

Monzer Kahf and Amiirah Nabee Mohomed

## Credit Cards: Contemporary Issues from Economic and Sharī'ah Perspective

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### 1. Introduction

The paper by Monzer Kahf and Amiirah Nabee Mohomed is a welcome addition to the, as yet, very limited literature on credit cards from an Islamic perspective. Most empirical research to date is focused on Malaysia where credit cards have been heavily marketed by Islamic banks<sup>(1)</sup>, but there has only been limited discussion of conceptual issues or practices in the wider Muslim world.<sup>(2)</sup> The research by Monzer Kahf and Amiirah Nabee Mohomed helps redress this imbalance by taking a more generic approach while proposing possible structures based on Islamic financial contracts that might contribute to greater social and economic justice.

Many condemn the debt creation that results from the increased use of credit cards while failing to recognize the benefits they can bring. Monzer Kahf and Amiirah Nabee take a less simplistic and more balanced approach, recognizing that credit cards can result in economic benefits. This type of nuanced

treatment is arguably a better way forward rather than an outright prohibition on the issuance and usage of credit cards, which might only encourage the growth of more harmful forms of credit such as, informal money lending. The cost of credit card finance is more transparent with the card holder having full information on the amount of the debt, as well as the monthly payments required. A formalized system brings greater certainty, and arguably reduces, if not eliminates, any element of *gharar*, which arises from contractual uncertainty. All too often *gharar* contributes to the exploitation by informal moneylenders of their less financially aware clients.

### 2. Consumer empowerment and macroeconomic stimulus

Whereas debit cards result in an immediate reduction in demand deposit balances when used at retail points of sale or for ATM cash withdrawals, the usage of credit cards draws on an additional financial buffer which the card issuer provides for the client. This allows scope for discretionary purchases of goods and services which the clients would not be able to afford to pay from their existing bank balances. In other words, credit cards help empower the consumer economically, bringing greater flexibility over the timing of purchases.

(1) Amin, Hanudin (2012) "Patronage factors of Malaysian local customers toward Islamic credit cards", *Management Research Review* 35.6: 512-530.

(2) Jamshidi, Dariyoush, and Nazimah Hussin (2012) "A conceptual framework for adoption of Islamic credit card in Malaysia", *Kuwait Chapter of Arabian Journal of Business and Management Review*, 2.3: 102-110.

The use of credit cards can stimulate demand, increase economic activity and result in employment creation and greater prosperity. There is no point in investing in supply capacity unless there is also demand, and a balanced approach to development is preferably to a situation where there is excess investment resulting in diminishing returns and waste.

The argument that savings is virtuous and that consumption is irresponsible is mistaken, as savings can take money out of the economy, sending it into recession or even a slump. Islamic economic teaching condemns hoarding money for its own sake which is seen as *khāti'*, literally translated as referring to the one who is in error. Rather than being beneficial, excessive savings can be regarded as a social evil, a view shared by the founder of macroeconomic theory, John Maynard Keynes, who identified the paradox of thrift.<sup>(3)</sup>

### 3. Balanced saving and consumption

Islam is often viewed as the religion of the straight path or the middle way, avoiding extremes and deviant behavior which cause social harm.<sup>(4)</sup> In the field of financial management, this implies balancing savings with responsible consumer spending. There is no special merit in living modestly and practicing abstinence, rather the aim should be to spend generously, not for personal indulgence, but rather for wider family and social benefits.<sup>(5)</sup> Purchasing luxury goods is permissible, as long as consumers have paid their *zakāh* obligations to contribute to the welfare of the less fortunate in society.

Excessive consumption at the expense of savings is, however, irresponsible, especially if consumers take a very short term perspective and ignore the long term implications of their failure to save. Those on comfortable salaries have the opportunity to save and provide greater long term financial security for their families. If they fail to take this opportunity and

they, or their dependents, become a burden on society, this is reprehensible. Any welfare benefits they receive will be at the expense of those in greater need who have no hope of earning sufficient income.

The danger with credit cards is that their ease of use encourages the irresponsible to indulge current desires rather than look to the future. There is the issue of the sustainability of consumption patterns, as it is tempting to spend more now and ignore the future pain of curtailing expenditure.

### 4. Credit card debt

Monzer Khaf and Amiirah Nabee Mohamed correctly identify the issue of indebtedness arising from excessive credit card use which is a negative consequence of consumerism. Credit card holders have the option of paying off their debt in full at the end of every month, usually by automatic direct debits from their demand deposits with their bank. Those who choose this option avoid long term debt as their liabilities are extinguished on a monthly basis. In contrast, those who pay only the minimum amount required, usually only five or ten percent of their outstanding balances, will find their debts grow significantly over time. The only constraint is the credit limit imposed by the credit card issuer, which will be related to the client's ability to pay. Those who have higher salaries or significant wealth will usually be given higher limits, especially if they have met all their previous financial obligations and have unblemished credit histories.<sup>(6)</sup>

When there are defaults on payments the issue arises of who is to blame, the credit card issuer for allowing an excessive credit limit, or the clients themselves, or some combination of the two. A client's inability to repay may reflect unnecessary profligate credit card spending, or an unexpected change in financial circumstances due to redundancy or illness. In the latter case, the debtor should not be judged too harshly, and debt forgiveness may be appropriate in line with Qur'ānic teaching on remission which stresses the merit of deeds of charity.<sup>(7)</sup>

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(3) Zhen, Huo, Rios-Rull Jose-Victor and Rios-Rull José-Víctor (2013) "Paradox of thrift recessions," Washington D.C: *National Bureau of Economic Research Working Paper*.

(4) Esposito, John L. (1998) *Islam: The Straight Path*, Vol. 4, New York: Oxford University Press.

(5) Harrigan, Jane and Hamed El-Said (2009) *Economic Liberalisation, Social Capital and Islamic Welfare Provision*, London: Palgrave.

(6) Ausubel, Lawrence M. (1997) "Credit card defaults, credit card profits, and bankruptcy", *American Bankruptcy Law Journal*, 71: 249.

(7) *Surah 2:276*.

Credit card debt can be a drag on economic activity as if card holders are paying off past debts, or in other words deleveraging, they will be spending less on current consumption. This can contribute to downturns or recessions, especially if the value of the outstanding debt is high. In the case of Malaysia, the launch of Islamic credit cards resulted in a wider spectrum of the population taking on more debt, including the Muslim majority. This undoubtedly had negative long term implications for the Malaysian economy, including reduced growth potential, as purchasers shifted to present expenditures at the expense of the future.

### **5. Interest and debt burdens**

Outstanding credit card debt, if not repaid in full monthly, incurs interest charges. This represents a major source of income for conventional credit card issuers, especially as the lending rates are relatively high in comparison with secured debt such as mortgages.<sup>(8)</sup> Credit card liabilities can be classified as junior debt with no collateral required as is the case with senior debt. Usually, a monthly rate of interest is cited, of for example two percent, which annually amounts to 24 percent plus compounded amounts, around SR 2,682 on a credit card debt of SR 10,000.

Although such interest charges are considerably cheaper than those charged by informal moneylenders, it is still expensive funding which can be regarded as usury. Arguably, those who do not pay off their liabilities in full each month are being exploited. The goods and services they used their credit cards to purchase are much more expensive when financing charges are included. Although there is competition between credit card issuers for customers, this is largely confined to the quality of service and does not extend to the costs of credit.

### **6. Islamic credit cards**

Monzer Kahf and Amiirah Nabee Mohomed rightly observe that modern Islamic finance attempts to provide as wide a range of products as conventional financial institutions, including credit cards. They note, however, that Islamic banks are struggling to

provide credit cards which are both acceptable under Sharī'ah and, at the same time, profitable for the issuer. They recognize that clients want the convenience of using credit cards rather than cash, which is risky to carry around in large amounts because of the danger of it being stolen. Cash cannot be used for online purchases and credit cards have become the normal method of paying for air travel, hotels and other travel services.

Monzer Kahf and Amiirah Nabee Mohomed are critical of the existing credit cards offered by Islamic banks, even though there are no interest charges, but rather fees. They stress that although the avoidance of *ribā* is a necessary condition for an Islamic credit card, it is not a sufficient condition. They believe that three further conditions must be satisfied. First, the underlying structure should be a sale or lease transaction otherwise, no profit can be permitted for the issuer. They favor a *murābahah* structure involving a purchase and sale. Second, no fee can be charged for cash withdrawals, as this would amount to interest. Third, the credit card should only be used for the purchase of goods and services which are *halāl*. As all credit card purchases are recorded, unlike cash purchases, this should facilitate the enforcement of Sharī'ah compliance.

The authors recommend pre-paid cards rather than the fee based structure favored by Islamic banks. Such instruments are not credit cards as the client has to pay up-front and is in substance providing an interest free loan, a *qard hasan*, to the card issuer. This type of payments structure would be excessively onerous for the client, and is unlikely to prove very popular. Pre-paid cards are regarded as a substitute for travelers' cheques which people carried for emergency purposes. They are regarded as complementary to credit cards rather than being a substitute. Many travelers carry both types of cards, often in different wallets or pockets, in case one gets mislaid or stolen.

### **7. Credit card charges and branding**

Most conventional credit card revenue is derived from the transaction charges levied on the retailer rather than from interest charges.<sup>(9)</sup> Retailers are

(8) Brito, Dagobert L. and Peter R. Hartley (1995) "Consumer rationality and credit cards", *Journal of Political Economy*: 400-433.

(9) Humphrey, David B., Moshe Kim and Bent Vale (2001) "Realizing the gains from electronic payments: costs, pricing, and payment choice", *Journal of Money, Credit and Banking*, 216-234.

willing to pay one or one and a half percent of the value of the transaction as the payment is immediate and is, in addition, electronically verified. Payment by cheque involves the retailer having to send the cheque to a bank, and the cheque will not be credited if the payee has insufficient funds in their bank account. Cash payments also present problems as retailers may be vulnerable to theft if they store large amounts of cash on their premises, necessitating investment in security systems. Furthermore, notes can be forged. Despite these advantages with electronic payments, in the past, some retailers charged customers more if they paid using credit cards rather than cash. Most credit card issuers no longer permit such discrimination and the taxation authorities also outlaw such practices as cash payments are often used to evade taxes.

With Islamic credit cards, the fees reflect the credit limit provided, the type of card and whether the card is part of a wider financial package including *takāful* insurance. Al Rajhi Bank, for example, provides nine types of credit card to suit clients with different financial positions and lifestyles. The most basic are the Al Fursan and Tasawaq Cards which can be used for cash withdrawals, point of sale transactions or on-line purchases up to a limit determined by the bank. The Ensan Card is similar but involves a charitable donation to benefit orphans for every riyal spent; an especially worthy concept. Women can apply for a Laki Card which entitles them to reward points for every riyal spent that can be used for future purchases. Laki Card holders also benefit from discounted prices at selected retail stores. These cards offer a grace period of 45 days before any charge is levied by the card issuer, which is also the case with the Qassit Card where repayments are by monthly instalments. Higher net worth clients are offered silver, gold and platinum cards with enhanced credit limits. The ultimate card is designated “Infinite”, which provides travel insurance and access to executive lounges at airports around the world.

Islamic credit cards, like their conventional counterparts, are branded usually with the Visa or MasterCard logos. This means that they are recognised at point of sale outlets world-wide. Seven

of the nine Al Rajhi Bank cards carry the Visa logo and the gold and silver cards the MasterCard logo. Most clients just use one card, but an increasing number have two cards or more. Both Visa and MasterCard compete to provide their franchises for Islamic banks and employ specialists who know about Islamic finance. Diners Club and American Express act independently and do not provide Islamic credit cards, but as the revenue is largely fee based rather than dependent on interest charges, Sharī‘ah compliance would not provide a major challenge.

## 8. Conclusion

There can be little doubt that credit cards, including Islamic credit cards, are here to stay, as clients appreciate their convenience, and cash payments are in decline world-wide. The pre-paid cards advocated by Monzer Kahf and Amiirah Nabee Mohomed really serve a different purpose, and have been most successful in the case of mobile telephones amongst those without monthly contracts who pay by charging up their SIM cards. In East Africa, those who are too poor to have bank accounts increasingly use their mobile phones for minor payments rather than cash. This new technology is the major threat to credit cards, and indeed banks, including Islamic banks. Apple Pay, Android Pay from Google and PayPal are increasingly used for payments, but as yet there has been no attempt to adapt these for Sharī‘ah compliance and provide *halāl* branding.

Such payments systems empower the poor who are excluded from using banks, as they lack regular income and have no savings or assets. Unfortunately, Islamic banks and the products they provide, including credit cards, largely cater for middle class salary earners. Their financing is mostly for vehicle purchase and Islamic mortgages, neither of which the poor can afford. For the everyday basic purchases of the poor, payments software applications that can be downloaded onto smart phones are a more suitable low cost method of payment than Islamic credit cards. It is in this area that what is proposed by Monzer Kahf and Amiirah Nabee Mohomed has the most relevance, and indeed has exciting possibilities in promoting financial inclusion for all sections of the society.

**Rodney Wilson** was the founder of the Islamic finance program at Durham University in the United Kingdom where he continues to be an Emeritus Professor. He was a Visiting Professor at the Qatar Faculty of Islamic Studies in 2009, 2010 and 2012 and since 2013 has been an Emeritus Professor at the International Centre of Education in Islamic Finance (INCEIF), Kuala Lumpur. He served as advisor on Sharī'ah governance to the Islamic Financial Services Board, Kuala Lumpur, (2007-9) and to the Central Bank of Qatar on monetary policy and prudential ratios, (2009-10). He has written 12 books and over 40 articles; his most recent publications being: *Legal, Regulatory and Governance Issues in Islamic Finance*, Edinburgh and Columbia University Presses, (2012); *Economic Development in the Middle East*, Routledge, London and New York. He was awarded the IDB prize in Islamic banking in 2014 in recognition of his contributions to the subject.

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