

An Introduction of Interest Free Micro Financial Institutions For the Alleviation of Rural Poverty

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Keywords: Micro Economy, Social Research or Social Science, Interest

Abstract. The Interest free finance sector has developed into a global phenomenon which is highly dynamic and growing rapidly. While the main centers of Interest free finance in the world today are traditionally acknowledged to be the Middle East, Malaysia and the U.K. In addition to the various Muslim countries, Islamic banking and finance is paving its ways in non Muslim countries and has spread over Europe, the United States of America and the Far East. There are near about 50 interest free financial institutions in various non Muslim countries like US, Uk Australia, Switzerland, France etc. In India Reserve bank has legally permitted to start interest free financial institution. The govt.of Kerala state of India, launched interest free, full-fledged Global Islamic Banking.

The wide growth of this shows the hope of a large number of populations around the world. It can be understood from this rapid growth that an alternative step cannot be expected from the modern financial banks and institutions. They continue the policies increase the gap between rich and poor. Instead of benefitting the poor they have been widely exploiting them. The conventional banks and other modern financial institutions are targeting the wealthy class beneficiaries of their financial schemes. They fiercely competing with one other to find out the rich people and make them as a part of their financial plan. Muhammad Yunus, the founder of Grameen Bank of Bangladesh, has observed that “poverty is not created by the poor people. Poverty is created by the institutions we have built around us. We have to go back to the drawing board, redesign those institutions so that they do not discriminate against the poor, as the present ones do. We hear about apartheid. We feel terrible about it. But the apartheid practiced by the financial institutions-we don't hear anything about that. Why should some people be rejected from the financial institutions? Simply because it is taught that these people are not credit-worthy.”

Alleviation of poverty and hunger is a preliminary step of development in every society and nation, particularly in this age when human resource and man power is considered as the major power of a nation. Living standard and level of income of the citizens are important while measuring the development of a country. Many nations are planning a lot of projects and welfare schemes to uplift the poor. Even though the poor remains as poor and their condition of poverty seems to be beyond controlled. 2.60 billion People of the world (40% of the total world population) are not getting 2 dollar per day.

The interest free micro financial institutions which are based on the principles of justice and equity are focusing on the welfare of the poor people particularly in the rural area. It has a large scope

among the upcoming generation of the modern world. People are waiting to the openings of such institutions. All people like growth in their income. لَقَدْ أَرْسَلْنَا رُسُلَنَا بِالْبَيِّنَاتِ وَأَنْزَلْنَا مَعَهُمُ الْكِتَابَ وَالْمِيزَانَ لِيَقُومَ اسن بِالْقِسْطِ الَّذِ Assuredly We sent Our apostles with evidences, and We sent down With them the book and the balance, that people might observe equity.

Micro financing is the giving of small loans to people who need capital to start a small business and become self-employed to help themselves and build a sustainable future. With microfinance, poor people are given an opportunity to change their lives with capital and sweat equity. The various characteristics of micro financing are that microfinance provides small short-term loans mainly to poor farmers and villagers.

The of growth of unemployment and poverty in the midst of growth of output and income which is in evidence in many countries today is largely due to the failures of concerned governments to give adequate attention to the problems of distribution. In fact, economic science itself is guilty of neglecting distribution side for long. Drawing attention to this neglect by economists Irwing Fisher wrote in 1922 that although the problems of distribution are of great interest and concern to humanity than any other problems, the studies on distribution are few and far between while compared to the other problems. This neglect can be understood from the fact that of about 1500 articles published in internationally reputed journals, economic journal and American review during sixties only about 100 articles were concerning distribution. The sum and substance of what has been mentioned is that modern economics had neglected the problem of distribution till the seventies and this was primarily the reason why the countries were till recently banking on production oriented strategies with the result that the poverty and unemployment brought out unprecedentedly in these economies in spite of significant growth in output and income.

That growth per se will not bring about distributive justice and that there can be a conflict between growth and justice was realized only by the turn of 1970s. Islam from its early days had addressed to the problem of distributive justice. One fundamental teaching of Quran about wealth is that it is not to be concentrated in few hands but to be circulated among the people.

The interest bends the backbone of poor class. The modern financial system has been exploits the poor instead of protecting them. James Robertson a prominent economist opines that the income and properties are flowing from the poor to the rich, from a poor country to a rich country in the form of interest. He says:

The transfer of revenue from poor people to rich people, from poor places to rich places and from poor countries to rich countries is systematic. One cause of the transfer of wealth from poor to rich is the way interest payments and receipts work through the economy. The transfer of money from poorer to richer localities takes place through the automatic working of the national and international banking and financial networks. Third world in 1980 and 1990 illustrate some of the causes and effects of the systematic transfer of wealth from poorer to richer countries. Out of \$1,200 billion owed by the third world to the first world in 1990, only \$400 billion constituted original borrowing. The rest consisted of accrued interest and capital liabilities.

Nejatullah Siddiqui, an expert on Islamic economics, says that “for the faithless humanity swinging between two extremes Islamic system is the greatest boon. It can play a truly integrative role in man’s life. Being God given it should be acceptable to all, especially as it is not partial between nations, classes and the two sexes.”

The interest free micro financial institutions should be reconsidered in order to implement various types of productive works and entrepreneurial activities to uplift the rural poor and reduce the imbalances within the society. They have to target the lower class and financially backward people of the rural sector. They can make them beneficiaries of its scheme. I will present a paper on a practical way of establishing the interest free micro financial institutions in rural sector and its role in the development of villages and alleviating poverty.

1. Introduction

Poverty is a global issue with its many faces and dimensions; it varies from region to region. Generally, the poor in any society or in any part of the world is one who suffers from very limited access to the basic needs of human existence. It is considered as the situation of not getting enough money to acquire desirable and necessary things. Every human being requires some minimum consumption level to live. These requirements contain the minimum needs in respect of food, clothing, housing, education and health. Poverty is the incapability to secure this minimum consumption level. Rowntree, the president of “War on Want” (an international movement to uplift poor) observed that “a family was considered to be living in poverty if its total earnings were insufficient to obtain the minimum necessities for the maintenance of physical requirements.”¹

Alleviation of poverty and hunger is a preliminary step of development in every society and nation, particularly in this age when human resource and man power is considered as the major power of a nation. Living standard and level of income of the citizens are important while measuring the development of a country. Many nations are planning a lot of projects and welfare schemes to uplift the poor. Even though the poor remains as poor and their condition of poverty seems to be beyond controlled. 2.60 billion People of the world (40% of the total world population) are not getting 2 dollar per day.

The interest free micro financing is the giving of small interest free loans who need capital to start a small business and become self employed to help themselves and build a sustainable future. With microfinance poor people are an opportunity to change their lives with capital and sweat equity. The various characteristics of micro financing are that micro finance provides small short term loans mainly to poor farmers and other rural poor.

2. Poverty line

The level of poverty is decided by using the poverty line. It is a cut-off point which divides population as poor and non-poor. According to Oxford Advanced Learner’s Dictionary, poverty line is “the official levels of income that is necessary to be able to the basic things you need such as food and clothes and to pay for somewhere to live.”² People whose income is Below Poverty Line (BPL) are poor and those whose incomes are Above Poverty Line (APL) are non-poor.

If the poverty line is kept very high, many people would be placed in the Below Poverty Line category. On the contrary if the poverty line is kept very low there will be only a small number of people below the poverty line. For example, in the eight persons whose monthly income is Rs.500, 550, 600, 650,700,750, 900 and 1000. If the poverty line is defined as Rs. 900, there will be six persons below the Poverty Line. If it is defined Rs. 550, there will be only one person below the poverty line. Therefore there is a possibility that there will arise disputes regarding the number of persons living in poverty.

3. The Causes of Poverty

The parameters adopted for the definition and measurement of poverty have appeared in various forms of poverty. This brings in the understanding of the factors which are the causes of the poverty. It is difficult to put all causes of poverty under a single parameter. They may differ from region to region, society to society or from nation to nation.

- A large number of people become poor because they prefer that way and do not try to overcome poverty.

¹ Rosemary Rees, *Poverty and Public Health 1815-1948*, Heinman Educational Publishers, Oxford, 2001, p.5

² Sally, Wehmeier, *Oxford Advanced Learner’s Dictionary of Current English, 7th Edition*, Oxford University Press, New Delhi, 2005, p. 1179

- **Ignorance:** poverty is sometimes caused by illiteracy and ignorance. In an illiterate society people do not know how to increase their wealth.

- **Insufficient capital.** The inability of the sufficient capital always leads to the poverty. Low income does not allow saving and without saving there could not be investments and without investment there can be no economic progress and it leads to poverty.

- **The natural poor circumstance of the countries.** This happens when a country does not possess enough natural resources and land consists of useless soil.

- **Colonization and colonial policies** are responsible for the poverty of the colonized countries. Over the years this has been the most indicative of explanations. The British, the French and the Dutch colonized bulk of Asia and Africa to benefit their countries. A large number of people in different parts of the world are still paying heavy prices because of the colonial invasions.

- **Class exploitation:** There are more poor than rich people. The poor remains in poverty because of the various types of class exploitation. A poor peasant or an agricultural labor seeks to improve his income by irrigation or agricultural work. But they are constantly exploited by the land lord, tax collector, money lender or the merchants. Sometimes, poverty is visible and exploiters are hidden. However the world has much poverty without evident exploiters. In India there are a large number of small land owners who are very poor.

4. The Rural Poverty

A large number of people in rural areas are poor because they do not possess income like land property or other permanent resources. They work as agricultural labors, and a little amount they can earn as their wages and the work which they get is only for a few months in a year. On the other hand, the urban poor work for long hours but they get low wages for their works. They are employed mostly in the unorganized sectors. They are called 'sub-employed' because these employed people are not employed in the real sense of word.

There are three kinds of sub employed workers;

- a) Those who work part time but want full time work.
- b) Those working full time but do not earn enough wages which make them able to overcome poverty.
- c) Those who are discouraged from work and no longer look for work.

Population pressures lead to rural and urban poverty because large population pressures reduce the employment opportunity. There are many dependents on every earning member. In the rural villages there are not sufficient employments. If the population was smaller it is said each person would have a greater share. On a farm there may be work only for five persons. But seven or eight persons may be there on the farm. The marginal output of the additional persons is approximately zero. So the additional persons remain as unemployed or underemployed; agricultural labors do not get work throughout the year. Even during the year in which there is good rainfall.

Agriculture is noticeable by low output, so majority of those engaged in agriculture are poor. The mainstream people in rural areas do not have enough resources particularly land. The main reason for this is the concentration of land in the hands of a small number of families.

Most of the urban labors who are migrants from rural areas have been suffering from sub-employment.

5. The Alleviation of Poverty in Rural Sector through the Interest Free Micro Financial Institutions

The conventional banks and other modern financial institutions are targeting the wealthy class beneficiaries of their financial schemes. They fiercely competing with one other to find out the rich

people and make them as a part of their financial plan. At the same time the poor people have been hardly helped by their housing loan and business loan etc. But the interest free micro financial institutions which are based on the principles of justice and equity are focusing on the welfare of the poor people.

Here, the interest free micro financial institutions can play a vital role. It is a fact that many people have properties or wealth but they are unaware of the investment scope. The recognition of investment scope and the profit motive accelerate the financial sector. It makes increased savings and creates a developed condition. As a result the money flows to the entire society and the poor can be secured. The development programs particularly in the rural areas expand the self-employment opportunities and improve the investment climate. Umar Chapra says that "Restructuring the conventional financial institutions in the light of Islamic teachings will help restrain them from extending credit for wasteful and unproductive spending to both the public and the private sectors and thus enable them to provide more financing for productive investment, particularly to entrepreneurial talent among the poor."³

Interest free micro financial institutions can offer financial services by providing interest free loans (*Qard Hasan*) to their poor clients in case of needs and emergency situations. They can easily establish a relief fund for the eradication of poverty. It can be a permanent source of funding to reduce the economic hardship of the poor and the needy. The relief fund can be mobilized from the yearly poordue of shareholders of interest free micro financial institutions and many other depositors on the basis of *Mudarabah*, *Musharakah* and other Islamic financial instruments which are practiced in interest free banks. Most of the depositors and share holders give their consent and give the bank the authority to manage their poordue funds. Then the bank management can deduct their poor due and distribute it among the poor.

They can also remove the burden of rural poverty by financing education and providing training which enhance human resource development. Basic education of poor children creates a literate and educated society. Similarly the adequate training increases the skill and the productivity level of labor force on a large scale.

It is clear from the teaching of Islam that the utilization of the labor force and the productive works are the real weapon to fight against poverty. The Prophet (*Pbuh*) has said that; "to strive to earn a livelihood through right means is an obligation after the main duty (prayer)"⁴ and the "bread earned by one's own labor is the best of all earnings."⁵ similarly he also said that "the honest truthful Muslim trader shall have his rise with martyrs on the Day of Judgment."⁶

The interest free micro financial institutions can implement various types of productive works and entrepreneurial activities to uplift the poor and reduce the imbalances within the society. They have to target the lower class and financially backward people of the society. They can make them beneficiaries of its scheme. So the interest free micro financial institutions have to adopt the following steps:

6. Formation of Core Group

Every interest free micro financial institution has to form a core group. Commitment, credibility, conviction, and confidence and good character should be the major qualities of the members of core group. The core group can coordinate all kinds of voluntary activities of a particular interest free

³ Chapra, Umar, M., *Islam and the Economic Challenge*, International Islamic Publishing House, Riyadh, 1995, p.350

⁴ Ibid. p.18

⁵ Khan, Muhsin, Muhammad, *The Translation of the Meanings of Sahih Al-Bukhari*, Darussalam Publishers, Riyadh, 1997, vol.3, p.168

⁶ Ibn-e-Maja, Muhammad bin Yazid, op.cit., p.171

micro financial institutions. The core group can mobilize *zakah*, *sadakah* and other financial resources. In every society there will be some rich people who want to contribute something for the benefits of the poor of their surroundings. The core group can receive and channelize their assistance. In this way the core group can collect a huge amount of money for the welfare of the poor from the same good-minded people of every society. The core group can generate the funds from the national and international agencies and governmental and nongovernmental organizations. The number of the core group can be ten to fifteen as the need may be.

7. Identifying the Target Group

The core group has to identify the target group of beneficiaries. Generally they are spotted among the street dwellers in urban area and agricultural labors in rural society. The core group has to plan a geographical map which gives grass root level information about the poor class of society. They should have accurate information about every single person of their target group. This geographical planning helps the core group to get the number of poor in a village or a town, the current income of poor family, the skill and resources of the poor family members, their health condition, educational status and their time for work at present or future and the types of training they need. Such information helps in making effective plans for poverty eradication.

8. Evaluation of the Need

The core group can evaluate the needs of the target group after getting the clear identification and the exact information. They can mobilize the financial resources and manage the budget of the financial institution according to their needs. By evaluating the needs they can estimate the financial resources and requirements for the future activities also.

9. Adequate Assistance

One of the most important duties of the core group is to manage the adequate and permanent financial assistance or job opportunities for the target group. An assistance of five months and then avoid the next five months leads to increase in poverty. Similarly creating a job for three months and then making the employee jobless for next three months would also not work. Regular management and permanent assistance alone would uplift the target group. The core group has to ensure this level of management until the poor members of the target group can stand on their own legs with sufficient earnings which is enough to sustain their families.

10. Basic Support

Mainly the core group has to give the basic support to the poor. They can easily uplift them by giving small tools and machines and other work equipments. In some cases they can lease some equipment also. For example giving a free of cost rickshaw to a rickshaw puller, renting a taxi for a poor driver, and giving a stall to a small business man may work wonderfully. In many cities and towns the core group can support the poor by giving small amount of loan to the vegetable and fruit venders. They can encourage them to start several types of industries and small types of business. Cottage industries, dairy farming, poultry farming, Bee Keeping, Pisci Culture, Horticulture and etc...are some examples of small scale business easily can be applied in every village.

The core group has to provide proper training and guidance for those who enter in the above mentioned jobs. They can utilize the service of different educational institutions and colleges to give the training. The young generation of the modern era, particularly the students of the technical and scientific institution are much qualified to do these training. The core group can utilize their services. Similarly the core group can collaborate with the local administrators and governmental agencies also to give the training and also implement some projects. At the time of training and financial assistance the core group has to identify the level of the target group and classify them in to different groups according to their socio educational and financial conditions.

11. Summary

In brief, interest free micro financial institutions have a large scope in the modern world. People are waiting to the openings of such institutions. All people like growth in their income. The small scale business under interest free micro financial institutions can multiply the capitals. It causes increase in production from up to bottom, because the money has been transferred among all members of the society. The interest free micro financial institutions can play a vital role in solving the issue of poverty the world over.

Today, a large portion of world population wants humanization, not commercialization; the financial and banking sector should be humanized. It is the developmental and prosperous concept. It is clearly understood that the interest free financial system can do the same. The poverty in general and the rural poverty in particular cannot be alleviated until the people rethink about the financial institutions have been built around the world. Muhammad Yunus, the founder of *Grameen* Bank of Bangladesh, has observed that “poverty is not created by the poor people. Poverty is created by the institutions we have built around us. We have to go back to the drawing board, redesign those institutions so that they do not discriminate against the poor, as the present ones do. We hear about apartheid. We feel terrible about it. But the apartheid practiced by the financial institutions-we don't hear anything about that. Why should some people be rejected from the financial institutions? Simply because it is taught that these people are not credit-worthy.”⁷

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