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Title of Thesis: Islamic Microfinance Institutions in West Asia:
Feasibility for India with Special Reference to Jammu and Kashmir

Abstract

This research work aims to discuss the causes of poverty under the prevailing interest-based economic systems and then illustrates the feasibility of the poverty alleviation through the interest-free perspectives of microfinance in a few districts of Jammu and Kashmir mainly dominated by the Muslims who are religiously more inclined to opt these facilities if given opportunities under the rules and regulations of Indian government.

Over the past decade, the determinants of the success of microfinance credit methodologies have received extensive attention from both practitioners and academics. The resulting literature reflects consensus on the principles for the successful provision of micro financial services that address the two central problems of all financial markets: imperfect information and contract enforcement difficulties. Microfinance technologies attempt to overcome these problems by developing non-traditional mechanisms to screen applicants, monitor the actions of borrowers and create incentives to repay.

Islamic Microfinance as an Alternative

Islamic microfinance may be defined as a type of microfinance that complies with the principles of *Shari'ah*, eliminates *riba* (interest) and *gharar* (excessive speculation and risk taking) from the financial transactions. It promotes business productivity by linking financial services to real economic activity and promotes industries that benefit the welfare of society.

The existing interest-based microfinance has not been able to fulfill the demand of the financially inaccessible section of the society. The reasons being mostly the exorbitant rates of interest exceeding the rate of return on micro-credit, commercialization of microfinance institutions, combining multiple products like savings insurance and loan, unregulated hyper competitive

markets, multiple lending, least supervision and monitoring for the end-use of borrowed amount, unethical and abusive recovery practices.

To overcome such constraints, interest free microfinance (Islamic microfinance) may be conceived as an alternative to interest based microfinance to some extent. A variety of recent research studies show that there is a large chunk of Muslim population who do not access conventional microfinance as it is interest-based and interest is strictly forbidden in Islam. Provision of Islamic microfinance may help to accommodate this group of population as well, who desire to access the interest-free financial services that are *Shari'ah*-compliant.

The Islamic approach to poverty alleviation is more inclusive than the conventional one. It provides for the basic conditions of sustainable and successful microfinance, blending wealth creation with empathy for the poorest of the poor. *Zakah* and income from *waqf* can be integrated into the micro-financing system to benefit the poorest beneficiaries. *Zakah* given to the poor can be used for consumption, asset building, and production purposes to complement funds of Islamic Microfinance Institutions. These complementary funds can either be given as grants or interest free loans (*Qard-Hasan*) according to the needs of the beneficiary. As an alternative to the interest-based system, the profit and loss sharing arrangements of *Shari'ah*-compliant microfinance are held as the ideal modes of financing. It is expected that this system (interest-free) would be able to remove the inequitable distribution of income and wealth. At the same time it may also lead to more efficient and optimal allocation of resources compared to its conventional counterpart. As the depositors are likely to get higher returns, it may lead to self-reliance through improved rate of savings and would thus reduce the subsidy dependence syndrome. Faith-based microfinance can further maximize social services by using *Zakah* to fulfill the basic needs and increase the participation of the poor. Another advantage lies in its financial instruments that are based on profit and loss sharing schemes rather than loan. The *Shari'ah*-compliant approach to poverty alleviation provides for the basic conditions of sustainability and successfully blending wealth creation with empathy for the poor.