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Shariah Finance for Poverty Reduction in Muslim World

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Abstract: Poverty is a multi-dimensional phenomena and a result of a complex socio-economic and political structure of a particular country. It is associated with poor economies, poor human resources, poor social services provision and poor policies to tackle the challenges facing human and socio-economic development. The issue of "poverty eradication" and "access to finance "are important ends in Islamic economic development, hence, the need to focus on a broader approach in evaluating the condition of people in Muslim society. The main objective of this study is to explore the conceptual framework on the role of Shariah compliant micro-finance to eradicate poverty. Use of risk-sharing financing instruments can offer Shariah-compliant microfinance, financing for small and medium enterprises and micro-insurance to enhance access to finance and redistributive instruments such as Zakat, Sadaqat, Waqf and Qard-al-Hassan complement risk-sharing instruments to target the poor sector of society to offer a comprehensive approach to eradicating poverty and to build a healthy and vibrant economy. The methodology of this study is based on analysis of relevant theories. The findings of the study indicate that Shariah-compliant micro-finance is a growing market niche with a comprehensive approach towards socio-economic justice. Zakat and Waqf institutions are requisite for generating community assets, productive capacity building, wealth creation and knowledge and skills that will enhance the technical standing of entrepreneurs. This approach towards poverty eradication of less affluent Muslims before and since Shariah compliant finance was introduced.

Key words: Shariah compliant, micro-finance, poverty, eradication, Zakat and Waqf

INTRODUCTION

This world that we know seems to be human-centered in the sense that the human reigns supreme over all other fellow creations. One would have expected that in this human-centered story, human dignity would also reign supreme. Unfortunately that is not the case when one takes into consideration, for example, the challenge of poverty, deprivation and suffering. Our sensitivity seems to fade into a black hole and our quest for solving problems reaches a miserable dead-end when it comes to poverty. While poverty is a common story transcending religion, this study will particularly focus on the experience of the Muslim world, especially in the context of Shariah finance.

Poverty is a global problem and it is estimated that more than half of the world population live below US $2.50 per day (Choudhury, 2011). The level of poverty in Muslim countries is considered relatively very high compared to non-Muslim countries. More recently, Ashraf and Hassan (2013) noted that 15.6% of the total Organization of Islamic Conference (OIC) population are still living on <1$ a day which is well above the world average of 11.6% and developing countries average of 11.7% in the 2008-2010 period. Alpay also notes that 31% of OIC total population are still living below the income poverty threshold of 1.25$ a day by remaining quite above the world average of 14% and developing countries average of 17% during the period in the 2008-2010. The world bank defines extreme poverty as living on less than US $1.25 per day while moderate poverty as living on <$2 a day.

Accounting for about a quarter of world population, the 57 member OIC produced only 10.9% of the world total GDP (Rahman, 2013). The devastating socio-economic and political consequences of this problem are increasingly evident in muslim countries, especially regarding the vulnerable groups such as rural

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dwellers, widows those whom are sick, the aged, orphaned children, the landless and physically challenged (Dahlquist, 2013). Financial inclusion through microfinance has been reported to improve the living conditions of the poor. It avails them the opportunity for income generation, productivity, capacity building and as well contribute to economic development process and overall national development (GIFR, 2012). According to Rahman (2013), micro-finance organizations target micro-employment and grass-root economic activities such as agriculture, horticulture, cattle rearing and micro-enterprises and support products that lead to industrial clusters. This study concludes that Islam offers a rich set of instruments and unconventional approaches if implemented in a true spirit and can lead to reduced poverty and inequality in Muslim countries plagued by massive poverty.

Objectives: To provide a brief overview of poverty profile, poverty alleviation programs in Bangladesh.

- To study the concept of Shariah compliant microfinance
- To examine the potential of Zakat and Waqf as viable source of financing microfinance institutions

Literature review: Islamic micro-finance is an innovation in micro-finance to attract ethical consideration in line with the dictates of Islam in doing business. This is essential owing to the fact that conventional micro-finance does not meet with the expectations of Muslims in accordance with their faith (Akhter *et al*., 2009). Islamic micro-finance is an offshoot of Islamic finance which has its foundation imbedded in the Quran and Sunnah (teachings of Prophet Muhammad, peace be upon him). Islamic finance aims to promote trade based on profit and loss sharing and prohibition of interest, speculation and uncertainty in business transaction (Bhuiyan *et al*., 2011). The provisions by Islamic law (Shariah) that prohibit interest, speculation and uncertainty in business transactions are the key issues that distinguish Islamic micro-finance from the conventional micro-finance. The risk that the commercial banks and other conventional financial institutions evade is shared between the financier and entrepreneur under the PLS arrangement. It mobilizes funds, investments and employment opportunities as well as growth to fulfill the basic needs of the poor and hence fight poverty (Kahf, 2007). The Islamic micro-finance experiment has brought a positive attitude for development, in providing benefits to one another and has created real value in improving the standard of living.

MATERIALS AND METHODS

To achieve these three objectives, the study adopted the following research methods: survey of the literature, content analysis and the data collected from various secondary sources like books, journal, newspaper and internet. The accuracy of the study is limited to the accuracy of these sources.

Poverty in muslim world: Like everywhere else, poverty in OIC member countries is a multi-dimensional phenomena and a result of a complex socio-economic and political structure of a particular country. It is associated with poor economies, poor human resources, poor social services provision and poor policies to tackle the challenges facing human and socio-economic development. In many OIC member countries, poverty has been on such a large scale that it has become a structural phenomenon of human deprivation in terms of hunger, malnutrition, diseases, illiteracy and low level and quality of consumption of hundreds of millions of people. The mass poverty in the majority of these countries is a product of complex structural processes embedded in their political economy. Within this complexity, identifying the key causes of poverty should be considered as a crucial precondition for formulating effective anti-poverty strategies.

According to the latest data available based on the World Bank Word Development Indicators (WDI), the percentage of the population living on >$1.25 a day at 2005 international prices is highest in OIC member countries located in sub-Saharan Africa (Fig. 1). Besides African countries, Bangladesh also stands out as having a very high incidence of poverty. Other non-African countries with high to moderate high degrees of poverty include Pakistan, Indonesia and Yemen.

Poverty alleviation programs and policies in Bangladesh: Poverty alleviation remains a core agenda in many least developed and developing countries. In most of these countries, mainly two types of programs are dominant. One is offered by Governmental Organizations (GOs) and another by Non Governmental Organizations (NGOs). The GOs rely on domestic funds to carry out different poverty alleviation programs either on short-term or long-term basis. The NGOs mostly get support from foreign donors in collaboration with governmental agencies to finance poverty alleviation programs (Fig. 2).

In Bangladesh, government based poverty alleviation programs are quite substantial and diverse. These include food for work, production and employment project, Vulnerable Group Feeding, renamed Vulnerable Group Development, Rural Poverty Cooperative Project (RPCP)

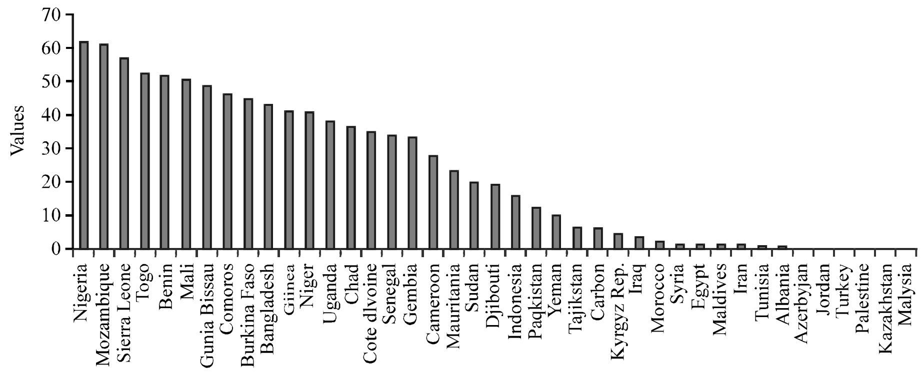

Fig. 1: Poverty headcount ratio at $1.25 a day (PPP) (% of population); World Bank WDI Indicators (latest data available during 2002-2014)

Fig. 2: Poverty alleviation programs and policies

and Rural Poverty Alleviation Programme, Rural employment project, Integrated Poverty Alleviation Programme, Rural Livelihood Project (Khan, 2007). Besides these government initiated programs, nongovernmental organizations are also actively involved in numerous programs and policies. These include Bangladesh Rural Advancement Committee's (BRAC) community empowerment programme, Grameen Bank's Housing for the poor (1984), BRAC's Income Generation for Vulnerable Group Development Program as A's Microfinance (credit and savings program, BRAC's Rural Development Programme (RDP), Grameen Bank's Microenterprise Loans and Grameen Bank's Loan Insurance, BRAC's groundbreaking ultra-poor programme (2002) asA's Hope for the Poorest, BRAC's.

Integrated development programme (MDG, 2012), etc. The most prominent Microfinance service providers are Grameen Bank, BRAC asA and Islamic Bank Bangladesh Limited's Rural Development Scheme (RDS). Microfinance has played a significant role in poverty alleviation. Islamic microfinance appears to be very instrumental in this context.

Poverty eradication through risk sharng instruments: Poverty can be reduced in Islamic economy through two approaches:

- Use of risk-sharing financing instruments such as Shariah-compliant microfinance, financing for small and medium enterprises and micro-insurance to enhance access to finance
- Redistributive instruments such as Zakah, Sadaqat, Waqf and Qard-al-hassan complement risk-sharing instruments to target the poor sector of society

Shariah compliant micro-finance: Shariah compliant micro-finance is an innovation in micro-finance to attract ethical consideration in line with the dictates of Islam in doing business. This is essential owing to the fact that conventional micro-finance does not meet with the expectations of Muslims in accordance with their faith (Akhter *et al*., 2009). Islamic micro-finance is an offshoot of Islamic finance which has its foundation imbedded in the Quran and Sunnah (teachings of Prophet Muhammad. Shariah compliant microfinance projects follow similar concepts of conventional microfinance, including group saving and monitoring, targeting female borrowers, etc., two characteristics distinguished them from conventional ones. First, Shariah compliant microfinance institutions actively adopted various Islamic financial tools such as trade and project finance as well as non-financing instruments such as Waqf (entailing no reimbursement at all, consisting in pure charity) and Qard al-Hassan(loan granted as if it was in favor of God without any expectation) imposing neither profit nor deadline for the repayment in the process of absorbing savings and making loans. Second, since interest income is prohibited, most institutions charged administrative/service fees plus a portion of the profit from the business venture (Fig. 3.)

Islamic microfinance institutions in Bangladesh: The economic environment in OIC countries under which microfinance operates can broadly be categorized into

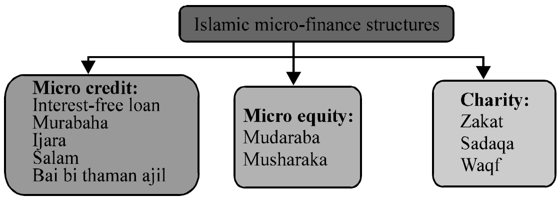

Fig. 3: Shariah compliant figure micro-finance structure

two: countries with abundance of financial capital resources but inadequate human capital resources and countries with moderate financial and human capital resources. RDS in Bangladesh is considered quite effective non-government organizations providing microfinance services. This study highlights various programs offered by Governmental Organizations (GOs) and Non-Governmental Organizations (NGOs) Bangladesh.

In agro-based countries like Bangladesh, poverty is primarily linked to unpredictable natural calamities. The natural disasters have serious implications for damages to crops, infrastructures in terms of destroying the communication system thereby affecting normal distribution systems. Due to the very nature and source of poverty, most microfinance institutions in Bangladesh are centralized in urban areas. The Grameen Bank Model by Dr. Mohammed Yunus in the late 1970s was instrumental in the development of micro-finance. The Grameen Bank Model is based on the premise that even without collateral, microloans can be extended and the poor people can equally be productive if given the requisite funding. The target was rural poor households and adopted a group lending method that emphasized joint liability among the group members (Omar *et al*., 2012).

The Rural Development Scheme (RDS) of the Islamic Bank Bangladesh Limited (IBBL) has been actively involved in pursuing policies/programs to alleviate poverty since the mid-1990s. Unlike all other conventional microfinance institutions that charge a predetermined interest rate over the capital/loan amount which is forbidden in Islam, the RDS pursues Shari'ah-compliant financing. With an impressive growth rate of 13% per annum, RDS has the potential to attract Muslim clients involved in interest-based microfinance.

In the absence of a regulatory framework for Islamic microfinance, the RDS is highly constrained to expand its activities for poverty alleviation. Islamic microfinance institutions offer a wide variety of financial products based on Musharakah, Mudarabah, Qard Hasan, Wakalah and Hawalah. Murabahah seems to be the most dominant mode of financing Bangladesh.

In summary, RDS has been instrumental in poverty alleviation efforts that are Shari'ah-compliant. As argued by a number of scholars (Kahf, 2007), the mobilization of funds through Wqaf (as well as from Zakah, Sadaqah) can be an additional source of funds to assist in poverty alleviation endeavors in OIC countries. While the integration of Waqf resources into microfinance schemes (that are run mainly on voluntary basis) will be quite challenging.

A waqf-based islamic microfinance: Waqf are basically real nonperishable properties that are voluntarily donated for philanthropic purposes. Wqaf are dominated by fixed property mainly land or buildings but can be applicable also to cash, shares, stocks and other assets. The concept of Waqf is a well-practiced phenomenon in recent times in both the Muslim and non-Muslim world. Waqf are usually named endowments in Non-Muslim countries and are providing a wide range of services especially in education and community services.

Waqf/endowment: 'Waqf' by definition needs an institutional setup to ensure perpetuity and good governance. The functions of a Waqf are as follows: a founder who has accumulated private wealth decides to endow his personal property for a specific, often religious purpose. The amount of the original capital, corpus and the purpose for which it is endowed and all the other conditions of management are clearly registered in a deed of endowment submitted to the authorities. In this way the privately accumulated wealth of a devout Muslim becomes God's property. The founder strictly stipulates how the annual revenue of the Waqf should be spent. This revenue (usufruct) may be allocated completely for a social welfare purpose (Waqf khayri) or to a group of beneficiaries.

The Waqf as an additional source of funding for Islamic Microfinance, Waqf was considered as a direct source of financing for Islamic microfinance and human resource development. In turn, Islamic microfinance institutions would complement their operations with Takaful services. This would help promote affordable finance, human resource development and security. All of these are aimed at alleviating poverty. The Waqf institution was considered as the "funding agency" while the Islamic microfinance institution as the "implementing agency" that was offering microfinance services together with Takaful services and financing human resource development programs.

Islamic microfinance institutions/NGOs: Microfinance institutions, Non-Governmental Organizations (NGOs) and various government schemes that focus on poverty reduction in Muslim countries and communities. Islamic microfinance is the provision of financial services for low-income populations in which the services are provided in conformity with Islamic financing principles. In addition, Waqf and Zakah institutions have the potential of utilizing their proceeds for genuine socio- economic development of the poor. For example, the interest-free microfinance provided by Rural Development Scheme (RDS) of Islamic Bank Bangladesh Ltd (IBBL) is found to be contributing to new job opportunities for unemployed rural poor and enhancing economic growth in the nation (Choudhury, 2011). In fact, Macuja and Khambaja argue that the rate of labor absorption by this sector is significantly higher relative to that of large scale industries in Bangladesh. Such positive socio-economic impacts by Islamic Microfinance Institutions (IMFI) clearly indicate the vital role they play towards poverty alleviation.

RESULTS AND DISCUSSION

The proposal to have Waqf as an additional source of funding for Islamic microfinance is supported by all the relevant stakeholders such as NGOs and government agencies involved in poverty alleviation programs. There was consensus that Waqf could play a significant role in providing affordable finance and financing for human development programs related to microfinance and poverty alleviation. The results from Bangladesh indicate a very strong support for the Waqf which shows significant relationship among the components (Waqf Resources→Islamic microfinance; Islamic Microfinance→ Takaful financing; Islamic microfinance→Human resource development; Islamic microfinance→Project financing; Islamic micro finance→Human resource→Project financing and takaful financing→Poverty reduction. Hence, Waqf must be the pivotal factor in poverty alleviation programs. Overall poverty declined from 58.8% (1991-92) to 35.2% (2010). Urban poverty declined from 42.8% to 21.3% while rural poverty declined from 56.7% to 31.5% in the same periods, respectively (Table 1-4).

Table 1: Operationalization of islamic microfinance institutions in bangladesh: RDS at a glance

Areas of performance	RDS of IBBL Bangladesh
Year of establishment	1995
Districts covered	64 (2013)
Village covered	16,000 (2013) out of 70000 villages
Branches (for population in millions)	228(152), 2013
Total member (million)	0.812 (2013)
Total staffs/field officer	2171 (2012)
Disbursement (million)	Tk.74,779.14 (2013)
Outstanding loan (%)	17
Profit/interest (flat) rate % (service charge)	10
Average investment size per client (million)	0.0153 (2009)
Rate of recovery (%)	99.6 (2013)
Assets growth (in terms of capital) rate of the respective microfinance institution	12-57
Dropout rate (%) (from the respective institution	5

Table 2: Pference for islamic finance in the muslim world

Country	Survey year	Findings
Algeria	School of finance and management	A study revealed that 20.7% of microenterprise owners do not apply for loans primarily because of religious reasons
Malaysia	Saad (2012)	Clients of Amanah Ikhtiar Malaysia show willingness to participate in musharaka and other Islamic financial contracts if they are provided. They also pay Zakat from their loans
Indonesia	Bank Indonesia	In East Java, 49% of the rural population considers interest prohibited and would prefer to bank with Shariah-compliant financial institutions
Bangladesh	Rahman (2013)	There is strong need for Islamic alternative to microfinance. Islamic microfinance was also found to be significant contributor to poverty reduction
Jordan	IFC and FINCA	Studies show that 25 and 32%, respectively, of those interviewed cite religious reasons for not seeking conventional loans. The study also showed that 18.6% of those interviewed rank religious reasons as the single most important factor in their decision on obtaining a loan
Lebanon	Gafoor (2001)	The success in outreach of Islamic programmes relative to conventional microfinance institutions strongly suggests that large numbers of poor people prefer Islamic finance. In addition, microfinance practitioners report that many of the poor refuse financial services unless they are Sharia-compliant.
Palestine	PlaNet Finance	The >60% of low-income survey respondents claim a preference for Islamic products over conventional products. More than half of such respondents prefer such products even if they come at a higher price

Table 2: Continue

Country	Survey year	Findings
Syria	IFC	Survey revealed that 43% of respondents considered religious reasons to be the largest obstacle to obtaining microcredit. In addition, 46% of respondents who had never applied for a loan stated that religious reasons were the primary reason they had never applied. Nearly 5% of current borrowers said they would not apply for another loan for religious reasons
Yemen	National microfinance foundation	An estimated 40% of the poor demand Islamic financial services, regardless of price
Nigeria	Adewale and Muhammad	Majority of micro entrepreneurs interviewed stated that their religion prohibits dealing with interest, thus the reason for avoiding conventional microfinance banks. In addition, they express their intention to utilize Islamic micro-investment model
33 OIC	Ashraf and Hassan (2013)	Religious and cultural norms in Muslim countries drive preference of Islamic microfinance over countries conventional microfinance

Farrigan and Parker (2012), Saad (2012), Ashraf and Hassan (2013)

Table 3: MDGs, target and achievement on poverty

Particulars	Bangladesh
MDGs	Half between 1990 and 2015, the proportion of people whose income is <1$ a day from 56.7 (NPL) or 70% (IPL)
Target	Reduce poverty gap ratio to 8.0% by 2015
Achievement	Achieved in 2012 as the figure was 29.0% (NPL) or 43.6 IPL in 2010
	Reducing poverty gap ratio to 6.5% against 2015 target of 8.0

Table 4: Poverty reduction rate in Bangladesh

Particulars	1991-92	1995-96	2000	2005	2010
Rural	56.7	50.1	48.9	40.0	31.5
Urban	42.8	27.8	35.2	28.4	21.3
Bangladesh	58.8	54.5	52.3	43.8	35.2

Household Expenditure Survey (HES) 1991-92 and Household Income and Expenditure Survey (HIES), various years, Bangladesh Bureau of Statistics (BBS), World Bank 2011

CONCLUSION

The major contribution of this study lies in Waqf and microfinance there by incorporating both income and non-income aspects to ensure more effective and efficient contribution towards poverty alleviation. In conclusion, the concept of Islamic micro-finance is a growing market niche with significant potentialities. The developmental and ethical benefits to the society will enable it to compete favorably as an indispensable financial alternative. This study is a modest attempt to explore the role of Waqf as funding agencies and Islamic microfinance as the implementing agencies toward eradicating poverty in Muslim world. More work has to be done to improve the current study with empirical data.

RECOMMENDATIONS

Based on the studies done in Bangladesh, there is strong indication that the Waqf can be a viable alternative for poverty alleviation. This study has reaffirmed that microfinance is an important institution in the fight against poverty and that Islamic microfinance provides additional value in the context of riba-free financing. Therefore, in some OIC member countries the role of government may be more pronounced whereas in other OIC member countries there could be a need to have external funding from other sources such as the Islamic Development Bank (IDB), International Zakat/Waqf Agencies or other charitable donor agencies. All these funds can subsidize the cost of lending as well as supplementing the existing limited funds of Islamic microfinance institutions. As far as implementing agencies are concerned in some OIC member countries such as Bangladesh, Non-Governmental Organizations (NGOs) are playing a leading role in Islamic microfinance activities/programs.

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