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Islamic Microfinance Model and the Hypothesis of Poverty Alleviation

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Abstract

Efforts to alleviate poverty in the world have the most perilous impact in human history. Contrary to the prevailing paradigms in public and private policies, the erosion of poverty remains very shocking. The Islamic finance model tried to present its alternative vision and to participate in international efforts to at least help the poor in Muslim countries. This paper is an essay among others that analyzes the effectiveness of this system based on official data.

Keywords: poverty, impact, Islamic microfinance, alternative, effectiveness

Introduction

Muslim societies have long been, and still are, suffering problems of intractable solutions to escape the iron fist of underdevelopment and poverty that are growing in a geometric succession. Such sustainable curse and inconvenience has destroyed the hopes and souls of Muslims and fortifies them dependency in all aspects of contemporary time. The increasing specter of poverty and unemployment *systematically threatens the stability and peace of Muslim nation depriving them of a dignified life.* Counter-attack policies, either from local initiatives or those developed within the framework of international cooperation between governments and specialized international bodies have failed. Despite the mediocre results, majority of Muslim economists and specialists are confident and show a certitude that Islamic economic theory provided believers a practical and effective solutions to achieve development and a decent life. In this paper, we will approach this insolvent problem that has disturbed the past and threatens the present and the future of the Muslim population. It focuses on the myth of Islamic microfinance and its effectiveness fighting poverty improving the living conditions of the individual and the community.

Through a simple extrapolation of the characteristics of the Muslim community, the microfinance industry appears to have a wide field for expansion and growth. Indicators of that success are illustrated by several factors that can be summed as following:

First, Islamic nation, from a long time, is experimenting one of the highest rates of poverty and unemployment in the World, it disposes also on a huge market that can absorb all investment initiatives and offering a sustained level of consumption. A market that represents 24% of the population of the World, exceeding one billion and eight hundred million people.

Second, Muslim countries dispose on huge sources of wealth: fertile lands, precious and diverse minerals, exceptional energy sources, cheap and young qualified labor.

Third, a rich experience that Islamic finance has matured from the period of its emergence since the early seventies. Banks and other financial institutions were able to develop their operational systems and their legal status through a combination of international standards, as known in conventional finance industry, and Sharia financial provisions.

In a general constatation, we can assume that the Islamic microfinance industry disposes on all elements necessary to alleviate and limit the expansion of poverty and destituting it, at least in Islamic countries. Only real facts show ineffective and substandard results, a widening gap between the goals settled in public policy and the real living of citizens.

Islamic microfinance: instrument of redistribution and creation of wealth

Before initiating the evaluation of the Islamic microfinance experience in terms of effectiveness, it is among the objectives of this paper to expose, the priorities of Islamic economic theory, so as not to separate between the general underpinning and the special funding (microfinance), as an instrument to redistribute and create wealth in a complex paradigm realizing balanced growth and prosperity.

Islamic economic theory, when establishing its fundamental elements, did not limit its construction just to maximize benefits and profits, which comes to say the material dimension of the human life. It settled its priorities and objectives in consideration of two large pillars. First pillar reflects the relationship between man and God ″*al-iman*″, a consideration that places faith at the center of this report. It means that believers submit to divine predictions to reject or accept a transaction and, consider the preventiveness to not derogate sharia rules. Second pillar concerns the human relationship in guided by a real sense of responsibility, a relationship translated to real economy, as the main source of wealth next the Man work. The interaction between the two categories of relationship results in a deep consciousness that balances the faith and the material life of human **[** Cafouri. A.H, 2000**].**

Decoding the precedent leads to a conclusion imposing a certain control of lawfulness of all transactions, financial or not,"*Shari'yyatu AT-tasaruf wal mu'amalah*". A verification process ensuring the duties of the individual and governance to protect the common interest.

The teaching of Islamic economic theory focusing on human behavior distinguished two situations, situation when man acts on the environment to dominate the nature and produce more wealth (production relationship), and the situation when man undertakes relations to satisfy his needs and develops his richness, on the same basis of rights all to enjoy goods generated by the nature to benefit more from the interrelational report in a given society, (distribution and redistribution of wealth). As for the production activities, the distribution one is also subjected to fairness rationality up to sharia rules limiting waste and improving performance, without harming sources or other individual. The interaction between the two categories of relationship (production, distribution), should in no way have a negative influence on the stability of the distribution ratio, which reflects generally the best side and appearance of common life. To consolidate this economic construction the work (intellectual or physical), in Muslim society is indicated as the instrument for a dignified life and sustainable development **[**Al-'Umur F.A., 2003**].**

Poverty in the juridical (religious) context

To clarify the value of this approach "religious juridical context", we have to recall the nature of the rules and provisions that organize, even in a secondary way, private and public life in countries that are guided by religious principles. These principles traditionally enjoy unanimous consensus of the community and, are reproduced in international charters, do not deeply differ from the ten Commandments in the Torah, then which have been confirmed in the Bible and in the Quran. These principles are the so-called *"Furqan"*, in the Quran, a system of common morality in the three monotheistic religions, which is the basis of human relationship, regardless of faith [Shahrour M., 1990]. These principles are summarized by the Quran in two verses of chapter Al-An'am: "*Come, I will recite what your Lord has prohibited to you. [He commands] that you not associate anything with Him, and to parents, good treatment, and do not kill your children out of poverty; We will provide for you and them. And do not approach immoralities - what is apparent of them and what is concealed. And do not kill the soul which Allah has forbidden [to be killed] except by [legal] right. This has He instructed you that you may use reason*"; "*And do not approach the orphan's property except in a way that is best until he reaches maturity. And give full measure and weight in justice. We do not charge any soul except [with that within] its capacity. And when you testify, be just, even if [it concerns] a near relative. And the covenant of Allah fulfill. This has He instructed you that you may remember*" [Quran 6; 151-152].

Quran approach to poverty

Several verses introduced, in a generous specification, the meaning of poverty according to its different degrees and situation. Quran imposes a known right to the needy and the deprived in the goods (fortunes) of wealthy people under the form of *charity* "Sadaqah", obligatory charity "*Sadaqah wajibah*", alms "*zakat*" and endowment "*waqf*". In the same time Quran classified them in categories and segments according to specific criteria, including age, gender and economic capacity. Referring to the verses about poverty, we do not find a definition that is beyond the scope of the need to determine the meaning of poverty "*al.-faqr*". *The word poor indicates the humiliated person in his society, because of his law income or lack of income. And more concretely, this determination charges on the society, establishment and individuals, the responsible for those people according to their relations with the means of production and, the possibility of assistance in the community. The circle of the word poor, up to this reasoning, can be widened or retracted according to the circumstances in the society* **[**Shahrour M., 1990***]***. Judaizm and Christianity, others important component in many Arab societies, even in countries where Muslims are majority, are no different in their vision to the poor and poverty. The two oldest monotheistic systems, clearly emphasize the need to preserve the dignity of the poor urging wealthy people to care of them, and to end this injustice.

Poverty in international standards

To measure poverty and its evolution, four methods are the most commonly used: the first is based on a level of income (the poverty line) defined in relation to the general standard of living of the population; the second, on receiving a minimum income allowance; the third on criteria of deprivation in terms of living conditions; and the las test, on the definition of a minimum standard of living (absolute poverty) **[**Zümrüt Selçuk Z., 2015**]**. Since the 1990s, the World Bank has been measuring poverty in the world using the international comparison program. A statistics system based on converting the poverty line of the world's poorest countries into a common currency using exchange rates in parity of purchasing power, which allows to attract a value equivalent to the same quantity of goods and services from one country to another. Regardless of the effectiveness of this system in conveying the expansion of poverty in the World, the World Bank in its report of 2016 estimated that the extreme poverty rate for 2013 was 10.7%; today, it is amounted to 11.2%. [The World Bank's 2018 Report on Poverty and Shared Prosperity: Completing the Poverty Puzzle]. The recent data we dispose on to determine the international poverty threshold was established on 2011 conversion rates in purchasing power parity, that settled US $ 1.90 per person per day, as determinant base distinguishing the poor from the others **[**The World Bank's 2018**]**.This determination is the same indicator adapted in Arab and Muslim countries, fact that raises doubts on its effectiveness as this measuring instrument applies a standard of statistics to different regions of the world with citizens who express multidimensional needs. In order to perfect the instrument of

poverty measurement, statistical specialists have introduced new methods and approaches to solve the inefficiency of this instrument and its shortcomings. Consequently, as the debate on poverty has been enriched by new terms such as extreme poverty and multidimensional poverty, experts use different approaches (monetary, basic needs, livelihood, life satisfaction, capability), to satisfy the methodological requirements for the study of the phenomenon **[**Burchi F., 2018**]**.

Islamic microfinance: challenges and impact

The World Bank in its annual report ``Poverty and Shared Prosperity 2018'', established a new conception of poverty according to a number of living considerations. All of a sudden, many negative repercussions changed the map of poverty in developing countries, especially Arab and Islamic world. From Asia to the Middle East to North Africa, where most governments are trying to adapt their reports to the international requirements and standards for a decent appearance, the consequences of such change affected these regions in depth **[**World Bank, 2018**].** The five criteria adopted in the report that are:

Cash income per capita and household,

level of education,

level of infrastructure and utilities,

level of health services,

level of security.

These criteria pushed thousands of citizens from these countries to the circle of the poverty and deeply affected the decision-making independence of its governances. The important deduction that emerges from these five criteria used to determine the global poverty rates are directly related to the suffering of the people in these countries since ages. Before presenting some cases from these regions we have to consider that the majority of Arab and Islamic countries experienced several forms of fluctuation in their economic systems. The persisting tensions between equity and growth, import substitution, industrialization for export, investment in agriculture against industry, oil wealth, workflows, remittances and bilateral aid, all these factors have significantly influenced the course of development in this area stretching from Morocco to Indonesia.

The case of Arabia Saudia

The world's largest oil producer Saudi Arabia, in more than one official report has acknowledged the phenomenon of poverty, but did not disclose the numbers or percentage as they deliberately concealed any statistics on this subject, in contrast unofficial reports revealed that the poverty rate has worsened to range between 15 and 25% of the total number of Saudis of 32.6 million in 2017 (non saidi *37% from the* population that is 12.2 million).*The programs launched by Saudi Arabia did not*

succeed in reducing poverty despite possessing tremendous resources and wealth. According to the State Statistics Authority, poverty is linked to unemployment as one of the most prominent indicators of the aggravation of living crises. The percentage of unemployed Saudis reached 12.7% during the first quarter of this year. 22.6% in the Al.-Madinah 21.2%, in Jazan 17.5% and in Hail 16.8% and in Riyad 11.6%. . In April 2017 the Saudi Ministry of Labor published that more than 11.84 million Saudis have applied for the government's cash subsidy program to ease the consequences of imposing fees and further increases on many goods and services, (about 60% of the Saudis) [Ministry of Labor Saudi-Arabia 2017].

Saudi officials, in general, talk about the ″needy″ rather than talking about poverty or extreme poverty, however they offer no information on the subject despite its centrality for the reports that should be made in this area **[**Human Rights Council, Report Saudi Arabia, 2017**].** Which increases the astonishment of specialists and scholars is the Arab report on multidimensional poverty published on 2017, prepared by the Economic and Social Commission for Western Asia, League of Arab States, United Nations Children's Fund and Oxford university **[**Arab report on multidimensional poverty published on 2017**].** It turned out to be a simple essay which describes the interaction between poor households and poor children especially in countries known for their extreme poverty either from Asia or North Africa (no data about MENA countries). This is a sign that raises doubts about the usefulness and the authenticity of the study. Generally, information on who benefits from microfinance in Saudi Arabia, conditions for beneficiary, capital invested, economic and social impact will remain among the mysteries of faith in this country.

Technical efficiency

Depending on the approach, experts' analyses (DEA), from 2008 to 2016, demonstrated a variation in the averages scale (inputs outputs, constant return), resulting from local factors such as size and volume, the reach of the bank and the duration on the market, also from international factors so as oil market and regional stability (Yemen and Syria wars) **[**Ul-Hassana M., 2018**]**. Indulgent approaches evaluating technical efficiency reveal an overall, financial and social inefficiency, that Islamic microfinance has a long way to go before achieving its objectives, especially poverty alleviation or social and financial inclusion **[**Widiarto I., 2015**].**

Feasibility challenges for Saudi Arabia's microfinance

In 2006 Saudi Industrial Development Fund launched Kafalah program to provide credit for SMEs however, the results were disappointing. Banks and customers found themselves facing the di lemma related to the Lack of grantees, higher risk and the lack of codified legislation and model that could be applied for all cases and customers. These facts are among other multiple factors limiting the impact of microcredits and its feasibility **[**Adewale A.A., 2015**]**.

Indonesian Islamic microfinance model

Republic of Indonesia most populous Islamic country, 264,162,000 citizens up to the 2018 census, is facing a real problem in curbing unemployment which has led to widespread poverty in large segments of the Indonesian territory. Indonesian finance system represents a distinguished system with micro-and rural finance in which Islamic microfinance is evolving consistently (cooperatives, commercial banks and rural banks). Apart from the bids regarding the effectiveness of this sector and the achievement of the desired results (poverty reduction), it has enjoyed a systematic legal organization since the late 1990s. From the 1998 (Act. No. 10) Bank Indonesia recognized a dual banking system, conventional and sharia-based. And *under Law No. 23 of 1999,* Bank Indonesia introduced sharia financing authorizing the central bank to act also according to sharia provisions. Actually, Indonesia disposes of three categories of Islamic financing institutions: Islamic commercial banks; Islamic banking units and Islamic rural bank [Hans D. S. 2005]. From the beginning in 1977, Islamic Microfinance activities covers the main services such as saving, Lorans and charity loans in the entire territory of Indonesia. It is a sector in continuous development but still insufficient to satisfy the needs of tens of millions of customers in both rural and urban areas (covering middle and upper class and SMEs) **[**Nurfadilah D., 2018**]**. Among the factors limiting the effectiveness and the profitability of this sector arising customer distrust we note:

weak Communications and absence of interaction,

low return,

lack of supervision and reporting,

lack of professional management,

lower professional staff

limited infrastructure,

less innovative product.

Mostly, these factors form the basis of criticism of Islamic finance, but it would be prudent to take into consideration the specificity of some Islamic finance institutions that have a charitable character. Mainly Zakat (alms) and *waqf* (endowment), remain variable, depending on the circumstances, so they can not constitute stable and sustainable funding sources on which the financial institutions can base their forecasts and activities. These two institutions serve more to satisfy the persistent needs of individuals and households more than fund to invest, this reasoning is supported by the legal rules that are the basis of these practices. Zakat is due or not due to the poor according to the rules establishing the merit of the interested, the same consideration determines the people who usufruct the Waqf. Deduction is that these instruments are means of wealth redistribution among members of society

more than funds that could be used to fight against poverty or to finance SMEs **[**Mysqaoui O., 2010**].**

Islamic microfinance efficiency in Indonesian Market

In a holistic approach, Islamic microfinance in Indonesia seems to sustain the Gross domestic products (GDP) maintaining financial stability and social cohesion. From a social point of view zakat and sadaqat generate a positive impact limiting negative and collateral effects of recession, risks and credit cycle life. It is a system functioning and acting as stabilizer the country economy **[**Widodo A., 2018**]**. We read in the report of Islamic finance news 2018 under the title of ″Social financing expansion″, that Indonesia is combining financing and faith to achieve financial inclusion. Charitable acts is directed to investments (infrastructure and trade arrangements), exploiting local capital instead of borrowing with exhausting conditions subjecting the economy to foreign institutions. Simultaneously the report highlights the potential of the halal industry exploiting natural resources, Indonesia's strategic position and the global aspect of Islamic finance (providing capital). Also, the report focuses on micro-waqf financing (endowment) offering considerable loans to SMEs to support their activities (US$ 66.5-199.49). in fact, Waqf banks made a customer portfolio of 6,764 in a budget of 493,653 USD. To cope with global political constraints, the report raises the question of green investment project through ″*Green sukuk*″. investments that would be used to achieve energy efficiency sustaining renewable energy, green buildings, green tourism and agriculture **[**Report, 2018**]**.

Technical efficiency

Studies conduct up to 2012 (applying DEA method) shown that commercial Islamic banks did not realize optimal efficiency, that cost efficiency of this sector compared to conventional banks stayed at a low level. Despite this result relatively insufficient, Islamic banking succeed when acting as intermediary enhancing resource inputs to produce outputs **[**Ray A., 2017**]**.

Dilemma of evaluation

Empirical studies, rhetorical paradigms offer several instruments and present different factors measuring social and financial impacts of Islamic microfinance fighting poverty. It is a struggle for a holy cause and an objective enjoying the consensus of religious and secular standards, but from other hand it is a system of measure deprived from a unified standard of indicators **[**Adair, 2010**.** In the absence of a single instrument of measure, scholars use different factors in substitution such as the number of customers, scale of outreach, number of borrowers, the average loan balance per borrowers but these indicators do not inform us about how many families and individuals were successfully saved from the sphere of the poor or from the extreme poverty (not only the profit of the Islamic financial institutions must interest the scholars). Financial profit, instead, is measured by the return on equity and asset

and the cash flow, factors opposing the Islamic ratio when redistributing wealth considering charitable characteristic and solidarity feature **[**Fersi M, 2016**].**

Conclusion

The analysis presented in the paper encountered a number of challenges and constraints related to the availability and comparability of data across the two countries. These difficulties affect both the struggling and analysing of poverty and multidimensional poverty, *also it affect* the data related to the impact of Islamic microfinance in combating the poverty and multidimensional poverty in the two chosen models and analogically in the Arab and Islamic regions. This conclusion is what Economic and Social Commission for Western Asia of United Nations *presented in the Arab report on multidimensional poverty for 2017 as* recommendations. In exceptional cases researchers can obtain or prepare them surveys on the ground yet for the region of the MENA and the North of Africa, however their efforts remain less credible because of their limited effectiveness. Wars that flame in the Middle East or the instability of the systems in the Maghreb do not allow the access to reliable and correct data. For Indonesia the World bank in its web pages announces an economic advance for the region of South East Asia with an average of growth of 7.0 percent in 2019, then 7.1 percent in 2020 and 2021, if the region increases its exports. Only that this previsions did not announce any thing about Indonesia. Certainly, the Islamic microfinance can have a real impact, even extraordinary, in its fight against poverty and multidimensional poverty but even its effectivity remains very limited because of different factors more related to the public policy, the lack of cooperation and the preparatory studies which approach the population falling every day in the economic, financial and social exclusion.

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