectives of conventional debts, that is 'in order to maximize satisfaction of wants and desires' rather than fulfilling necessities or needs. Which meaning to say, although Islamic banks have been providing debt financing for necessities and needs fulfilment, but there is huge portion of this debts caters for the provision of luxury and satisfaction. Moreover the phrase 'limited to the permissible subject matters as guided by *shariah*' evidences that the conditions to use Islamic debts is only constrained to the permissible contracts and the lawful subject matters consumed, but the overuse quantity of debts has never become a crucial issue in Islamic banking and financing. Again, it shows that apart from financing necessities and needs, Islamic banks also give a wide room for luxury financing.

On the other hand, the view regarding the encouragement of consuming luxuries might not be properly evidenced, though a person has fulfilled his 'essentials and comforts financing'. The phrasal term used 'subject to the condition that it does not create wasteful consumption' does not necessarily mean 'on the condition that it does not use an excessive load of debts'. When people are encouraged to spend on luxury goods or services, meaning to say people are encouraged to use more and excessive amounts of debts. Today's situation means that, in order to afford a luxury, a large amount of financing is required, and the financing is normally from external financiers or lenders, and not from their own pockets or savings, as confirmed by Suwailim (2009). That kind of suggestion, encouraging people to consume luxuries might be

[4] Muhammad bin Yazid Abu Abdillah al-Qazwini Ibn Majah, *Sunan Ibn Majah*, Vol. 2, p. 812. Translated by Muhammad Manzoor No`man, *Ma`ariful Hadith: Meaning and Message of the Traditions*, Vol. 4, p. 72, 73. A hadith that gives pretty similar meaning without specifying 'eighteen times of rewards', the so-called 'from Anas bin Malik said: *Qard al-Syai' Khairun Min Sodaqatihi* (loan is better reward than giving out to charity). However, traditionists are in dispute whether this hadith is really from the Prophet, or from Anas bin Malik. On the other hand, another hadith that is ranked '*hasan sahih*' status by Imam al-Tirmidzi, saying that the Prophet (peace be upon him) make loan rewards equal to freeing a slave, and it is well-known that freeing a slave is of huge reward from the Almighty God. Quoted in Sulaiman Abdullah Abdul Aziz al-Qusoyyir, *Ahkam al-Dayn: Dirasa Hadithiyya Fiqhiyya* (Riyadh: Dar Kunuz Ishbilia, 2005), p. 169, 171, 182. In brief, the researcher might say that the latest hadith would confirm that giving debt would have huge rewards.

indirectly leading Islamic banks to provide more debt financings. It is worse off as the luxuries having been converted as necessities, since justice and wellbeing are no longer the objectives.

In addition, the verse in which Allah commanding taking 'adornment', does not then refer to indulgence in both spending and financing luxuries. According to Ibn Abbas (the eminent companion in Qur'anic commentaries), it means wearing clean and proper clothes that cover all private parts of the body, and the best clothes that they have had when performing every prayer. It is similar said by Mujahid, 'Ata', Ibrahim al-Nakha'i, Said bin Jubayr, Qatadah, as-Suddi, al-Dahhak, Malik and al-Zuhri. In addition, the cause of its revelation is because of the pagan Arabs used to perform *tawaf*[5] around the *ka`bah* (sacred House) while naked, forbidding themselves the wearing of any garment (Ibn Kathir, 2003).

Therefore, the Allah's commandment is for the sake of their nudity walking around the sacred House, whereas donning the best clothing that they have already had, and not spending luxuries beyond one's means and capability, in particular by furthering debt financing.

The researcher has never denied Allah's grant of luxury to His servants as in that following verse, but it could be realized only in the specific circumstances of the absence of debt financing and borrowing. *Shariah* has taught Muslims to live within their means without any excess and wastage, thus it is really different from luxury, whose acquisition needs excessive amounts of debts nowadays. Unless there is no other option to upgrade and improve one's basic needs of necessities but by debts.

As such, a sane financial and economic policy for an Islamic society must be based on 'living within one's means' (Kurshid Ahmad, 1994). Utilizing and providing debt financing is admitted by Islam only when a person is in dire need, with no other option except debt or credit. Muslim scholar, such as al-Qurtubi (1996) emphasizes that the prohibition on dealing with debt arise when someone is not in dire need. But it is an obligation to carry out debts in order to fulfil the basic necessities, and from the wisdom of the indebtedness of the Prophet (peace be upon him) is to become a guide for those who are in dire need. Ibn Hajar (1997) gives an explanation upon the hadith Jabir[6] by saying:

> (…) and this hadith indicates the difficulty of the matter of debt, and it should not be dealt with unless being in needs. [7]

Muslim scholars are in consensus concerning the fact that dire need becomes a paramount criterion to meet the permissibility of applying debts or loans as also claimed by Qasim (1405H):

> There is no different view among Muslims in terms of the permissibility of asking for a loan due to the dire needs.

[5] Walking around the *ka'bah* in the Holy Mosque of Mecca, Saudi Arabia.
[6] Hadith Jabir: 'Reported by Jabir as said: A man died and we washed him, enshrouded him, and embalmed him. The Prophet (peace be upon him) came to us to perform *janaza* prayer. We asked him: Are you going to perform *janaza* prayer? He then took small step and asked: Is with him a debt? We answered: Two dinar, then he turned away. Abu Qatadah was then willing to bear the debt. And the Prophet immediately performed the *janaza* prayer. Then one day the Prophet asked Abu Qatadah concerning the two dinar and he responded that the debt had been paid. The Prophet then said: Now his skin is relieved'. Narrated by Ahmad bin Muhammad bin Hanbal bin Hilal al-Shaybani, *Musnad Ahmad* (Beirut: Muassasa al-Risala, 1420H), Vol. 30, p. 58.
[7] Ahmad bin Ali bin Hajar al-'Asqalani, *Fath al-Bari Bi Sharh Sahih al-Bukhari*, Vol. 4, p. 547.

And again a Muslim economist, as Suwailim (2009) confirmed:

> If there is a dire need, but no other alternative rather than debt, thus it is indeed requested to carry out the debt in fulfilling the necessities.

Hence, debt is only to be utilised when it is for someone in real need, he finds no other option unless by debt. On the contrary, it would trigger a huge financial impact on the economy where indebtedness is a part of this. Ever-indebtedness is a cause of excessiveness of debt-based financing in the financial sector. As debts build up along with daily, weekly and monthly spending, a less earning allocation is then left for future necessities and needs. Soon then the family would find that every single purchase of foods, household items and other immediate-consumption is dependent on debt (Habibur Rahman, 2006), which most of the time might switch over to and become luxury items. People fall into this self-destructive pattern today, but they have not always been mired in debt before. Hence, the conclusion of this point is that financing institutions should not have been encouraged to provide funding for the 'satisfaction of wants and luxuries' financing, and the public must not seek to fulfil their wants and luxuries, in particular, by debt financing contracts, as ruled against in Islamic law. Otherwise, it would constitute massive use of debts and stimulate ever-indebtedness amongst people.

B) Desire and want debts

Although Islamic banks provide debt financing to fulfil people's necessities and needs, but this financing is also used for the satisfaction of desires and luxuries, as according to studies, inter alia, by Lee and Lee which show that the credit cardholders are the people who normally make luxury (maximizing satisfaction of wants) transactions with numbers of credit cards approved of by bankers or financiers, and quite sometimes credit facilities are approved to consumers who are not capable of repaying (Board of Governors of the Federal Reserve System, 2006). Such a kind of transaction is known as consumption-oriented financing (Lee and Lee, 2001/2002). Suwailim (2009) then emphasizes that credit-based sale or instalment means is a preferable transaction amongst the majority of people. A myriad of consumer goods and luxuries are consumed by them from widely available debt financing products in Islamic markets. Such kinds of goods and luxuries are actually beyond their own income capacity and are unable to afford them, unless consuming a large amount of debts. In that sense, the habit of lavish and luxurious spending with the ever-greater accumulation of debt has influenced the Malaysian Muslim community directly and indirectly as studied by Hussin (2008). Such a habit has been becoming more common at all groups of income levels, in order to catch up the pursuit of status and social prestige (Hussin, 2008). Debt is indispensable, but must not be introduced for nonessential and wasteful consumption (Ahmed, 2010); which means to say that debts or loans are only for those who are in needs of them and not for fulfilling a want of luxuries and satisfaction, as ruled in the previous discussion.

Thus, based on the consumption-oriented financing for 'satisfaction of wants' mentioned by Lee and Lee, Suwailim, and Hussin, the researcher deserves to say that the following statistical diagrams of 'consumption credit' [8] below, released by the Central Bank of Malaysia, show the consumer debt transactions are for maximizing satisfaction of wants and luxuries, in the case of those debt-based products

[8] Excludes debt-based financing on agriculture, hunting, forestry and fishing, mining and quarrying, manufacturing, electricity, gas and water, wholesale, retail, hotel and restaurants, construction, residential property, non-residential property, real estate, transport, storage and communications, financial, insurance and business services, purchase of security, purchase of transport vehicle, community, social and personal services.

provided by Islamic banking (Central Bank of Malaysia, 2007-2009), as confirmed by Schooley and Worden (2010), such a consumer debt includes total of credit cards used, instalment credits, credits for durable goods purchases, second mortgages and home improvement and remodelling, and other personal debts or loans, inter alia, margin loans. This consumption of debt has already excluded all necessities, essential goods and services, and needs purchased by credits.

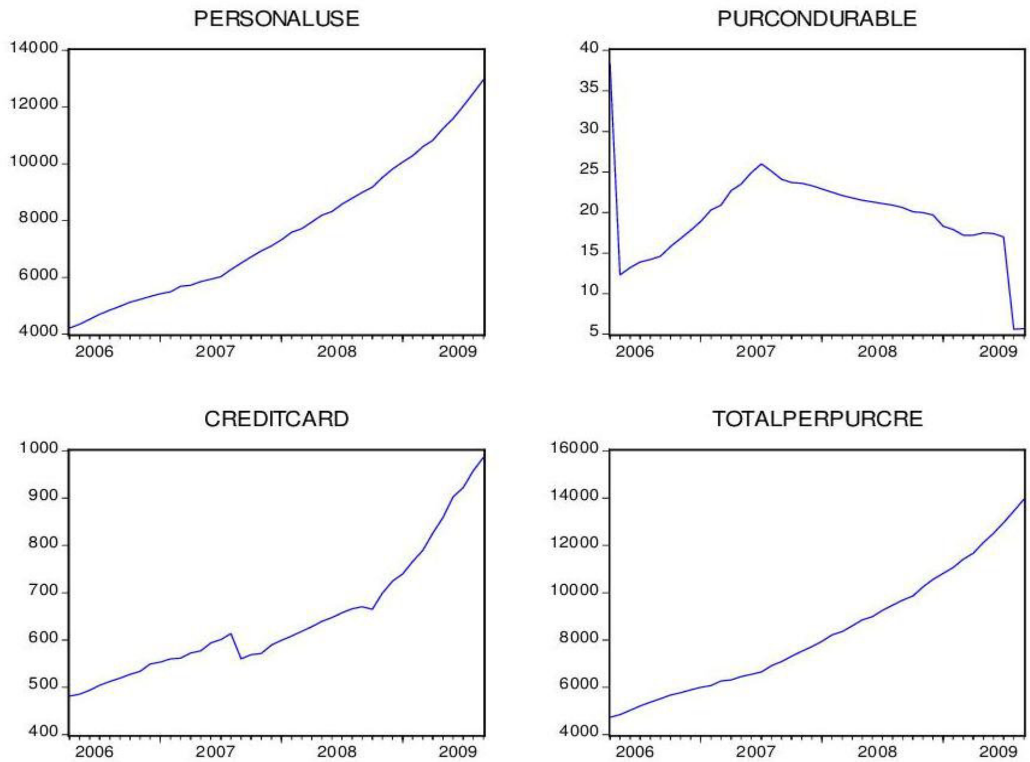

Figure: Three forms of Islamic debt for 'satisfaction consumption' with the total of them, (TOTALPERPURCRE) in range April 2006 - September 2009. (in RM million)

Where,

PERSONALUSE = Islamic credit for personal use
PERCONDURABLE = Islamic credit for purchasing consumption durables
CREDITCARD = Islamic credit card
TOTALPERPURCRE = PERSONALUSE + PERCONDURABLE + CREDITCARD

The graphs indicate that debt or credit transaction for maximizing satisfaction and luxury consumption kept increasing over time. These types of debt might be considered to be forms of extravagant spending beyond bounds (*israf*) since the use of debt, as discussed in the last sub-topic, is only for people in-need. Accordingly, extravagance and transgression beyond bounds (*israf*) is technically (*istilah fiqhi*) defined as 'spending on something permissible originally, but not according to the principles complied with Islamic law, such as applying permissibility beyond moderate form and needs' (Hammad, 2008), as the Qur'an confirmed: 'Those who, when they spend, are not extravagant and not niggardly, but hold a just (balance) between those (extremes)'.[9] It is then to be understood that the use of debts or loans for the sake of satisfying maximum wants and luxuries, rather than needs, are forms of *israf* by which has been seriously forbidden by the textual studies of the Islamic law of contract.

In fact, people are attempting to fit the philosophy of conventional finance and economics in their life-style. They keep trying to maximize satisfaction of wants from the available resources (cash in hand) which are, so-called, limited relative to wants. The problem in current finance and economics is assumed to rise because of the scarcity of resources. Suppose the limited resources are removed, would the problem be solved? For sure it would not be. Most probably, this is because of the inherent inability of material resources to satisfy all human wants and desire for luxuries. It is not only referred to consumers, indeed it includes all suppliers or providers of credit product, since they are keen to provide more fixed return from debts in whatsoever the objective is due to maximize satisfaction of profiting or profiteering.

3.2 *Sadd al-zarai'* and *al-dharar yuzal*

A concept in the principles of Islamic jurisprudence, namely 'blocking the means

(*sadd al-zarai'*)', plays a big role in Islamic finance and economics. Blocking the means to excessive borrowing and easy debt availability, and constraining the sum of debts to only *maslaha*, would save borrowers from submerging in a pool of default and encourage them to be involved in investment. The analogy (rationale) that the researcher can quote here is the decree of the Caliph Umar upon Hudhayfa to divorce his Jewish wife, though the marriage had been confirmed by him as permissible contract, according to the textual studies in the Qur'an (Kamali, 2003). The decree released by the Caliph was not because of its permissibility, but to block the means to an evil, as he perceived it at that time. The evil meant by the Caliph is that the act (marrying *ahl dhimma*) would be followed and would act as a lure to other Muslim brothers, and this matter would for sure bring *fitna* (persecution) upon Muslim women.

Secondly, one of the legal maxims; 'harm is to be eliminated (*al-dharar yuzal*)' could be considered to encompass half of the *shariah* in that all its rulings are enacted by the Lawgiver to either secure the benefit (*maslaha*) or prevent harm (*mafsada*). The *shariah* considers the harm inflicted in human relations to be a manifestation of injustice, which must be removed. Although the existing debt-based products benefit certain groups of people up to certain extent but since the current practice of the said products reflects greater harm to majority of people, hence Islam requires the elimination of all those harm. It is supported by another legal maxim namely 'averting harm takes precedence over achieving benefit' (Laldin et al., 2013), by which if the existing products their harm overweighs the benefit, or the harm and the benefit are of the same magnitude, the *shariah* gives precedence to preventing harm.

Therefore, the prohibition of excessive debts or loans either to the financier or to the consumers has to be put in place. The ruling that has been pointed out by the Islamic law at the first place is juristically convertible concerning the objectives, benefits and welfare of the people at large. Although debt or loan is a beneficial source for an individual, since it does have a negative impact on the socio-economic interest, such a form of financing has to be constrained along with exercising the other and better alternative, the equity-based financing. In brief, it suggests that *shariah* ruling is potentially convertible from one to another, in order to ensure the objectives of *shariah* are to be realized.

[9] Surah al-Furqan, 25: 67.

4. Recommendation

Traditionally, commercial banks including Islamic bank have a right to 'create' money in order to fulfil borrowers' desire by loaning out or giving credit that is based on the fractional reserve banking system. However, excessiveness of debt circulating in the market could be expunged by a full reserve system being put into place in lieu of the fractional system. This would guarantee financial liquidity for financial providers and depositors in pursuit of their socio-economic interest and the economy at large. Otherwise, the fractional reserve system would saddle financial institutions (including Islamic ones) with a shortage of liquidity (insufficient funds) and further result in financial burst and collapse. When financial intermediaries (including Islamic banks) provide Islamic debt-based financing products through the fractional reserve banking system; competition for money will then occur. This is because such an amount of debt in the form of fiat money does not exist in the market. And thus only few of them (borrowers) are able to service debts, and the rest are sure to get into default. Any bank whose their borrowers defaulted, that bank is sure would have insufficient funds to pay back the depositors' money. It is best to put into words by stating that 'total debts are not repayable in aggregate'.

However, it is perhaps hard to implement a hundred percent reserve requirement in one go, but it could be based on the means and methods of the Almighty God, who put certain prohibitive rulings into action by gradual steps and stages. These means and methods are very important in order to give some reassurance to the markets about the changes to the financial system without experiencing a drastic reduction of debt-based practices, and allow for responsive policy modifications over time. As narrated by the Prophet: 'The best thing in doing something or taking a job is in moderation (*khair al-umur awsatuha*)' (Ibn Athir, 1974). Hence, the researcher put a periodic parameter prior to exercising such a requirement by introducing gradual steps phasing in the hundred percent reserve requirement and the equity-dominated system. The reserve requirement might be appropriately shifted from the current rate of one percent to, perhaps, an initial 33 percent reserve. It is based on the following foundations by referring to the practice of Islamic deduction in Islamic law.

A) The prohibition of interest (*riba*) in three levels

Interest or usury (*riba*) is prohibited in the Qur'an within three distinct passages. By considering the chronological order of the Qur'anic revelation, firstly, the Almighty God gave a warning in chapter *al-Rum* (The Byzantines), 30, and in verse 39, as saying: 'That which you give in usury for increase through the property of (other) people, will have no increase with Allah: But that which you give for charity, seeking the Countenance of Allah (will increase): it is these who will get a recompense multiplied'. Which means to say, Allah grants in multiples to those who spend their money for the sake of no reason other than to please Him and to win the will of God, and at the same time He also removes from usurers who seek to expand and raise their wealth or capital at other people's expense (Qutb, 2003). The former is the guaranteed way of increasing money, wealth and capital but not the later. Those who spend on the path of Allah, they are gainers of multiple rewards, not only in this current world but also rewards in the life to come. Society can make profits as long as the socio-economy is strong enough with no exploitation occurs amongst each other in the community, and this would drive towards the fulfilment of the will of God, that He has already guaranteed the rewards of the after-life, but not for usurious market players. This is a general statement that is applicable to all the means that people use to usuriously increase their wealth.

Secondly, Allah has then ordered all believers and warned them never to take interest or usury (*riba*) at compound rates, as saying in chapter *Ali `Imran* (The House of `Imran), 3, verse 130: 'O ye who believe! Devour not usury, doubled and multiplied; but fear Allah; that ye may (really) prosper'. When financial sectors rely on usury, it makes the financial cycle revolve around it. All Muslims have to take into account that every single usurious transaction does not only stop at that point, but it is repetitive and compounded. When the element of time is added to these two aspects, it does for sure lead to the exponential multiplication of the principal or capital over time (Qutb, 2003), as is going on with the Islamic debt-based financing underlain by fractional reserve system today that is ubiquitously available in Islamic markets. This is the nature of the usury system that is unlimited in its potential to expand.

Thirdly, interest and usury (*riba*) in all forms were utterly condemned, and those who take ignore its prohibition are warned of a holy war against them by Allah and His Messenger, as in chapter *al-Baqarah* (The Cow), 2, verse 275-279:

> Those who devour usury will not stand except as stands one whom the Satan by his touch hath driven to madness. That is because they say: 'Trade is like usury', but Allah hath permitted trade and forbidden usury. Those who after receiving admonition from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (the offence) are Companions of the Fire: there will be abide therein (for ever) (…) O ye who believe! Fear Allah, and give up what remains of your demand for usury, if you are indeed believers. If you do it not, take notice of war from Allah and His Messenger: But if ye repent you shall have your capital sums: Deal not unjustly, and you shall not be dealth with unjustly.

The verses have made a final passionate appeal to the true believers to desist totally from usurious activities, or face a relentless war undertaken against them by none other than the Almighty God and His Messenger. The Qur'an is very clear and unambiguous on this matter, and leaves no room for doubt or confusion. The true believers have no chance at all to pronounce their faith and belief in God verbally, only to take up a way of life that is opposite to His laws (Qutb, 2003). The war that has been warranted by The Almighty God and His Messenger and promised to be waged against usurers covers every single aspect affecting psychology, economy, emotion, conflict, instability, human civilization and ending up with the final punishment on the Day of Judgment.

B) Minimizing debt consumed for the need of luxury or embellishment (*tahsiniyyat*)

The purposes of Islamic law are divided into three levels, as has been listed by Imam Al-Ghazali (1994) in his distinguished book '*al-Mustasfa*', and put them in order into three ranks, known as necessities (*daruriyyat*), need/comfort (*hajiyyat*) and then followed by embellishment (*tahsiniyyat*). As referred to in the previous discussion, the consumption of debt or credit for the requirement of luxuries and the satisfaction of wants has become the primary objectives of most consumers. Such a financing, by extension, has dominated other methods of financial system (equity financing) by which the latter would be the better source in pursuit of economic growth and upgrading the socio-economic interest. Hence, the increase of reserve ratio to 33 percent would indirectly at least minimize the use of debt products for the purpose of embellishment, luxuries and satisfaction of want, instead the debt products are then only to be provided for necessities, needs or comfort use. Such an increase would, therefore, allocate financing pools channelled to the equity-based products that are in fact the cornerstone for the pursuit of the economy.

Therefore, these foundations could possibly become strong bases towards upgrading the reserve requirement to 33 percent from the very low current ratio. Although the current financial system is likely yet to be 100 percent reserve requirement and fully-fledged equity (or equity-dominated financing), but the guidelines shown by the Almighty God on interest and usury (*riba*) prohibition, suggest that it is best to treat the well-entrenched excessiveness of debt in financial system by stages and phases, not in one go. In addition to interest prohibition, this gradual process is also braced by the three phases for the minimizing of the rate of debt for embellishment. Nevertheless, the main objective does not stop at this level; it should pursue further efforts to ensure 100 percent reserve and equity-based system be positioned in Islamic banks. With respect of this 33 percent implementation, we are then on the first step to Islamizing all conventional banks without declaring or imposing regulations forcing all conventional banks to shift to Islamic forms.

Secondly, the researcher is proposing that all Islamic banks should be involved in Islamic investment, by directing the customers' demand deposits to real productive investments (projects) by sharing risks through a full reserve banking system. The portfolio of investment has to be a diversity of long-term and short-term financing (Ahsan, 2006). According to El Diwany (2003), the investment accounts that be invested with entrepreneurs under profit-sharing or rental contracts would have no reserve ratio. The pools of funds do not belong to Islamic banks; it can be then an off-balance sheet item managed by the banks on behalf of the investors. The money transferred into an investment account could be treated in the same way as an investment fund unit. Any profit or loss is given to the investor, less the agreed share of the profit (if seen as a *mudarabah*) or management fee (if seen as an agency - *wakalah*) paid to the bank. On the other hand, Askari et al. (2010) view that the investment banking is a model of an equity shareholding system. When the system does not contain money creation through credit (hence contributes to zero credit multiplier), the investment banking thus pools deposits and invests them by purchasing equity shares. The amount of deposits in investment accounts will be determined by real deposits, but not by the credit multiplier.

Chapra (2004) then suggests that equity-based financing might take both forms of investment, whether shares in joint stock companies or profit-and-loss sharing (PLS) in projects and ventures based on *mudarabah* and *musharakah* financing modes. Further, this view is maintained by Al-Jarhi (1996) who proposes the establishment of 'member banks' that would undertake direct investment and profit-sharing ventures. Direct investment allows banks to hold shares in enterprises, partake in their administration, and to give technical assistance and expertise, whereas profit-sharing ventures cater for short-term pool of funds to finance businesses or entrepreneurs who need additional financial liquidity support; and after allowing for the financing, returns will be divided between entrepreneurs and banks, based on an agreed formula. On the other hand, he also suggests that banks can provide a small portion or percentage of their pooled resources to interest-free lending, since individuals would expect to consume today's spending with insufficient resources against a higher level of resources in the future.

Profit-sharing investments through entrepreneurship would give consumers or depositors more chance to obtain a higher income and would indirectly reduce the level of borrowing. Besides, this form of investment is equally important in the development of small-and-medium sized enterprises, many of which might presently lack financial support. By extension, investing in the equity shares of joint stock companies through banks should also be taken into account; customers would obtain the use of bank's expertise in benefitting from this form of investments. Therefore, equity investments are not only limited to either profit-sharing or investing in stocks, but both forms of investment have a vital role to play side-by-side in pursuit of economic growth, rather than credits or loans. In addition, making depositors and financial intermediaries partake in risk sharing of investment would motivate the depositors to take greater care in selecting their financial intermediaries, and the financial intermediaries' management would be forced to assess the risks more cautiously and to supervise or monitor the use of funds by investors more effectively (Chapra, 2004). Hence, this would then attract more depositors in investing with them.

5. Conclusion

Debt-oriented of Islamic banking products amounted more than 90 percent of overall Islamic banking products. Although it became a financing facility for consumers and borrowers, but they have been misleading people through the fractional reserve system towards oft-indebtedness and excessive use of debt for satisfaction and the fulfilment of want for luxuries; that put them and the economy into destructive circumstances. People and financial institutions are eager to use debts and credits as a primary source of earning and income, rather than utilizing wealth-creating investment products. It does not really reveal favourable and splendid impacts on the economy for Malaysians as well as people all over the world in general.

There is a need, therefore, to move further to a full reserve banking system and from the debt-based to equity-based products in order to fulfil the Islamic principles in economy and finance. The transformation from the current system to that better system would mitigate the use of debt and its adverse impact on the economy. Nevertheless, in order to make sure that the transformation is effectively delivering, gradual steps forwards to its implementation should be taken into action, as it is a methodology of Allah's revelation to His creation. Again, human beings will better accept a new matter if it is imposed in gradual steps and stages, but would be much more likely to oppose it totally if it is carried out at one strike.

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