

## **Poverty Alleviation on a Sustainable Basis in the Islamic Framework**

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### **1. INTRODUCTION**

Allah (SWT) is the sole creator of this vast universe and whatever it contains. He created man as a master piece of His creation and elevated him to be His vicegerent on earth. He made all physical systems and other creations to cater human needs from the time immortal. And those holding political power in Muslim countries under Islamic teachings are required to make necessary arrangements for the satisfaction of his material needs through efficient utilisation of resources and equitable distribution of goods and services and also to fully protect him from all kinds of fear besides the fear of starvation.

There is ample evidence in Quran, Sunnah, and practice of Caliphs to provide food as well as social security to each and every individual in an Islamic economy. Pointing to this fact, an Ayah of Quran enjoying upon Quraish to worship Allah because He has protected them both from starvation and fear by granting them food and peace.<sup>1</sup> Similarly a Hadith says that a society where a Muslim has to starve is forsaken by Allah.<sup>2</sup> The first four Caliphs were fully conscious of their obligation towards meeting the needs of poor. Hazrat Umar (RA) declared, “if a camel dies at the bank of Euphrates, I am afraid Allah would make me accountable for it”.<sup>3</sup> The overwhelming stress on satisfaction of basic needs and social security both of current and future generations leaves no justification for the prevalence of widespread poverty in Islamic framework. As a matter of fact, Islam and absolute poverty cannot persist together.

A really pitiable situation emerges when aforementioned Islamic commitment is juxtaposed alongwith pervasive poverty in Muslim countries. According to World Bank report, 34 percent of Pakistan’s population lives below the national poverty line –36.9 percent in the rural areas and 28 percent in urban areas. In terms of

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<sup>1</sup>*Quran*: (106:3-4).

<sup>2</sup>Al.-Hakim, al.-*Mustadrak ala as Sahihayan*, Vol. 2. p.12.

<sup>3</sup>Muhammad Ibn S’ad al.-*Tabqat al.-kubra*, Beriut. Vol. 3. p.305.

internationally poverty lines, 31.2 percent of population lives on less than US\$ 1 per day and 84.7 percent lives on less than US\$ 2 per day.<sup>4</sup>

The strategies to tackle the problem of poverty are many. The typical strategy recommended for developing countries consists of three elements: opening-up the economies, seeking labour-intensive growth, and broad provision of social services. The example of successful experience of East Asian countries is often cited in this context. They achieved historically unprecedented rates of growth and also succeeded in reducing poverty and avoiding rise in inequality in the distribution of income.<sup>5</sup>

In the backdrop of secular approaches this paper explores an Islamic strategy for poverty alleviation. The proposed strategy stresses on the impact of equitable growth on poverty. The sustainability aspect also occupies an important place in this formulation. It assigns key role to the utilisation of internal resources and Islamic sources of financing. It stresses that growth must be internally-generated. Top-down approaches hitherto followed by the Muslim countries for economic growth and poverty alleviation do not fit in this strategy. The rest of paper proceeds as follows:

Section two briefly reviews the literature. Section three looks into recent poverty trends in Pakistan and their causes. Section four briefly discusses policy-based actions in Pakistan. Section five develops an Islamic framework. In the light of this framework the paper argues in favour of small and medium enterprises for economic revival and poverty alleviation in Pakistan. Section six discusses policy-based actions under Islamic framework. Section seven discusses policy implications. Finally section eight concludes the paper.

## 2. REVIEW OF LITERATURE

The Islamic literature on the subject is scanty. Relatively few writings are available and most of them are discussion in general terms. In a recent article, Sirageldin analyses the issue of elimination of poverty with the help of an axiomatic approach.<sup>6</sup> He finds Islamic ethic is supportive of poverty-alleviation strategy based on the principle of promoting economic growth with productive equity. According to him Islamic ethics rely on individual and private action to reduce poverty. The most obvious is the institution of Zakah which institutionalises the principle of care at individual and community level.

In his seminal paper, Ahmad proposes formulating an appropriate strategy for pursuing development efforts in such a way to practice Islamic way of life. The focus of this effort should be on development of man and his socio-cultural environment.

<sup>4</sup>World Development, Report, 2000-2001. p.281.

<sup>5</sup>Azizur Rehman Khan. Globalisation, Liberalisation, and Equitable Growth. *The Pakistan Development Review* 36:4 (1997), p. 916.

<sup>6</sup>Ismail Sirageldin. Elimination of Poverty: Challenges and Islamic Strategies. *Islamic Economic Studies* 8:1 October (2000).

He emphasises on the improvement of the quality of life of all people through socio-economic and moral development of the society.<sup>7</sup> Another scholar contends that battle against poverty has to be fought on many fronts. The issues like human motivation, limits to profit motive, market mechanism, distribution of income and wealth and the role of monetary, fiscal and welfare policies have to be fixed simultaneously. Accordingly, he stresses on the adoption of Islamically-oriented growth strategy with three components: the overall rate of growth, the mechanics of growth and the pattern of growth.<sup>8</sup>

Ansari points out that Islam does not offer any unique theory on sustainable development but it presents powerful principles for its realisation.<sup>9</sup> He suggests normative approach to development that has economic, social, and ecological dimensions. He stresses on the importance of developing economic aspect. However, the broader dimension is that of social justice. In a society the welfare of individuals is interdependent which is a type of externality. The principle of mutual interest is used to establish social optimality in distribution of resources and wealth. Zakat and Sadaqat are part of social security system to ensure social justice. He finds that overriding emphasis on attaining efficiency in resource allocation has led to pollution and ecological disaster. He opins that misuse of environment that involves waste and destruction is a sinful act.

Chapra maintains that satisfaction of the material needs requires the development of all human and material resources and distribution of income and wealth in such a manner that the needs of all human beings are adequately met. Additionally, Islam is against inflicting injuries to human beings and environment the prevention of excessive depletion of non-renewable natural resources and pollution of environment, which harm both the present and future generation, is individual as well as social obligations of Muslims. He relies mainly on proliferations of SMEs as an instrument of poverty alleviation and economic recovery.<sup>10</sup>

### 3. RECENT POVERTY TREND IN PAKISTAN AND ITS CAUSES

Pakistan had a good record in reducing the incidence of poverty until 1987-88. Afterwards economy witnessed both a deceleration of the rate of growth and a worsening of the distribution of income. From different poverty indices it appears that poverty has been surging in 1990s. Recent studies show that caloric based poverty has increased from 17.4 percent in 1987-88 to 32.6 percent in 1998-99.<sup>11</sup> On

<sup>7</sup> Khurshed Ahmad. *Studies in Islamic Economics*. The Islamic Foundation. pp. 171–184.

<sup>8</sup> Ziauddin Ahmad. *Islam, Poverty and Income Distribution*. The Islamic Foundation. p. 27.

<sup>9</sup> Muhammad I. Ansari. Islamic Perspectives on Sustainable Development. *The American Journal of Islamic Social Sciences* (USA). p. 400.

<sup>10</sup> M. Umar Chapra. *Islam and Economic Development*. The International Institute of Islamic Thought and Islamic Research Institute, Islamabad. p. 7. and pp. 104–113.

<sup>11</sup> Ishrat Husain. Impact of Globalisation on Poverty in Pakistan. *Mahbulul Haq Human Development Review* 1:1 (2001), p. 24.

the basis of head-count measure 31 percent people in 1996-97 were having income levels below poverty line. World Bank estimates also identify one-third of population to be living below poverty line in Pakistan. The basic needs and social sector indicators also corroborate the same findings.<sup>12</sup>

A multitude of factors have been responsible for causing poverty in Pakistan among which the erroneous strategy of growth is most important. Being capital intensive it achieved a high growth rate of 6 percent till 1980s. But its fruits could not reach to the poor. Also the high growth achieved also degraded the environment which further deteriorated poverty through reciprocal links. The decade of 1990 turned out to be a period of restricted growth in income and employment. The economy recorded slower growth rate of 4 percent in 1990s. The income inequalities surged in this period. The Gini-coefficient increased from .32 in 1970-71 to .41 in 1996-97.<sup>13</sup> Additionally, huge fiscal deficits and external borrowing have highly leveraged the economy leaving little fiscal space for poverty alleviation programmes. Finally, the declining flow of remittances are partly responsible for rising poverty. These flows have fallen from \$ 3 billion in mid 80s to less than one billion dollar in 1990s.<sup>14</sup>

#### 4. POLICY-BASED ACTIONS REDUCING POVERTY IN PAKISTAN

Recently, the government is addressing poverty on the basis of two track approach. The first track includes actions aimed at reviving macroeconomy and fostering economic growth through the structural adjustment programmes which basically seek to narrow budget deficit and current account deficit. It is largely believed that their success will lay foundation of sustainable economic growth by creating enabling environment for investment. The sustained investment in the medium term will reduce poverty through job creation. However, the macro-economic impact of this approach is not expected to be different than the earlier approach of import-substitution industrialisation of 1960s and 1970s. The benefit to the poor from these approaches reaches through the trickle down effects which is essentially a slower process. According to the Economic Survey of Pakistan 2000-2001 the economic growth has failed to trickle down to the poor during last three decades.

Being conscious of the above cited limitation the government through the second track has initiated targeted programmes to alleviate poverty. These programmes include projects to be completed by provincial and federal governments. An allocation of Rs 30 billion has been made for this purpose. The projects like market town roads, building water courses, small dams and improving drainage are

<sup>12</sup>World Development Report 2000-2001, p. 281.

<sup>13</sup>Frances Stewart. Income Distribution and Development. *Mahbubul Haq Human Development Review* 1:1, (2001), p. 5.

<sup>14</sup>Ishrat Husain, op. cit, p. 24.

being undertaken. These projects are estimated to provide temporary jobs to half a million people across the country and will increase income of the working people.

The food subsidy programme is another major step undertaken for poverty reduction. An allocation of for Rs 2.5 billion has been made. A cash subsidy of Rs 200 per annum is being provided to needy people at the distinct level. Third action relates to the functioning of Khushhali Bank for the benefit of low income people. It is supported by the Asian Development Bank. Besides financing, it provides articles that facilitate outreach of the poor households. Through this window, vehicles, office equipments, furnitures, instruments, cycles etc. are being provided to small firms and poor households. Fourth is the role of Small and Medium Enterprise Development Authority (SMEDA) and Small Business Finance Corporation in (SBFC). They are facilitating the development of small and medium enterprises in Pakistan. SMEDA has recently started and it will take some time to see its role. However, its direction and approach is correct. As far SBFC is concerned it has so far failed to play a significant role due to high interest rates which have depressed the profitability of small units and increased their default rate thus affecting continuity of funds.

Fifth and most important policy action is Zakat distribution and Zakat rehabilitation package. Currently there are 1.894 million Zakat recipients. Total Zakat collected during 1998-99 was Rs 4210 million. Sixty percent of the total Zakat collection is distributed among the mustahiqeen at the rate of Rs 500 per month per mustahiq as guzara allowance through a network of 39523 Local Zakat Committees in Pakistan. The remaining forty percent is spent in the form of educational stipends, health care, marriage assistance and rehabilitation. Due to snags in the Zakat distribution system the total Zakat collection is not being distributed and the Government is now starting Zakat rehabilitation package with the accumulated capital. Initially 44 small businesses are being started with an allocation of Rs 2 billion. The basic purpose of the scheme is to make deserving people financially self-supporting once for all. Through this scheme such people will be provided necessary guidance besides financial assistance. In view of low level of morality, it is likely that this programme may fail and Zakat money may be wasted.

## **5. ISLAMIC FRAMEWORK FOR POVERTY ALLEVIATION**

Islamic framework regulating human activities on the earth is based on three principles: Tawhid, Khilafah and Adalah.

### **Tawhid (Unity)**

This principle is the foundation stone of the Islamic faith. Islamic approach covering all aspects of life draws its intuition from this principle. It means that the universe has been created and being fully controlled solely by Allah (SWT). Every creation big or small including man has been created for a purpose. This principle guides Allah-man, man-man and man-universe relationships. Tawhid guides a

Muslim that he and ecosystem are part of same universe and both are being regulated by the divine law. Conceptually, it creates uniformity between the physical and human parts of the universe. Moral and religious motivation is therefore generated to protect the environment and keep it clean and in sustainable condition.

### **Khilafah (Vicegerent)**

Man is vicegerent of Allah on earth. Allah has given him resources and physical and mental faculties to change individual and social conditions for living a good life. Allah has placed a measured quantity of natural resources in the universe for all time human sustenance. This quantity is sufficient for the well-being of all provided it is used efficiently and equitably. He is encouraged to make rational decisions about allocation of resources in production and consumption activities. However, he is not the only one who is a Khalifa and there are millions of other human beings who are Khalifas like him. His real test lies in utilising resources in 'efficient' and 'equitable' manner to achieve the well-being of all on sustainable basis.<sup>15</sup>

The Khalifa principle accords a dignified status to human beings in the universe.<sup>16</sup> It assigns a mission to the life of man and woman. Their mission is to act in accordance with the commandments of Allah and His Prophet (PBUH) in 24 hours of their lives inspite of being free. This is what has been called worship. Quran says that human beings and Jins have been created for His worship. Man must submit to Allah and no one else and he lives for no other mission except His. His real abode is Hereafter where he will be rewarded or punished according to how much he has observed or deviated from the assigned mission in this world. The concept of Khilafa has numerous implications three of which are discussed below:

### ***Universal Brotherhood***

Khalifa provides a framework of social equality and universal brotherhood. This framework produces a flexible social structure which motivates an individual to grow on the basis of efficiency and good character. It introduces social equality among human beings irrespective of colour, race, and geography. These features promote beneficial cooperation and mutual sharing of resources.<sup>17</sup> The private utility and profit maximisation behaviour is not consistent with the status of Khalifa.

### ***Trusteeship of Resources***

The resources at the disposal of Khalifa are in the nature of trusteeship which in fact does not imply negation of private property. It carries a number of

<sup>15</sup>M. Umar Chapra. *Islam and the Economic Challenge*. The Islamic Foundation and the International Institute of Islamic Thought, (USA). p. 203.

<sup>16</sup>*Quran*, 17:70.

<sup>17</sup>*Quran*, 2:30, 6:165, 35:39.

implications which create fundamental difference in the concept of private ownership of resources in Islam and other economic systems.<sup>18</sup> First, the resources are for the benefit of all and not just for few.<sup>19</sup> Second, the ownership of resources must be acquired in rightful way. Third, the benefit from these resources must spread to all and not just to the owner and his family. Fourth, no one is allowed to destroy, waste or pollute environmental resources. Quran commands the believer not to spread mischief.<sup>20</sup> When Hazrat Abu Bakr (RA) sent an army, he addressed to his commander not to kill indiscriminately or destroy vegetation or animal life even in the enemy territory.<sup>21</sup> Thus there is absolutely no scope for burning crops, forests, dumping of products into sea for seeking profit through illegitimate ways.

### ***Simple Lifestyle***

Khalifa, is supposed to live a simple life avoiding pomp and show. He has to abstain from extravagance. Quran says “Do not be extravagants, surely Allah does not like extravagants.”<sup>22</sup> Prophet (PBUH) and his Caliphs lived very simple life. Therefore, Khalifa emulating their example should live a simple life. This enables him to release some resources for spending on others to please Allah. Moreover, he saves to make bequeath. The Prophet (PBUH) said”, It is better that you leave behind your relatives well-off rather than obliged to beg-alm of other.”<sup>23</sup> Through bequeath system Islam provides safeguards against the poverty of the posterity. Thus if each person lives simple life and spend part of his surplus income on poor and needy then much of the poverty can be reduced at micro level.

### **Adalah (Justice)**

According to Quran, primary mission of all Prophets has been establishment of justice and elimination of Zulm (i.e. injustice, exploitation and oppression).<sup>24</sup> Chapra notes that there are no less than one hundred different expressions in the Quran embodying the notion of justice either directly or indirectly.<sup>25</sup> The Prophet (PBUH) warned, “stay clear of oppression for oppression is darkness on the Day of Judgement”.<sup>26</sup> World can survive with justice and unbelief but it can not survive with injustice and belief.<sup>27</sup> Thus if the labourer receives just wages and small farmers

<sup>18</sup>For further elucidation of these points, please see Chapra, op. cit. pp. 207-212.

<sup>19</sup>Quran, 2:39.

<sup>20</sup>Quran, 2:205.

<sup>21</sup>Abu al-Hassan ali ibn Muhammad al-Muwardi al-Ahkam al. Sultaniyyah (1969), p. 34.

<sup>22</sup>Quran, 6:141.

<sup>23</sup>Sahih-al. Bukhari, Vol. 3. p. 1006.

<sup>24</sup>Quran 57:25.

<sup>25</sup>Chapra. op. cit. p. 209.

<sup>26</sup>Sahih Muslim (1955), Vol. 4, p.199 6:56.

<sup>27</sup>Chapra. op. cit. p. 209.

receive just prices of their produce and product market works competitively, the poverty can be reasonably contained.

### **Implications of Islamic Framework**

Islamic framework generates at least three implications favourable to the cause of poverty alleviation. They are briefly discussed below:

- (i) *Basic Need Fulfilment*: The principles of brotherhood and trusteeship logically imply mutual sharing and utilisation of resources so that material needs of all individuals can be met at a befitting level. In particular, it is collective duty of the Muslim society to take care of basic needs of poor.<sup>28</sup> There is complete consensus of all schools of thought on this point.<sup>29</sup>
- (ii) *Respective Earning Opportunities*: As a Khalifa, the primary responsibility of need fulfilment lies on his shoulder. Accordingly, the jurists have stressed the personal obligation of every Muslim to strive and earn livelihood for himself and his family. However, a Muslim may not be able to fulfil the duty of earning sustenance unless opportunities of self-employment and wage employment are available. In that context, it becomes social obligation to provide equal earning opportunities to everyone. The network of productive activities has to be extended throughout nook and corner of the country where the poor could participate. However, there will still remain many who are left out, like physically handicapped, unemployable and some because they lack the appropriate skill. For all such people social safety nets will have to be provided which may take any form like family, friends, neighbours and altruistic organisation.<sup>30</sup> The state enters if these efforts are inadequate to meet the basic needs of such people.
- (iii) *Equal Distribution of Income and Wealth*: In Islamic framework equity is simultaneously as important as efficiency. Efficiency induces growth and equity widely spreads its fruits reaching to the poor. Thus the success in poverty alleviation is the joint result of the growth in income and of its distribution. Islamic framework allows only mild differential in incomes of the people which are caused by natural factors like initiative, skill, effort, and risk. These differentials cannot produce extreme inequalities with the functioning of Zakat, Sadaqat and inheritance law. There is no logic for concentration of resources within

<sup>28</sup>Abu Muhammad Ali ibn Hazm, *Al-Muhalla*, Vol. 6. p. 156:725.

<sup>29</sup>“Guarantee of Minimum Living in an Islamic State” by Dr M. N.Siddiqui, in *Distributive Justice and Need Fulfilment in an Islamic Economy* by Munawar Iqbal, International Institute of Islamic Economics, p. 257.

<sup>30</sup>Chapra, *op. cit.* p. 211.

few people. That is the message of Quran, “wealth does not circulate only among your rich”.<sup>31</sup> To achieve the goal of income equality, it is thus essential to restructure the social behaviour as well as the economy in accordance with Islamic teachings.

## 6. POLICY- BASED ACTIONS UNDER ISLAMIC FRAMEWORK

The Islamic framework requires that discretionary policy measures are undertaken for poverty alleviation. It is not enough to rely on Para to efficiency approach as it has so far made no dent in poverty. A policy measure that increases incomes of the poor by one dollar is desirable though it may cause two dollars fall in income of the rest of society. There are measures benefiting poor which are justifiable both on the efficiency and equity consideration. Among them development of small and medium enterprises on the basis of Islamic financing figure prominently. On the other hand, specifically tailored social sector programme for the poor should be undertaken on the basis of social desirability. The implementation of these measures will provide double benefits to the poor and reduce poverty.

### **Small and Microenterprises (SMEs): Their Importance and Major Constraints**

Pakistan like many other developing countries is facing surplus labour, scarcity of capital, technology and foreign exchange. Under these conditions, small and medium enterprises provide better alternative for expanding wage employment and self-employment opportunities. These enterprises fit into our cultural and technical environment since they are run with family labour and use simple and endogenous technology. They are frequently located inside house premises and thus involve less social friction. Their significance lies in the fact that they constitute nearly 99 percent of all enterprises in Pakistan. Small and medium enterprises are the biggest source of low cost employment. Providing a total non-agricultural labour force of 80 percent to the economy, SMEs contribute approximately 40 percent to the GDP of Pakistan.

Among many problems facing SMEs the financing problem is the major one as it constraints production. Its real solution lies in instituting Islamic banking and Islamic modes of financing. This change will facilitate establishment of SMEs on sustainable basis which, in turn, will generate employment opportunities for the low-income people. The resulting growth in income will enable them to finance their economic needs from the market on sustainable basis. The growth and promotion of SMEs will thus increase income level, avoid inequalities, and promote home-grown development.

<sup>31</sup>*Quran, 59:7.*

The historical financiers of SMEs like friends, family members and local money lenders are gradually fading. They provide a small fraction of their total demand for financing. The local money lenders in particular charge extremely high interest rates. Likewise mandatory credit scheme for SMEs implemented by the commercial banks has turned out to be marginally beneficial as substantial part of this credit is pre-empted by influential people. The recovery rates of these loans has been very low which impair the continuity and sustainability of micro-credit programmes.<sup>32</sup> To maintain such programmes heavy amount of subsidies are required which involve budget deficits and inflation. These factors explain why the micro-credit programme in Pakistan and elsewhere are most likely to be insolvent and unsustainable. The high default rate posted by the SMEs is paradoxical when it is noted that they earn reasonably high return. One study observes, "It is very rare indeed to find a real microenterprise where the annual return on capital invested is less than one hundred percent in real rather than nominal terms, and figures of several thousand are not uncommon".<sup>33</sup>

The conventional wisdom says that network of commercial banks can solve the financing problems of SMEs. But experience has shown that they are reluctant mainly due to high transaction cost and default risks involved in dealing with multitudes of SMEs. To overcome these difficulties Grameen Bank approach of lending on group-basis is now being widely practiced. However, the group-lending scheme based on high interest rate impose heavy cost on SMEs. Even in Grameen Bank case, rehabilitation of clients has turned out to be difficult because of significant amount of interest payment to the bank. As a matter of fact, there can never be sustainable growth in productive activities financed with interests as declared by Allah in Quran" that ye lay out for increase through the property of (other) people will have no increase with Allah: but that which ye lay out for charity, seeking the countenance of Allah (will increase): it is these who will get a recompense multiplied".<sup>34</sup> Thus interest based financing offers no real and long-term solution to the financing problem of SMEs.

The real, long-term, and sustainable solution of the financing problem lies in accessing SMEs to market-based Islamic modes of financing. Islam being the divine religion discards interest and allows financing transactions through Islamic modes. Musharakah, Bay Salam and Bay Maujal are quite suitable modes for SMEs. However, their practicing requires functioning of Islamic banking in the economy. Now as the government is taking concrete steps to make such a shifting in the light of historic Supreme Court decision it is genuinely hoped that Islamic banking system is soon being launched.

<sup>32</sup>Muhammad Ramzan Akhtar. Partnership Financing of Microenterprises. *International Journal of Social Sciences* 24:24 (1997), p. 1472.

<sup>33</sup> Muhammad Ramzan Akhtar. op. cit. p. 1471.

<sup>34</sup>*Quran*, 30–40.

Frequently doubts are expressed about the viability of Islamic banks in contemporary times. In fact there are more than 90 Islamic banks and financial institutions working in the private sector (excepting Pakistan, Iran, and Sudan where entire banking sector is being Islamised) in different parts of the world. These institutions are managing about \$28 billion. The total assets of these institutions amount to \$31 billion<sup>35</sup>.

These banks compare favourably with their counterpart interest-based banks in terms of relevant economic and financial indicators. For instance, the dividends declared by the Pilgrim Management Fund Board in Malaysia during 1981-90 has been consistently higher than average interest rates of commercial banks for 12 months fixed deposits.<sup>35</sup> Similarly Islamic Bank Bangladesh has successfully mobilised deposits from clients who hitherto did not make any deposit with interest-based bank. It handles more than 10 percent of the country's exports and import trade. Among the contemporary commercial banks in the country, its position is first in respect of mobilisation of deposits, development of fund and earning profit.<sup>36</sup> Likewise top 10 Islamic Banks compare favourably with top 10 world banks in terms of financial indicators.<sup>37</sup> Even the secular banks are practicing Islamic banking in different parts of the world. Thus Islamic banking is practicable, profitable and welfare enhancing institution.

For reducing moral risk of financing SMEs, it is suggested that government may float guarantee scheme underwritten by itself. It will enable the small units lacking collateral to get financing from the Islamic banks. In case of business failure the bank will get money from the government. The guarantee scheme alongwith other security arrangement like mortgages, hypothecation, and guarantors will considerably reduce the risks for the banks. The guarantee scheme that we are talking can to be structured on the pattern of Pakistan Export Finance Guarantee Agency (PEFGA) with broader perspective. PEFGA has been set up to facilitate SMEs to access bank financing for working capital. It provides bankable guarantees that may be used as collateral. With the Islamic banks and guarantee scheme in vogue the SMEs can obtain financing through Islamic modes on long term basis.

Musharakah is most suitable mode. It is flexible and incentive compatible. It enables financier and borrower to pool their capital to undertake business on partnership basis. In case small clients lack cash then value of his instruments, machines, labour, rent of his building can be counted towards his share of capital in the partnership. A contract specifying the profit-sharing ratio is written which is not alterable. The loss is shared by the bank and client strictly with ratio of their respective capital contribution. Both parties may or may not participate in operating the business. Usually it is client

<sup>35</sup> Muhammad Ramzan Akhtar. Practice and Performance of Islamic Banks. *Hawliat al. Jamiah Al. Islamiyyah Al.-Alamiyyah*, No.1 414 H-193 AD. p. 48.

<sup>36</sup>Experiences in Islamic Banking—A Case Study of Islamic Bank Bangladesh. p. 67.

<sup>37</sup>Munawar Iqbal, *et al.* op. cit. pp. 24-25.

who runs the business.<sup>38</sup> Musharakah mode is being successfully practiced by many Islamic banks notably Sudanese Islamic Bank (SIB). More than 50 percent of SIB financing is done through this mode primarily for the small sector. Small farmers, artisans and small businesses have enormously benefitted through this mode.<sup>39</sup> Among other Islamic bank Kuwait Finance House is extending 20 percent of total financing through Musharaka and Faysal Islamic Bank is advancing 13 percent of total financing through Musharaka as shown in the Table 1.

Bay Salam is another mode which enables the small farmers and traders to get financing from Islamic bank through forward sales of their products. It was allowed by the Prophet (PBUH) to help farmers and traders by selling agricultural products and merchandise in advance. It is viable because it is incentive compatible. It is beneficial to the seller because he receives the price in advance and is also beneficial for the bank because normally the price in Salam is usually lower than the price in spot sales. The difference between two prices shows the profit of the Islamic bank. To make sure that seller shall deliver the commodity on agreed date, the bank can demand a security in the form of mortgage or hypothecation. In case of default in delivery, the guarantor may be asked to deliver the same commodity, and if there is a mortgage, the bank can sell the mortgaged property and the sale proceeds can be used either to realise the required commodity by purchasing it from the market or to

Table 1

*Financing by Modes 1994–96 Averages (Percentage)*

Name of Institution	Total					
	Financing	Murabahah	Musharakah	Mudarabah	Ijara	Others
Albaraka Islamic Bank	118567	82.03	6.87	5.67	2.43	3.00
Bahrain Islamic Bank	320072	92.63	4.93	1.93	0.00	0.50
Faysal Islamic Bank of Bah	944967	68.90	9.00	6.33	10.97	4.80
Islamic Bank Bangladesh Ltd.	308813	51.70	3.57	17.10	14.07	13.57
Dubai Islamic Bank	1299771	87.50	1.45	5.50	0.00	5.55
Faysal Islamic Bank of Egypt	1364456	72.80	13.00	11.33	2.87	0.00
Jordan Islamic Bank	574289	61.62	3.74	0.39	4.67	29.59
Kuwait Finance House	2454186	45.33	20.00	10.67	1.33	22.67
Bank Islam Malaysia Berhad	580259	66.33	1.30	0.67	7.37	24.33
Qatar Islamic Bank	597703	73.00	1.00	13.33	4.67	8.00
TOTAL (10 Banks)	8563083					
Simple Average		70.19	6.49	7.29	4.84	11.20
Weighted Average*						

Source: Munawar Iqbal *et al.* Challenges Facing Islamic Banking, IDB, IRTI, Jeddah, Saudi Arabia, p. 28.

\*Total Financing has been used as weights.

<sup>38</sup>For detail see Muhammad Ramzan Akhtar. *op. cit.* pp. 1474-1478.

<sup>39</sup>For detail see M. U. Khaleefa. Islamic Banking in Sudan's Rural Sector. *Islamic Economic Studies* 1:1 (1993). pp. 37-48.

recover the price advanced by him.<sup>40</sup> Islamic bank maintains a separate department for buying and selling of commodities and keeping full information on the product market.

Murabahah is the third mode through which Islamic bank can extend financing to SMEs. Islamic bank finances the client through actually purchasing his needed commodities from the market and then selling them to the client on cost plus basis. All commodities which may be subject matter of sale with profit can be financed through it. Even the shares of registered companies may be sold or purchased on Murabahah basis because according to Islamic principles, the shares of a company represent the holder's proportionate ownership in the asset of the company.<sup>41</sup> However, it cannot be used for purposes like paying the price of commodities already purchased by him, or electricity and other utility bills or for paying the salaries. Murabahah mode has been extensively used by the Islamic banks. It has been estimated that about 66 percent of total financing by top 10 Islamic banks during 1994-96 period was made through this mode.<sup>42</sup> The trade sector has been mostly financed by this mode. There is no need to tilt the interest of Islamic banks from the trade sector to the production sector.

SMEs also obtain financing through Mudarabah and Ijara modes. These modes are being used by the Islamic bank as shown in the Table 1. Many Islamic banks like Faysal Islamic Bank of Bah, Islamic Bank Bangladesh, Bank Islam Malaysia are using this mode. What is needed is to increase the interest of bank to use them for SMEs sector.

Aside from the financing constraint, the SMEs in Pakistan has so far remained stagnant due to the technology constraint. Marble, gem, and stone industry is a case in point. It is using traditional techniques in blasting, cutting, polishing and designing processes which has limited their value-needed. There is need to provide modern machinery, computers and technical knowledge to this sector.

### **Public Expenditure on Social Sector**

Public expenditure on social sector makes important contribution towards the development of poor households. It improves their productivity through better education, health and drinking water facilities. It is unfortunate that due to recurring budget deficits public allocation for the social sector overtime has been meagre. It has remained tiny and lacked growth as indicated by the Table 2.

<sup>40</sup>Muhammad Taqi Usmani. *An Introduction To Islam Finance*. Idaratul Ma'arif, Karachi. pp. 190-193.

<sup>41</sup>Muhammad Taqi Usmani. *op. cit.* p. 145.

<sup>42</sup>Munawar Iqbal *et al.* *op. cit.* p. 28.

Table 2

*Public Expenditure (as % of GDP)*

Country/Region	Education		Health
	1980	1997	1990-98
Pakistan	2.1	2.7	0.9
South Asia	2.0	3.1	0.8
World Average	3.9	4.8	2.5
Average of Low Income Countries	3.4	3.3	1.3

Source: World Development Report, 2000-2001.

According to the Table Pakistan spent 2.1 percent of GDP on education in 1980 which increased marginally to 2.7 percent in 1997. Even India is spending much higher on education. It allocated 3.2 percent of GDP on education in 1997. Also we are way behind from the average of the Low Income Countries. Similar is the case of health sector. Its share during 1990-98 was 0.9 percent which is below the average of the Low Income Countries. In fact the debt servicing and defence expenditure claim almost 75 percent of the current expenditure in our budget which leaves very little for the spending on social sector. A reasonable solution from Islamic point of view is operationalising welfare budget as proposed by Ahmad.<sup>43</sup> Its description is given in Table 3.

The proposal is to prepare a welfare budget separate from a general budget. It will provide more funds for spending on education and health sector besides providing financial assistance to the poor and need people. The Zakat collection and grants from the general budget will be major sources of revenue of this budget. While resources will be transferable from the general budget to the welfare budget the reverse transfer will not be allowed. Also the voluntary sector may be activated. Awkaf historically played vital role in extending social services to the people. Even today this institution is in tact. It needs to be systematically mobilised for the social sector. Mobilisation of the voluntary sector will reduce the burden of the public sector. These arrangements can effectively work to meet the needs of the poor for education, health and drinking water. The proposed measures alongwith the network of SMEs will doubly benefit poor and thus effectively and sustainably alleviate poverty.

## 7. POLICY IMPLICATIONS

Forgoing discussion generates important policy implications for the planners and managers of the economy. Firstly, the state has to recognise the poverty as the single most important national problem. This recognition, in turn, should be reflected in all relevant policy decisions. Secondly, the policy consensus should be

<sup>43</sup> Ziauddin Ahmad. *Public Finance in Islam*. IMF Working Paper 1989, p. 18.

Table 3

*The Structure of the Islamic Fiscal System*

Welfare Budget		General Budget	
Receipts	Expenditure	Receipts	Expenditure
1. Zakah receipts	1. Cash grants to	1. Tax revenues:	1. Defense
2. Transfers form The general budget.	the poor and the needy.	a. direct taxes	2. Law and order
3. Voluntary contributions.	2. Financial assistance in Cash or kind to make the unemployed or underemployed self supporting.	b. indirect.	3. Judiciary
	3. Schemes of social welfare (Especially education and health care) designed for the exclusive poor.	2. Nontax revenues: a. natural resources	4. Civil administration
	4. administrative expenses of collecting and disbursing.	b. public domain.	5. Infrastructure and other public sector projects.
	5. Situational categories of which: a. protecting and propagating the religion. b. paying off debt of poor debtors c. others.	3. Equity Financing: a. domestic b. foreign sources.	6. Propagation of virtues, suppression of evil, and spreading the message of public.
		4. Borrowing a. general benefit of the Islam	7. Transfers to the welfare budget.
		b. commercial c. central banks d. foreign sources.	
		5. Voluntary contributions.	

evolved around the solution lying in accelerating growth favouring poor. Thirdly, a policy shift in favour of proliferating SMEs is needed in the light of this approach. These units should be financed through Islamic modes. Therefore, Islamic banking system should be started, early. Fifthly, the government may set up a guarantee issue

guarantees which SMEs may use as collateral to while obtaining financing from the Islamic banks. Sixthly, the SMEs should be provided technical help. Seventhly, public expenditure on the social sector should match to the average level of low-income countries. For target provision of education, health, drinking water to the poor people the welfare budget separate from the general budget may be instituted.

### **8. CONCLUSION**

The paper has presented an Islamic approach of poverty alleviation on sustainable basis. The paper finds major problems in existing approaches wherein poverty alleviation is neither sought as a policy goal nor is addressed in correct ways. In fact, the focus has remained on assisting needy people through grants and financing small units through microcredit and soft loans schemes. The paper suggests two-pronged approach: one is accelerating growth favouring poor and second is systematically extending them education, health, and drinking water facilities. For implementing this approach the paper suggests starting of Islamic banking system, instituting of guarantee agency, and welfare budget in the country. The paper believes that policy actions on these lines will alleviate poverty on sustainable basis.

## Comments

The paper has presented an Islamic approach for poverty alleviation based on the intuition from the Quran, Sunnah and Islamic history. It has defined poverty as being a situation of non-satisfaction of material, physical and socio-political ingredients that provide well-being. The author argues that roots of poverty can be traced in malfunctioning of socio-economic and political institutions and moral value system in Muslim countries. He considers capital intensive pattern of growth, income inequalities, interest based banking system, and undemocratic and centralised political system responsible for marginalisation and victimisation of the poor. The policy agenda to reduce poverty and improve income distribution, as outlined in the paper, consists of ten interrelated measures, considering education and technology as the prime item of the agenda. Interest based system has been identified as an important cause of poverty. The author argues that switching to Islamic financial system will extend financing to the projects of low income people thus raising their income level and reducing poverty. The paper also stresses upon pursuing labour intensive pattern of growth to reduce incidence of poverty, on microenterprises. Similarly the author recommends for land reforms which will transfer land to the landless peoples. Development of the rural sector, restructuring of administrative and political system according to the teachings of Islam, giving more administrative and financial powers to provinces and enforcement of Zakat, inheritance and family law are the other important components of the policy agenda given in the paper.

In general I agree with the measures suggested in the paper to reduce poverty in Pakistan. However, there are some flaws in the paper. For example, it has defined poverty as being a situation of non-satisfaction of material, physical and socio-political ingredients that provide well-being. This definition is similar to the recent broad view of poverty. However, the main issue is how to measure these ingredients in order to know the magnitude of the poverty so that right policies can be drawn for its reduction.

In view of the recent rise in poverty, the government of Pakistan has outlined a strategy for poverty reduction. Interestingly the components of this strategy are similar to the policy agenda given by the author in his paper. The only notable difference is that the author has emphasised on switching to Islamic financial system for pro-poor projects. It would have been useful if the author has compared his policy agenda with the poverty reduction strategy given by the government. More importantly, there should have been some discussions why these policies have not been successful in reducing poverty. Only in the light of this discussion the policy agenda given in the paper can better be judged.

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