

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

# How to Improve the Efficiency of Microfinance in Islamic Economic Perspective?

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# Outline

- ∅ **Step 1: Understanding the subject matter**
- ∅ **Step 2: The target group**
- ∅ **Step 3: The method of financing**
- ∅ **Step 4: The efficiency of the method**
- ∅ **Step 5: The expected result**
- ∅ **Step 6: The ultimate goal**

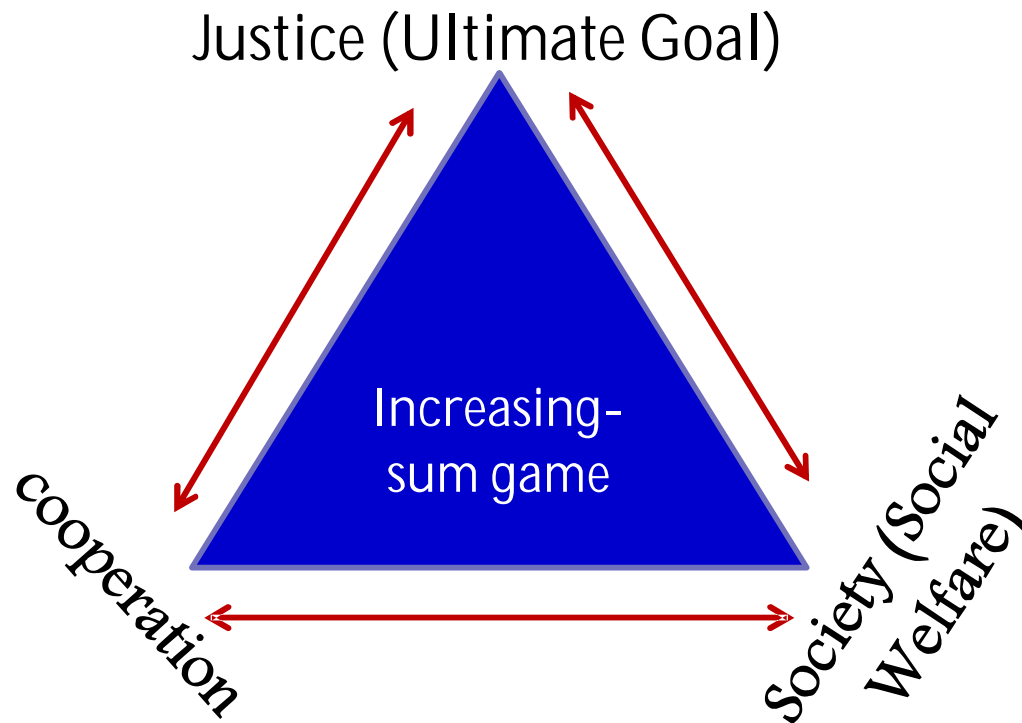


## Step1: Understanding THE SUBJECT MATTER

- ∅ We are in the realm of **Islamic finance** which is an integral part of **Islamic Economics**.
- ∅ All properties of Islamic economics have to be taken and put in Islamic Finance.
- ∅ As far as my studies allow
  - ∅ there are fundamental differences in **philosophical foundations** between Islamic banking and conventional banking
- ∅ Quranic **abolition of Riba (interest) does not allow money and debt markets to develop**.
- ∅ Every viable economic system is primarily based on **‘property rights’**.

## Step1 (Cont.)

### Ø Pillars of Islamic Economy

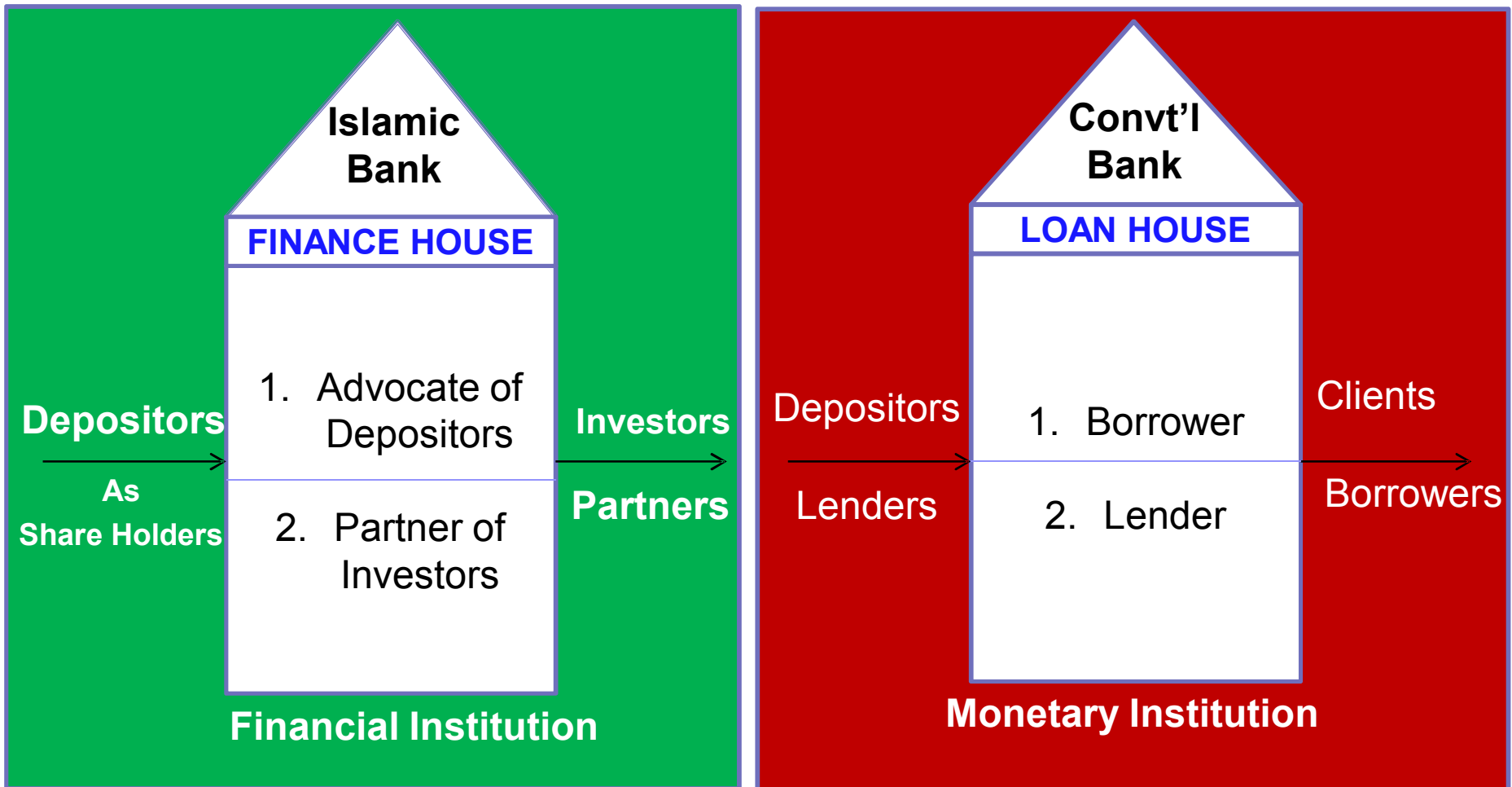




## Step1 (Cont.)

- ∅ Zero rate of interest does not imply that Qarad-ul-Hassan is the solution for all economic activities in Islamic environment.
- ∅ There are **Shariah-Compliant contracts** that seem to be more than **sufficient instruments** to finance needs, however small or large, of both individuals and firms.
- ∅ To **substitute Islamic contracts for interest-based loans** in the conventional system will change the character and nature of the 'Islamic banks' from **monetary** institutions to '**financial**' institutions.
- ∅ Islamic banks change the **legal character** of money to that of actual capital and hence making it eligible to claim part of the profit earned.

# SCHEMATIC WORKINGS OF TWO BANKING SYSTEMS





## Step1 (Cont.)

- ∅ As soon as **money (i.e. potential capital)** is legally combined with other factors of production it changes to actual capital:

**$M \rightarrow L$  → Actual Capital via the institution of 'firm'**  
(example: Mudarabah Contract)

- ∅ This legal transformation takes place in Islamic Bank.
- ∅ Again, Money and Debt Market will disappear due to abolition of interest.
- ∅ There are as **many rates of interest as there are durable goods**. We can have wheat rate of interest, copper rate of interest, gold rate of interest, even steel plant rate of interest. (**Keynes**)

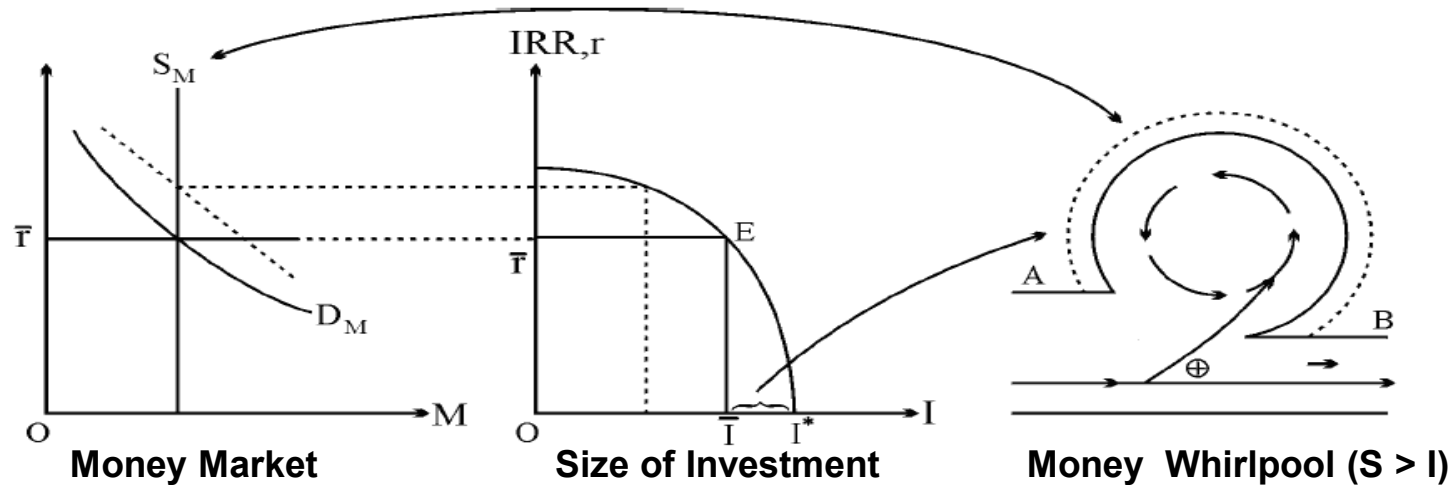


## Step1 (Cont.)

- Ø Keynes was the first economist to have discovered the root cause of the Great Depression by incorporating liquidity preference in his novel book, the General Theory

**$r \rightarrow$  speculation  $\rightarrow$  bubbles**

- Ø It can also be shown that **speculation  $\rightarrow r > 0$** , based on Keynes' assertion.





## Step1 (Cont.)

- ∅ The object of rational cooperative choice must be an optimal outcome....In non-cooperative interaction the core rationality property is **equilibrium**, whereas in cooperative interaction the core rationality property is **optimality**. (Gauthier)

**Not every equilibrium is optimal.**

- ∅ **John Rawls**: The circumstances of '**justice**' may be described as the normal condition under which **human cooperation is both possible and necessary**.
- ∅ **Justice** can be found in the successive reasoning of Islamic mandates.



## Step1 (Cont.)

∅ **QUESTION:**

**Where do we stand economically? North or south;  
Rich or poor; developed or under-developed regions;  
Islamic Economics or Capitalism.**



## Step 2-Who is the target group? The poor

### ∅ Peculiarities of the poor:

- ∅ limited, or no, access to **financial resources**
- ∅ limited, or no, access to **investment opportunities**
- ∅ limited or no, access, to **education** (formal, informal, or vocational)

### ∅ Identification of the socio-economic status of the target group receiving the finance is important in several aspects:

- ∅ the **type of Islamic mode of contract** to be used should match the need of the recipients of finance.
- ∅ **Long-run vision** leads to long-run return and **myopic vision** to short-run and dampened return and satisfies the immediate need of the class under investigation.



## Step 2-Who is the target group? The poor

- ∅ Identification of the socio-economic status of the target group receiving the finance is important in several aspects:
  - ∅ The nature of the approach used will have impact on the **efficiency of finance**.
  - ∅ Grouping of target groups matches the teachings of Islam and the recommendation to cooperate. **Micro-Finance (MF) and Micro-Coops (MC)** go hand-in-hand.
  - ∅ Any Islamic method of financing, among other things, have to be complied with Islamic teachings. This will vary from community to community, from region to region, from country to country. **IN THIS AND SIMILAR CASES, ONE SIZE WILL NOT NECESSARILY FIT ALL.**
  - ∅ The criterion in adopting any method of financing, in each case, should be **indigenous and Islamic-Value oriented**.
  - ∅ There are **other aspects** that make micro-finance more effective than often prescribed.



## **Step 3-The method of financing: Micro-finance via Micro Co-ops**

- ∅ **Micro-coops should be formed between peer groups**
  
- ∅ **Cooperation provides large externalities**
  - ∅ **Social collateral**
  - ∅ **Joint liability**
  - ∅ **Individual collateral-free Qard-ul Hassan**
  - ∅ **Islamic modes of sharing PLS minimizes the need for collateral**
  - ∅ **Human and social dignities of individuals should count.**
  
- ∅ **There is a need to establish Pooled-Circulating Fund among the poor**

**(e.g.: The one I introduced to a friend).**
  
- ∅ **Micro-Coops might as well edge toward the national scale.**



## **Step 4-The efficiency of the method: Least cost and highest benefit**

- ∅ **Socio-economic and cultural status** of the target group is vital to improve the efficiency of the micro-finance for both sides.
  - ∅ Working with **smaller groups** increases efficiency.
  - ∅ Members of micro-coops find themselves **more responsible** than otherwise.
  - ∅ **Risk of default** will be minimized.

### **Examples:**

**Northern part of Iran.**

**Weaving-carpet ladies.**

**The experience of Grameen bank.**

**My experience in Indonesia.**



## Step 5-The expected results

- ∅ This is economic **justice**:  
more equitable distribution of income and wealth increases **price elasticity** that leads to more stable price index
- ∅ Push the poor to the mainstream, gradually:  
**Gradual gap-reduction** between rich and poor
- ∅ More viable **economic growth**.
- ∅ **Caveat**: above results rely mainly upon expansion of Islamic economics through the country.

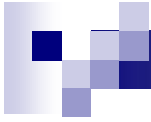




## **Step 6- The ultimate goal: Fulfillment of Maqasi-Al Shariah**

- ∅ **Maqasid-al Shari'ah** are intuitively interwoven with the **“Three Pillars of Islamic Economics”**.
- ∅ **Repeatedly**, one of the important aspects of implementing economic justice is to narrow the gap between the income-and-wealth of the rich and the poor.

**‘This is nothing but standing for JUSTICE’**



**Thank You**