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Considerations of Credit Card Markets from the Sharīʿah Perspective

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1. Faith in Credit Card Markets

The authors (Kahf and Mohomed) raise several interesting points, not only with regard to credit card markets and products, but also with regard to associations between faith and finance. Within the concept of Islamic banking (or finance), there is a clear desire to incorporate critical religious tenets, and to account for these in the design of products. This is articulated in the clear discussion of what characteristics would need to be present in a truly Sharīʿah compliant credit card, which ideally involves limitations on features (i.e. no potential for interest charges) as well as potential purchases (i.e. not valid for use in casinos or for other purchases that are considered unacceptable from the Sharīʿah perspective). Thus, the interaction between the financial industry (provider) and a cardholder acknowledges the critical role of religion in society. In contrast, Western financial markets might best be considered as agnostic, as little consideration is given to the faith of an individual customer in product design or practice. Some of this divide may be due to cultural and sociodemographic differences, as Western financial markets may face a wider variety of religious backgrounds, thus making it very difficult (i.e. costly) to tailor products to any specific group's beliefs or needs. This blending of faith and finances from the perspective of Islamic finance raises a number of interesting questions, and has spawned a number of unique products as detailed by the authors.

The authors adeptly address the progression of credit card markets in the United States, highlighting their rise in popularity and the contribution of cards to a culture of consumption. This commentary will provide some further expansion of the development of these markets, highlighting some of the critical components of why management of cards can prove problematic for some consumers.

2. Evolution of U.S. Credit Card Markets

Credit cards serve as a core component for a modern financial system, allowing owners access to a convenient, flexible line of credit, should they desire it and meet certain metrics related to credit worthiness. This dual nature of credit cards, or the fact that they may serve as both a transactions medium and a form of short-term borrowing, makes these instruments of particular interest from a consumer decision-making standpoint. Originally established as a tool to reward a seller's most valued customers (associated with convenience and prestige) in the form of a credit line with a particular merchant, the model was later expanded to include virtually all consumers (including those without any real proof of income, such as college students).

These changes to the credit card market began in the late 1970's, with heavy deregulation of the U.S. banking industry. This decrease in regulations allowed

banks to become more aggressive in the development of credit cards as a new means of profit generation, resulting in a dynamic shift in the picture of who exactly owned credit cards (Manning and Kirshak, 2000). In 1983, roughly 65% of all U.S. households reported holding, at least, one credit card (Castranova and Hagstrom, 2004), whereas 83% of households indicated holding cards by 2002 (Min & Kim, 2003; Swift, 2014). This trend in increasing card ownership was largely the result of the fact that cards were being made available to consumers with more modest incomes. This loosening of requirements for cardholders reached an extreme point, beginning in the early 1990's, when industry leaders dropped the requirement that unemployed individuals under the age of 21 have a parental co-signor (Manning, 2000; Manning, 2005). This allowed for targeting of a large, previously untapped market, college students. The late 1990's saw a rapid expansion of credit card ownership and debt on college campuses, as 84% of undergraduates reported owning, at least, one card in 2009 to the tune of an average of $3,000 in credit card debt (Sallie Mae, 2009). Concerns over increasing debt among young adults eventually resulted in the passage of the CARD act in 2009[1]. Recent years have seen some declines in ownership rates, as a recent Gallup poll suggests that only 71% of households owned, at least, one credit card in 2014 (Swift, 2014).

3. Consumer Use of Cards

One of the most critical factors in exploring the present issues raised by Kahf and Mohomed in their discussion of Islamic finance has to do with the behavior of credit card users in a broad sense. Because credit cards provide consumers with a flexible financial product, consequences of use vary greatly depending on whether individuals are convenience users or revolvers (Canner and Luckett, 1992). As raised in the article, the usage of credit cards as a pure transactions medium does not pose any ethical dilemmas for those who are opposed to the use of debt, since no interest payments will be applied or incurred under the model of convenience use only. However, if a consumer carries a balance over from one period to the next (i.e. revolves a balance) for any reason, then interest costs will be triggered. U.S. statistics indicate that roughly one-third of households are revolvers, with the remaining 66% identifying as convenience users. The critical question raised by the authors in the present discussion is whether it is at all acceptable to utilize cards that are not entirely Sharīʿah compliant. So the mere existence of the option for interest charges to be incurred raises a point of concern. This concern can be further explored by considering card mechanics and human tendencies underlying behavior.

A number of factors serve to make credit card use attractive, including convenience, safety, costs, and potential rewards. When utilized effectively, credit cards have the potential to provide consumers with a less expensive medium of exchange than cash alone. In cases of reward cards, this lower cost is based on the fact that cards may provide cash back or points on purchases that cash does not provide, thus, convenience users who pay off their cards at the end of each period will receive additional benefits based on consuming with cards as opposed to cash. Even if rewards are not a component of a card, convenience users may pay less than the marginal cost of credit to make use of credit cards (Chakravorti, 2003). In essence, the relatively smaller pool of revolvers serves to finance the cards being used by convenience users (King, 2004), and in a pure economic sense, a reasonable consumer might choose to make all of their purchases with cards and then pay the balance off at the end of the transaction period. However, such a strategy would only be effective conditional on a consumer's ability to avoid over-spending with their cards.

Under the Neoclassical economic assumption of rational economic agents employed in many models, there would be no need to provide cards that were in any way different, even for the purposes of Islamic finance. Theoretically, those who found debt to be unfavorable (i.e. did not desire to employ the option to revolve a balance), for whatever reason, (i.e. religious, personal, cost, etc.) would simply not engage this feature of their cards. In short, these optional features would provide no real cost to those who chose to not utilize them, nor would they potentially cause hardship for consumers. Anyone opposed to the

(1) Credit Card Accountability Responsibility and Disclosure Act of 2009 (enacted), H. R. 627, 111th Cong., 1st Sess. (2009).

interest charges associated with cash advances or revolving a balance, could use the cards for purchases that they were capable of paying off within the transaction period, thus incurring no additional cost or interest factors. This is, of course, contingent upon individuals operating as purely rational economic agents, and existing data raises some questions about whether or not this is always the case.

The loosening of lending standards (reflected by the expanding availability of credit cards) corresponded with a period of increasing debt among U.S. adults. Kim and DeVaney (2001) noted an increase in total debt, but especially revolving debt, for the latter decades of the 20th Century. These data guided researchers to question the degree to which credit cards might serve to facilitate spending (or serve as a stimulus for spending) (Feinberg, 1986). The introduction of credit cards provides a degree of separation with regard to how spending decisions are considered, as credit cards serve to replace cash with a more abstract conceptualization of money. Some researchers have argued that this abstraction may make spending easier for a portion of consumers, resulting in potential over-spending (Feinberg, 1986). As a result, credit cards have received some criticism as tools that may promote problematic behaviors for consumers and society at large.

The consideration of credit cards as spending stimuli may be considered from the context of consumer attitudes, as Mansfield, Pinto and Robb (2012) analyzed the literature on affect, behavior, and cognition related to credit cards. For the present article on Islamic finance, consideration should be given to the affective components of impulsivity, compulsivity, and materialism that are often considered with respect to credit cards. This notion has been explored to a degree within the field of behavioral finance, which formally challenges the assumptions of purely rational economic agents with perfect information and willpower. Under this framework, consumers may be considered as bounded in their rationality, as decision-makers may be limited in their capacity to incorporate all relevant information in the decision process. In essence, individual knowledge, and the ability to draw from that knowledge in assessing alternatives, can serve as a critical factor for consideration (Simon, 2000).

Previous research has established a connection between individuals' financial knowledge and subsequent behavior, including the use of credit cards (Hilgert et al. 2003; Robb, 2011; Robb and Woodyard 2011). However, these associations are drawn from cross-sectional data leaving significant questions with regard to how much of an impact financial knowledge alone has on behavior.

Another unrealistic assumption of Neoclassical economic models is the idea that consumers have unlimited willpower to complement their full information. So even if a consumer is capable of outlining a reasonable course of action with regard to saving or borrowing decisions, their ability to follow through on the intended plans may, at times, be in question. Much of this difficulty (or conflict) originates from the fact that consumers may display time inconsistent preferences, along with naïve beliefs about future behavior (DellaVigna and Malmendier, 2004; Laibson, 1997). From a framework of hyperbolic discounting, consumers may struggle to effectively behave in a manner that is consistent with their long-term economic goals, largely driven by situations that present a conflict between present and future selves. So in many cases, consumers may obtain credit cards with the intention to utilize them as a convenience tool, possibly with an emphasis on reward points that can be obtained. However, for a significant portion of consumers, this model is difficult to maintain, as individuals find themselves consuming more than intended (and worse, more than can be repaid during the transaction period) and eventually revolving some balance from month to month.

Under such a model, innovations experienced in the consumer credit markets during the 1980's and 1990's may be seen as potentially problematic, since these market changes resulted in greater levels of liquidity (or a reduction in constraints on consumption behavior). Whereas the typical economic assumptions would be to consider any reduction in constraints on choices as a good thing, if consumers struggle with choosing optimally (i.e. display time inconsistent preferences as indicated by the research mentioned previously) then, such freedom may actually prove harmful to consumer welfare (Laibson, 1997).

4. Sharīʿah Compliance as a Form of Commitment

The authors raise some critical points about what characteristics are important for a card to be compliant and consistent with the notion of Islamic finance. This presents an interesting consideration of commitment devices. In cases where economic agents face difficulty in maintaining a chosen path of behavior or lifestyle (often based on insufficient willpower or other issues), they may consider employing a commitment device to assist in constraining their behavior (Bryan, Karlan, and Nelson, 2010). To put this in a simple context, an extreme example of such a commitment device would be the removal of the problematic factor. This can be exemplified by the destruction of one's credit cards by an individual who wishes to avoid debt. Cutting up the cards removes the possibility of incurring debts on said card if an individual has concerns regarding self-control. If economic agents do suffer from time inconsistent preferences in the context of borrowing decisions, then credit card contracts are effectively structured to take advantage of this issue, and may be particularly worrisome for naïve consumers who fail to accurately incorporate their own limitations into the decisions process (DellaVigna and Malmendier, 2004).

On its face, the simple solution for the problem presented by the authors (i.e. the unacceptable nature of interest costs) would be to provide cards that are essentially synonymous with debit cards or other similar options. These instruments, which might include a prepaid card or a mobile wallet, would not present any real conflict, provided the right structures were in place (for example, the nature of overdraft fees would need to be assessed, though it sounds as though this could be structured in such a manner as to be Sharīʿah compliant). However, one aspect that may make this less popular is the fact that credit cards as instruments often offer other advantages to consumers beyond simple convenience and safety as a transaction medium (for which debit cards can largely be perfect substitutes). As noted previously, credit cards often offer reward structures based on dollars charged, and this can essentially be equated to free money in the case of a non-revolver utilizing a card for most of their purchases.

Sharīʿah compliant cards can confer benefits on sophisticated and naïve economic agents. Whereas traditional cards present no inherent problems when applied as a transactions medium, they have the potential to trigger penalties, and the evidence from behavioral economics suggests that many consumers will find themselves struggling to manage consumption under a loose contract structure. A consumer who truly wishes to live in a way that is consistent with their religion can obtain a card that supports their lifestyle, effectively restricting usage through the imposition of structured card requirements (or firm commitment devices). This can be beneficial in cases where consumers fail to recognize their own problems with willpower, as well as for sophisticated consumers who actively seek out methods of curbing their own short-term desires.

5. Conclusion

As a market instrument, Islamic cards may provide a reasonable approach to providing consumers with some of the examined benefits of credit cards as a medium of exchange without many of the potential downsides or risks that come with cards that can encourage spending beyond one's means. These tools may provide a means of circumventing some unfortunate consumer tendencies, while also serving to make those consumers who adhere to Sharīʿah laws better off than cards that could potentially lead to behaviors which conflict with their desired lifestyle. From a Western perspective, it is often assumed that the lender need not necessarily worry about the ultimate behavior of the borrower, so the present paper raises interesting critical questions about the role of lenders in markets. As Sharīʿah compliance calls for strict usage rules, greater consideration must be given to card structures than for non-Sharīʿah compliant products. Ultimately it is reasonable to question the approach of non-Islamic lenders, as they do not necessarily present a "right" way of managing such contracts, and the experience of consumers in the United States can provide some useful cautionary tales with regard to consumer debt and credit management.

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