

EFFECTS OF RIBA ON LOANS IN A SOCIETY A CASE OF ZANZIBAR URBAN WEST REGION

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Abstract:

This study attempted to examine the effects of Riba on loans in Zanzibar society case of residents of Urban West Region. It is surprising to note that although these loans charge a high interest rate the demand has been increasing by the day. The study had three specific objectives; first to examine causes of residents of Urban West Region to take loan with Riba, second to identify positive and negative effects of Riba on loans in residents of Urban West Region, and third to identify the recommendation measures to be taken in order to overcome interest on loans in the residents of Urban West Region.

Theory of maqaswid by Ibnu Ashur was used. Interviews and focus group discussions were conducted during the study, the sample used was made up of adolescents and adults who are the main borrowers.

The study found that interest on loan has numerous effects in Zanzibar society among them are increased poverty, bankruptcy, division of family, increasing number of street children, diseases, to name but a few.

Certain measures have been suggested in order to overcome the effects of interest on loans. Among them are to improve the wages of wage earners, to reduce tariff for imports of basic commodities, establish community shops, the labour force to increase productivity that will eventually lead to higher Gross National Product and also to reduce luxurious life styles that eventually force them to borrow interest-based loans.

KEY WORDS: Financial Institution, Interest, Loan, Interest on Loan.

Introduction

Financial institutions are among the most important organs of a country's financial system. They play a vital role in determining the effectiveness and efficiency of the financial system. Indeed, these institutions provide the economic services and represent vital infrastructure through which money flows from savings to investors leading to an economic growth (Ghazi, 2019).

During that process, some fund providers charge interest. The interest charged by financial institutions on loans they provide has a significant impact on the profitability of such institutions. This is what motivates people as well as institutions to engage in interest related activities. The interest on loan is considered an important factor affecting saving and investment. It is widely accepted that interest on loan has negative effects on a country's saving and investment. A rise in the interest on loan encourages rich people to save more as the former leads to increased income. On the other hand, an increase in the interest on loan also raises the cost of capital, resulting in a reduction in investment within the economy.

Financial sectors are generally under developed in Sub-Saharan Africa, with banking systems accounting for the preponderance of financial sector. The scale of financial intermediation in the region remains significantly lower than in other developing regions of the world, while access to financial services is also relatively low, reflecting a combination of low-income levels, small absolute size, and infrastructure weaknesses (AnjelloPulkol, 2019).

According to Umar Chapra, the interest means the extra money that has to be paid, including the principal money of the debtor after the expiry of the term of the loan (Chapra, 2010). According to the terms of interest on loan, the other party is forced to pay extra money. There is no risk or uncertainty in interest on loan. Interest on loan can never be negative. The lender does not invest time and labor in the interest. It is claimed that, the interest-based economy teaches people ruthless and inhuman behavior (Rahman, 2009).

All Ibrahimic religions such as Judaism, Christianity, and Islam banned interest-based activities because interest has a great negative impact on human life. It has been proved that life was much easier when interest had not been used (Zaman, 2001).

The objective of this research was to examine the effects of Riba on loan in a society whereby Zanzibar Urban West Region was taken as a case study. The study collected data by using primary sources from selected locations due to their potential in providing the needed information.

As earlier hinter Theory was the Theory of Islamic Law known as *Maqasidu as- Shariah* (Objectives of Shar'iah). One of the objectives is to protect human from harm.

1. FINDINGS OF THE STUDY

Based on the objectives of this study, major findings were as follows below.

Firstly, on causes that lead residents of Urban West Region to take Riba on loan, the researcher discovered that there were different reasons leading to society to take it including increase in poverty,

low wages/income, increased cost for business capital, emergencies, imitating friends life styles, limited understanding regarding interest loan, lust for life and a love of pride, as well as lack of adequate knowledge on the distinction between Islamic bank and conventional bank,

According to Magfur, there is no provision in society to get loans without interest. As a result, the poor and middle-class people of the society were forced to take loans from the moneylenders at the peak and compounding rate at the time of the extreme need, danger, and misery during the crisis (Magfur, 2019). The society takes Riba on loan due to the lack of other avenues. They feel that these loans will help them solve their problems but instead they increase the debt day. According to some authors, and that is from a different point of view, when interest rates are too high, companies or firms do not like to borrow money from the bank that can raise unemployment between the people (Saleem, Khan, & Siraj, 2013).

According to respondents these are the causes of society taking Riba loan. If government and society work carefully in eliminating the causes, community will not take interest loan because the problem will be solved.

Secondly, it was asked, “what are the effects of Riba on loan in residents of Urban West Region?”. The answer of this question was divided into two parts, positive effects and negative effects. The positive effects that were mentioned by some respondents, some of whom claimed that Riba on loans has benefited them. It was claimed that people can solve various problems and restore their dignity by paying off debt on time. Others will get rapid development due to the business they run whose source is the interest loan. It also simplifies demand and brings equal opportunities to the society. For example, someone needs a modern house, she/he takes Riba on loan. This simplifies the situation and one gets what she/he needs. Due to the positive effects some people cannot ignore it.

The negative effects of Riba on loans according to respondents are numerous, among them are as follows: -

Increased poverty in the society, having a burden of debt, inefficiency at work, bankruptcy, sudden death, conflicts and instability in families, lack of love and compassion, lack of blessing in the property one owns, being a liar and dishonest, psychological effect to the children, division of family, increase of street children and gangs, leaving debt to the heirs, source of laziness, social isolation and getting sin from Allah.

There are cases of people in our society who have died from stress; due to failure to pay off debt, their properties were auctioned, and they became homeless. In order to live in harmony, the society must accept Divine revelation. All Divine books prohibit Riba on loan and great philosophers like Marx condemned the Riba on loan because they knew it has more negative effects than the positive ones.

Most of the respondents (90%) mentioned that economic and financial crises can raise the debt. At that moment the relationship between debt and economic growth goes into a negative relationship. Most of the respondents (90%) also commented that exploitation of people is another big negative

effect of interest in society (Magfur, 2019). In the short term, the debt burden becomes enormous and it continued to increase (Checherita & Rother, 2010). Another consequence of traditional finance is the unsustainable debt burden that emerges in both the private and public sectors (Saraç, 2016).

Thirdly, it was asked “What are the recommendation measures to be taken to overcome Riba on loan in the society?”. To this, the respondents tried to mention several measures, which could be divided into three groups; measures to be taken by the government, financial institutions, and those to be considered by the society.

- In order to overcome this problem the government must increase the wage of the civil servants, remove interest, establish the fund that will help poor people, the state fund should be used to help weak/poor people, educate people regarding interest on loan, provide employment for youth, regulate credit level for employees and ban debt consolidation, reduce the tax for internal commodities, build modern houses and sell them to citizens, reduce higher education fees and support poor families in education.

According to Sarac (2017), Islamic finance has shown to be the fastest growing discipline in the business arena. The interest-free financial system is based on basic principles such as partnership, profit sharing, halal profit, equity and fair income distribution. Interest-free loans like Qadr al-Hasan should be availed to the needy for humanitarian and welfare work without expectation of additional monetary benefits in return to the lenders (Magfur, 2019).

- For the **financial institutions**: In order to overcome effects of interest loan in the society the respondents recommended that, Financial Institutions should support setting up of community retail shops in order to manage the prices.

If financial institutions will do that it will help their clients to get profit through their shops for selling commodities,

For the **society**: There is need to raise awareness on the impact of interest loans. In addition, they must improve productivity by working effectively hard to earn more income. Also, they should reduce imitating others or follow luxurious lifestyles they cannot afford, which will land them on debt trap. Moreover, if unemployed they should seek means to employ themselves instead of waiting for government jobs.

2. CONCLUSION

The research has found that in order for society to live a happy, peaceful and loving life, its members should leave interest loans as these loans are the source of numerous problems that arise in society. Affirmative measures should be taken to increase awareness on the negative aspects of interest loans, Islamic financial institutions should prove to the society that much as they need profits to survive, they are there to support the societies around them by having programs that aim to achieve that goal by setting aside funds to groom or nurture Small Medium Enterprises through training and funding.

3. AREA FOR FURTHER RESEARCH

4. THE FOLLOWING AREAS NEED FURTHER RESEARCH:

- i) What makes Interest free financing cost effective?
- ii) Impact of Islamic Finance on Poverty Reduction.

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