

ENHANCING FINANCIAL INCLUSION IN ISLAMIC COUNTRIES: ROLE OF ISLAMIC SOCIAL FINANCE



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Poverty in Islamic Countries

- Five of the IsDB member countries account for over half a billion of the world's poor with incomes below \$2 a day or national poverty line.
- With another five countries, they account for over 600 million of the world's poor
- Most IsDB Member Countries rank among the lowest as per the Development Indicators



Financial Exclusion in Islamic Countries

Out of 44 IsDB Member Countries for which the estimate of financial access is available,

- In as many as 17 countries one-fifth or less of adult population have access;
- In 21 countries one-fourth or less have access and
- In 31 countries one-third or less have access to formal financial services
- In just 3 countries over half of their adult population have access and in another 5 countries over 40 percent have access



Enhancing Financial Inclusion through Islamic Microfinance

CGAP Survey I (2007) covers 125 institutions and revealed that Islamic microfinance has a total estimated global outreach of only 380,000 customers. It concludes “IsMF has the potential to combine the Islamic social principle of caring for the less fortunate with microfinance’s power to provide financial access to the poor.

Unlocking this potential could be the key to providing financial access to **millions of Muslim poor who currently reject microfinance products that do not comply with Islamic law.** Islamic microfinance is still in its infancy, and business models are just emerging.”

Enhancing Financial Inclusion through Islamic Microfinance

CGAP Survey II covers 254 Islamic microfinance institutions that together serve 1.2 million financing clients

Add 4000+ BMTs in Indonesia served 2 million depositors and distribute micro credit to more than 1.5 million micro entrepreneurs

Add 6000+ Qard Funds in Iran

And Other Indigenous Microfinance Institutions

Models of Islamic Microfinance

Models in Both Conventional & Islamic Domains:

- Joint-Liability-Groups (JLG)
- Self-Help-Groups (SHG)
- Village-Banks
- Credit-Unions
- ROSCAs
- Pawning

Models of Islamic Microfinance

Indigenous Islamic Models:

- Qard Hasan Funds
- Baitul-Mal-wa-al-Tamweels (BMTs)
- Zakah Funds
- Awqaf-Based Institutions
- Composite Models

Benevolence as a motive

Integrating Islamic Social Funds with Microfinance

Issues with Islamic Replications of Conventional Microfinance

- High Cost of Finance
- Often Excludes Ultra Poor
- Focus on Micro-credit

Perpetuation of debt; Less emphasis on skill enhancement; business development services and support services; project viability

Can composite models that combine social funds with for-profit modes resolve the issues in a sustainable manner?

Islamic Social Funds: Rooted in Philanthropy

Zakah: Shariah-mandated annual contribution by rich that can be used for eligible categories of recipients:

The fuqarā (poor); the masākin (needy); the ameleen-a-alaiha (those who are in charge thereof); the muallafat-ulquloob (those whose hearts are to be won over); fir-riqaab (human beings in bondage); al-gharimeen (those overburdened with debts); fi-sabeelillah (in Allah's cause), and ibn as-sabil (the wayfarer)

Waqf: Endowment of assets that may provide for a sustainable source of funds for community welfare in line with intentions of the endower

Sadaqa: Free charity funds

Integrating Zakah with Microfinance

Zakāh funds for the Poorest of the Poor

- To meet their basic consumption needs
- To cover skill-improvement costs
- To provide for micro equity
- To cover genuine debt defaults
- To provide insurance against risks

Integrating Zakah with Microfinance

Efficiency Issues:

- Scale
- Sustainability

Shariah-legal Issues:

- Tamleek
- Prioritisation
- Cost of administration
- Commingling with other charity funds

Integrating Waqf with Microfinance

Waqf is inalienable and irreversible

Sustained benefits/ cash flows for designated beneficiaries

Application of waqf benefits:

skill enhancement & business development services

absorption of specific cost elements

Issues in waqf:

- How to develop with private participation
- How to invest; how much risk to bear

Islamic Social Finance (ISF) Report

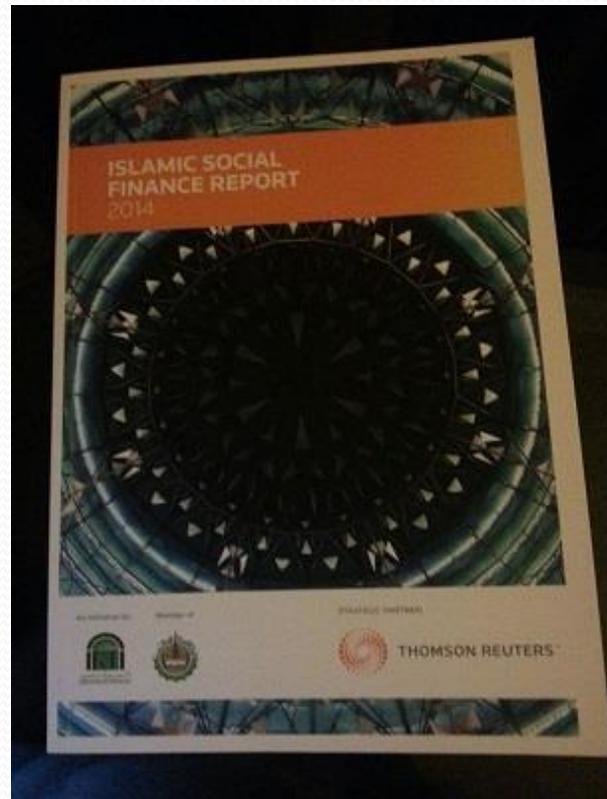
IRTI Study on Zakah, Awqaf, Islamic Mutual and Not-for-Profit Microfinance Sectors with the following key objectives:

- Estimate trends in flow of funds
- Undertake comparative analysis of enabling environment, e.g. regulations
- Document good practices of key players

Study I focuses on seven countries in South and South East Asia



Islamic Social Finance (ISF) Report

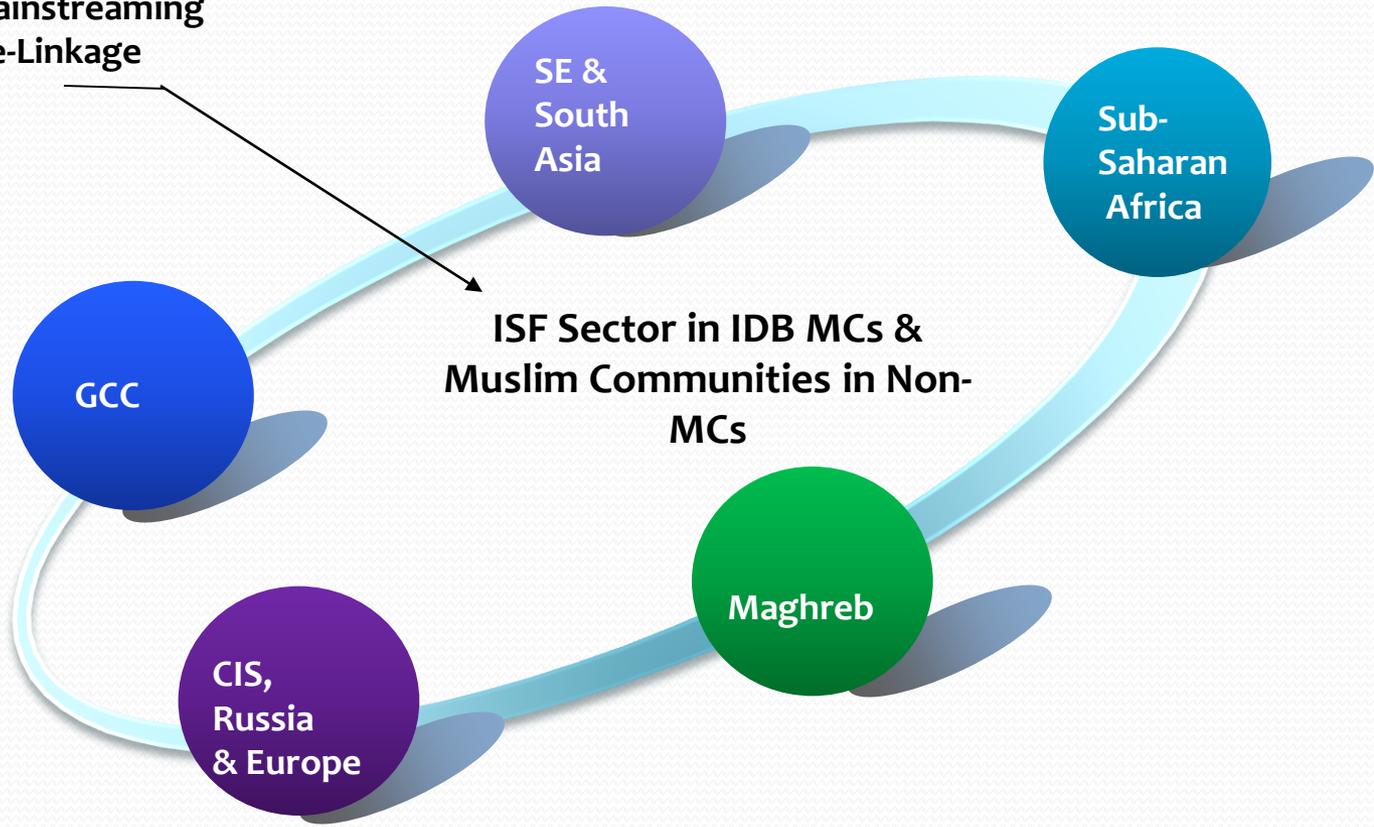


Download full report at Islamic Finance Gateway of Thomson Reuters and Zawya



Islamic Social Finance (ISF) Report: Revolving Focus

Focus on Mainstreaming
and Reverse-Linkage



Trends in Zakah Collection

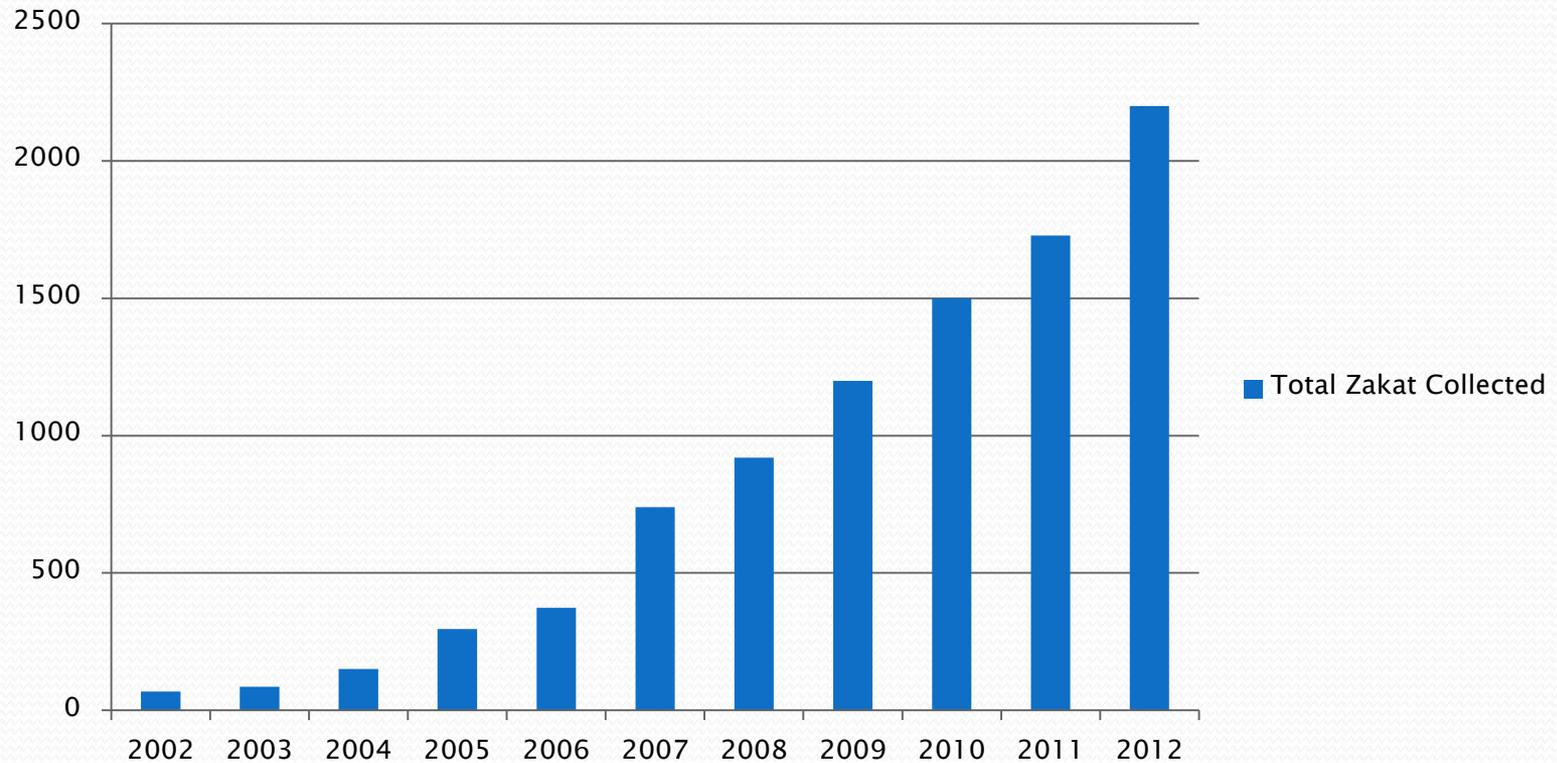
- Indonesia: 231.6 mill USD in 2012 (**Increased by over 32 times over 10 years**)
- Pakistan: 105 mill USD (by state) in 2011 (Increased by 40 percent over 3 years); 2 billion USD (state plus private)
- Singapore: 20.4 mill USD in 2012 (Increased by 20.2 percent over 3 years)
- Brunei Darussalam: 13.8 mill USD in 2010 (Increased by 55 percent over 10 years)
- Malaysia: 547 mill USD in 2011 (**Increased by 26.9 times over 20 years**)
- India: 1.5 billion USD (sample-based estimate, 2007)
- Bangladesh: 1.4 billion USD in 2010 (estimate)

*Estimates include p2p zakat; official agency in B'desh collected Tk14 million out of Tk110 million



Trends in Zakah Collection in Indonesia

(in billion IDR)



Trends in Zakah Distribution

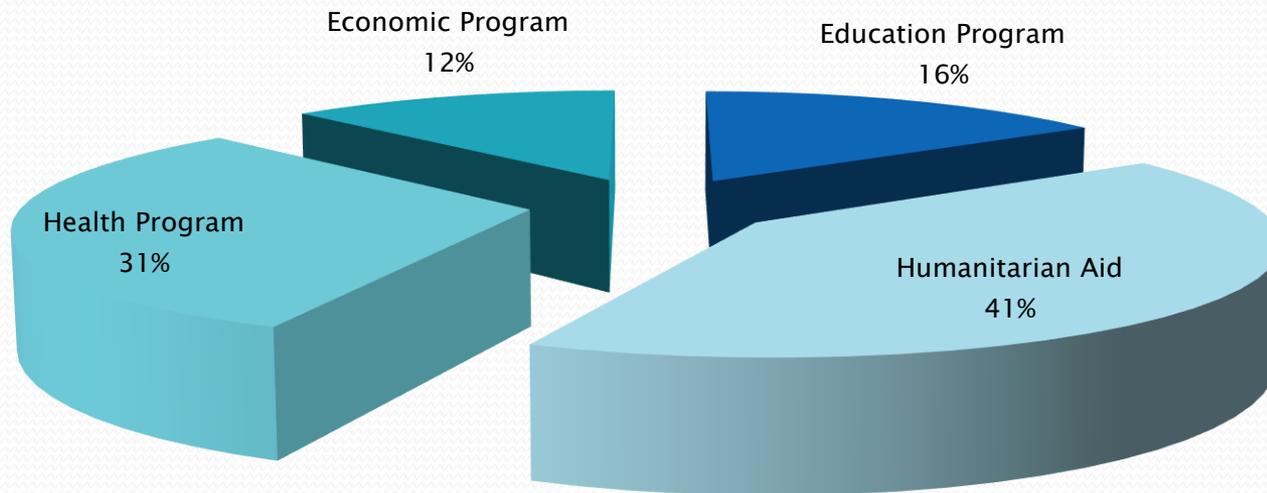
Indonesia, India, Pakistan, Bangladesh: Classification on the basis of sectors assuming zakat are primarily for the poor; Within the poor category, education, health, social safety nets receive priority; around ten percent for economic empowerment programs in Indonesia

Malaysia & Singapore: Poor account for 35-40 percent; Fi-Sabilillah accounts for about 40 percent



Trends in Zakah Distribution

Distribution Pattern in Indonesia (2012)



Enabling Environment for Zakah

- Indonesia: Zakat Act 2011
- Pakistan: Zakat Ordinance, 1980
- India: No formal institutional or regulatory framework
- Bangladesh: Zakat Fund Ordinance, 1982
- Malaysia: Administration of the Religion of Islam (Federal Territories) Act 1993 and similar Acts for individual provinces
- Singapore: Administration of Muslim Law Act, 1999
- Brunei Darussalam: Laws of Brunei, 1/1984, Religious Council and *Kadi Courts*,



Summary of Good Practices for Zakah Sector

- Government may be responsible solely for regulation and leave mobilization to private bodies
- Where state is sole collector with agency agreement with private corporate entities, there should be no competition between the two
- Zakah regulations should be dynamic with scope for continuous reforms
- Zakah payment should be made compulsory with effective deterrents against evasion
- Zakah payment should be allowed as a deduction to income tax payable and not just to taxable income



Summary of Good Practices for Zakah Sector

- Effectiveness in zakah management requires ensuring that zakah payment does not encourage dependence and leads to economic empowerment
- Priority rules of distribution require fulfillment of basic needs (relief and rehabilitation) of ultra-poor first and avoidance of carrying or investing any surplus
- Efficiency in zakah management requires ensuring that cost of zakah mobilization is pegged below one-eighth of funds mobilized.



Enabling Environment for Awqaf Sector

- **Indonesia:** Act of Republic of Indonesia No.41 on Waqf, 2004
- **Pakistan:** Provisional Waqf Ordinances 1979
- **India:** Wakaf Act, 1995
- **Bangladesh:** Waqf's Ordinance 1962
- **Malaysia:** Administration of the Religion of Islam (Federal Territories) Act 1993 and similar Acts for individual provinces
- **Singapore:** Administration of Muslim Law Act, 1999
- **Brunei Darussalam:** Laws of Brunei, 1/1984, Religious Council and *Kadi Courts*,



Summary of Good Practices for Awqaf Sector

- Proactive regulations ensure continuous reforms
- Individual as well as institutional role in making and managing waqf encourage new waqf creation
- Private financing of waqf development should be permitted for finite and limited period ensuring the perpetual character of waqf, thus balancing the apparently conflicting concerns of preservation and development
- Additional financial as well as non-financial costs with waqf (as compared to trusts and foundations) must be avoided to provide a level playing field



Summary of Good Practices for Awqaf Sector

- Expressed and documented Intention of waqif regarding intended application of waqf proceeds must be respected and complied with
- Emphasis on cash waqf encourages new waqf creation; investment of waqf funds should be permitted in financial as well as real portfolios while avoiding highly speculative investments
- Waqf was always meant to be in voluntary sector and should be allowed to remain so.

Summary of Good Practices for Islamic Microfinance

Integrate zakah, awqaf with microfinance for

- Provision of safety nets, relief and rehabilitation (Dompot Dhuafa Republika, Indonesia)
- Lowering of cost of finance to ensure affordability (Rural Development Scheme, Islamic Bank Bangladesh; Akhuwat, Pakistan)
- Economic empowerment through skill enhancement and provision of business development services (Masyarakat Mandiri Program, Dompot Dhuafa Republika, Indonesia)
- Provision of micro-takaful (Baitul Mal wat Tamweel wat Tamins, Indonesia)
- Institutionalization of charity; good giving and voluntarism; encouraging past beneficiaries to donate (Akhuwat)



Summary of Good Practices for Islamic Microfinance

- Use innovative ways to reduce operational costs, e.g. use of masjids and Islamic centers (waqf) as center of activity (Akhuwat, Baitul Mal Muamalat, Indonesia)
- Encourage cooperation & solidarity (most indigenous IsMF experiments follow cooperation-structure)
- Avoid debt, especially for ultra-poor; make use of multitude of Shariah-compliant modes (Wasil, Pakistan)
- Encourage family cohesion by treating family as a whole unit (Rural Development Scheme, Islamic Bank Bangladesh and Akhuwat)
- Ensure transparency, establish standard operating procedures and self-regulatory mechanisms (BMTs in Indonesia)
- Underscore inclusiveness and integration of microfinance with the formal financial system (BMT-IFI linkages in Indonesia)



THANK YOU