

## **Debt and Promises: A Toxic Soup**

A disturbing problem often encountered in contemporary financial practices is the manner in which people incur debt through a coterie of easy and sometimes absurd means. These include: lure of easy pay-day loans; credit card issuance; margin lending; credit union lending; in-store credit and loyalty programs, and 'loan sharking'. While some personal debt (such as housing loans) may be genuine, others are purely unnecessary and frivolous. They often originate at one extreme from: peer pressure and societal demands occasioned by changing lifestyles; over-capitalised homes; social occasions and events (aka lavish weddings and parties) to the destabilising and highly frowned extreme of gambling, Ponzi, and highly speculative investment schemes. To the extent debtors rationalise their payment future obligations will be met from some anticipated present illusory windfall or unexpected gain (lotteries and pokies), regular and genuine supplementary income (e.g. investment income) may be insufficient to service all their debt obligations. Compounding the debt problem are unexpected losses and income disturbances such as sickness, physical incapacitation and retrenchment. In short left unpaid, debt compounds further through interest charges, penalties and legal costs. In relation to commercial practices, a further debt layer is that accumulated through a myriad of borrowing practices and schemes contrived through complex legal stratagems that often go beyond the credit worthiness and repayment capacity of the business. All this makes for a toxic soup when the underlying debt is unable to be serviced or repaid.

Banks, institutions and suppliers may be accused of unfair and deceptive lending practices but that does not absolve debtors from their obligations. Many of these practices are simply highly leveraged 'debt traps'. Consider the so called 'interest free' schemes promoted by stores and suppliers. The 'front end' supplier merely intermediates on behalf some 'back end' financial institution so that once a sale is transacted, the ultimate creditor (lender) is the institution. What is sometimes conveniently forgotten in such deals is that when the debtor defaults (i.e. does not pay off the whole debt within the stipulated period) the lender effectively backdates all interest and charges to the actual purchase date which may be a few years. In so doing, the debtor is not only burdened with additional debt but also risks losing credit worthiness.

On the other hand are genuine businesses whose credit lines have been stopped or denied or who effectively are unable to access mainstream credit sources and who then, as a last resort, turn to the black economy and loan sharks for bailouts. Yet others resort to pawning valuables to meet debt obligations. Both circumstances are extreme measures aimed at narrowing cash-flow gaps.

The fundamental principle under most legal systems is that debt however incurred, is to be discharge in terms of contractual obligations. This view prevails very strongly under the shari'ah and goes much further through prescriptive ethical rules. Let's consider these:

## **From Qur'an**

The most conspicuous and easily attraction to debt is that occasioned by extravagance and prodigality. This tendency is the opposite of frugality – a highly commendable practice encouraged by Prophet Muhammad (pbuh). The Qur'anic injunction is explicit:

*Eat and drink, but waste not, for God loveth not the prodigals (7:31)*

This verse encourages a middle path in private consumption expenditure. As for wanton destruction of wealth through frivolous expenditure, the Qur'an is even more direct:

*Squander not wastefully, surely the squanderers are the devil's brethren (17:26-27)*

The reference to debt is that prodigality is often associated with the tendency to borrow money. A by-product of borrowing is the borrowers' habit of making promises. Promises of debt repayment increases as debt obligations accumulate. It is for this reason the Qur'an warns:

*And (truly pious are) they who keep their promises whenever they promise, and are patient in misfortune and hardship and in times of peril (2:177)*

Here the obligation to keep promises is equated with piety. The opposite i.e. broken promises would imply impiety or the distancing from virtuous acts. Al-Qaradawi argues that the shari'ah does not preclude people from taking on debt but that unfettered borrowing leads to personal failings, one consequence of which is the tendency to lie and break promises.

A further consequence of debt, but this time directed at the lender or creditor, is the potential for unjust enrichment at the expense of the debtor. This is specially so in riba-related debt. The Qur'anic exhortation takes in three prohibitions that are capable of much wider interpretation considering the legal stratagems employed in lending practices.

*And devour not one another's possessions wrongfully, and neither employ legal artifices with a view to devouring sinfully, and knowingly, anything that belongs to others (2:188)*

The above verse would apply to personal as well as corporate debt obligations. The first reference to wrongful acquisition can be thought of as financial practices that severely curtails the rights of borrowers and unsuspecting debtors. It takes in acts such as possession of property by mortgagees where the debtor is burdened with exorbitant legal costs and penalties. The second, unconscionable and obnoxious behaviour is that to related 'legal artifices' that, in contemporary financial dealings, include the extraordinary legal complexities of debt structuring, default and roll-over arrangements. This is easily discernible in large corporate failures triggered by lenders exercising their rights without granting the borrower adequate respite. The third prohibition covers exploitive behaviour occasioned by duress. This tendency is especially prevalent in marriage breakdowns and in division of property occasioned by irreconcilable differences between parties.

There is in all these cases the potential for unconscionable conduct on the part of the lender or the stronger legally endowed party. For instance, the prelude to the report on a unified code of conduct on debt collection in Australia concludes that creditors resort to extraordinary behaviour in debt collection. They cite in support of their argument, instances such as work harassment, oppressive legal threats, late night calls and random home visits at odd hours and even extortion.

What happens then when the debtor experiences genuine difficulty with debt and is in straitened circumstances? Here, the Qur'an appeals to the succour and conciliatory side of the creditor. It says:

*If the debtor is in difficulty, grant him time till it is easy for him to repay. But if ye remit it by charity, that is best for you if ye only knew (2:280)*

This verse is often relied upon by the borrower (debtor) for relief. Its import however, must be weighed against the requirement to fulfill contractual obligations. Thus it impresses on counter parties:

*O you who believe, fulfill all obligations (5:1)*

The fulfillment of obligations or *uqud*, takes on a very wide connotation – it means for instance fulfilling the rights of God. This has implications for all parties since the creditor, who may have waited or relied on the fulfillment of obligations, may himself be in a precarious situation as a result of the debtors' non-performance. It is for this reason that the Qur'an enjoins justice as a means of protecting both debtors and creditors when it proclaims:

*Behold, God enjoins justice and the doing of good, and generosity towards [one's] fellow-men (16:90)*

The practical manifestations of the Qur'anic injunctions are further supported in the Prophetic traditions.

### **From Hadith**

The advice to the debtor, before incurring debt, is the requirement and understanding of 'intent'. Pursuant with the law of contracts, the first requirement in debt obligations is the intention of the debtor to perform. The hadith states:

*Whoever contracts a debt intending to repay it, Allah will repay it on his behalf; and whoever contracts a debt intending to waste it, Allah will bring him to ruin (Bukhari)*

This hadith very clearly stresses the dichotomous consequences of intention. First, there is reward for proper performance with a clear warning of defeat for scurrilous intent. The second Prophetic advice to would-be debtors is that the shari'ah does not shun debt. However the debt must be within affordable limits and, must be repaid promptly – that is to say punctually:

*The best among you are those who are best in paying off debt (Muslim)*

Heavy debt can be harmful and is discouraged since it has a serious and direct effect on belief and conviction. This is evident in the Prophet's (pbuh) prayer:

*“O God, I seek refuge in You from sin and heavy debt”*

That this became a problem for people with genuine debt and its onerous burden, another hadith stresses the harmful consequences of heavy debt. Some of the companions of the Prophet (pbuh) asked:

*“How often do you seek refuge from heavy debt”, he replied, “when a man gets into debt, he speaks and tells lies, and when he makes a promise he breaks it” (Bukhari & Muslim)*

In relation to belief and conviction, the Prophet (pbuh) used to pray:

*“I seek refuge in Thee from unbelief and debt”. A man asked: ‘do you equate debt with unbelief?’ He replied, ‘Yes’*

What then is the position of those who are already indebted? Both sources of the law discussed above makes it clear that the debtor is obliged to fulfill the debt obligations even when respite is afforded by the creditor. As for those who *have* the means but *do not* do so willfully, their behaviour is fraught with disdain and contempt and equated with injustice as the hadith says:

*Postponement of debt repayment by a competent person is zulm (cruelty) (Bukhari)*

The reference to *zulm* is behavior associated with equity and fairness since, the creditor is placed in a very disadvantageous position by the recalcitrance of the debtor. Hence, accruing debt is a serious matter. Scholars argue that the Prophet (pbuh) disliked people being in debt because debt is a worry by night and a humiliation by day. The only exception for heavy debt it would seem, from the perspective of the shari'ah is in cases of *dharurah* – in other words, circumstances involving real and genuine ‘necessity’.