

(Conference Draft)

“Law and Development in the Islamic World: New Possibilities”<sup>1</sup>

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<sup>1</sup> This paper is intended only for conference participants and not for quoting without the express permission of the presenter.

## **Introduction: Poverty and Social Deprivation in the Islamic World**

Muslims are approximately 20% [n=1.66 -1.82B] of the global population [n = 6.67B]\* but disproportionately figure in the world's poor and experience collectively very low levels of economic and social development. If we examine figures provided by the UNDP and at the countries with predominantly Muslim populations (defined here as their membership with the Organization of the Islamic Conference – OIC), the statistics are startling – even if we include non-GDP data.<sup>2</sup>

According to the *UNDP Human Development Index* (2009), and tracking the performance of the 56 OIC countries, we find the following HDI assessments:

- ‘Very High’ = 10.52% (4/38) [n= 8.8m]
- ‘High’ = 22.73% (10/44) [n= 160.8m]
- ‘Medium’ = 36.49% (27/74) [n= 1,133.2m]
- ‘Low’ = 70.83% (17/24) {Ed. – I have included Iraq and Somalia which have no HDI ranking} [n = 293.7m]

(\*All figures based on 2007 data)

Of those 38 countries which the UNDP gave an HDI of “Very High”, only 4 of them belonged to the OIC; 10 out of 44 were ranked “High”, 27 out 74 “Medium”, and 17 out of the 24 grouped in the bottom ‘Low’ category. OIC countries disproportionately figure in the ‘medium’ to ‘low’ categories and have insufficient presence in the ‘very high’.

In addition to this, from the UNDP data we note:

- 36/56 OIC countries have >20% of their populations living on \$2 per day or less (representing countries with combined population of 1.212B out of total OIC 1.596B)[Source: World Bank, “World Development Indicators”, 2009]

In addition to widespread poverty, one finds inadequate access to financial services. Of 44 of the 56 OIC countries for which there are data, we discover:

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<sup>2</sup> Total population of OIC countries = 1.596B (includes non-Muslim minorities). Total global Muslim population difficult to be accurate because no ‘official’ statistics. Also China and India, though non-Muslim countries, have substantial Muslim populations – 28 million (official stats) and 137.9 million (if Muslim population is only 12% as claimed), respectively. Russia also has a substantial Muslim minority. While the stats are difficult to verify, there is evidence to suggest these Muslim minorities are also economically more disadvantaged than the majority populations (which in Xinjiang, has contributed towards a Muslim separatist movement). According to an Islamic Development Bank Report in 2008, more than 100 million Muslims in India are below the national poverty line.

- 17/44: 1/5<sup><</sup> of population have access (Pakistan, Nigeria, Sudan, Senegal and Mozambique among the worst performers. In Senegal, 94% of the population does not have a savings account).

- 21/44: 1/4<sup><</sup> of population have access

- 31/44: 1/3<sup><</sup> of population have access (Lebanon, Saudi Arabia and Malaysia among the best performers)

[Source: Patrick Honohan, “Cross-Country Variations in Household Access to Financial Services”, World Bank Conference on *Access to Finance*, March 15-16, 2007]

### **Pinning the blame**

- Post 9/11, common (especially in the US) to associate Islamic beliefs, culture and Islamic law as dominant factors in underdevelopment in the Muslim world (eg, see: Bernard Lewis (2009), *Foreign Affairs*): lack of a Protestant ‘work ethic’ and ‘enlightenment’ (‘fatalism’); large families, gender discrimination, poor education and health; bad government – little democracy or respect for rule of law. Can’t blame colonialism any longer – problem running far deeper.
- But picture not as bad as is painted when compared with similarly situated non-Western cultures – just not as economically developed or ‘successful’ as the West.
- Also there are many different “Islamic” cultures – so much divergence between them – how can you generalize?
- Islamic tradition dynamic and entrepreneurial – not complacent, defeatist or ‘fatalist.’

The reported sayings (*hadiths*) of Prophet Muhammad promote self-reliance and trade rather than aid and dependence on charity. Ubaydullah ibn Adl ibn al-Khiyar narrated: Two men informed me that they went to the Prophet (peace be upon him) when he was at the Farewell Pilgrimage while he was distributing the *sadaqah* and asked him for some of it. He looked us up and down, and seeing that we were robust, he said: “If you wish, I shall give you something, but there is nothing spare in it for a rich man or for one who is strong and able to earn a living” (*Sunan Abu Dawood, Kitab al-Zakah, Book 9, Number 1629*).

Hadiths of Prophet Muhammad also indicate a method for poverty alleviation. Anas ibn Malik relates: A man of the Ansar came to the Prophet (peace be upon him) and begged from him. He (the Prophet) asked: “Have you nothing in your house?” He replied: “Yes, a piece of cloth, a part of which we wear and a part of which we spread (on the ground), and a wooden bowl from which we drink water.” He said: “Bring

them to me.” He then brought these articles to him and he (the Prophet) took them in his hands and asked: “Who will buy these?” A man said: “I shall buy them for one dirham.” He said twice or thrice: “Who will offer more than one dirham?” A man said: “I shall buy them for two dirhams.” He gave these to him and took the two dirhams and, giving them to the Ansari, he said: “Buy food with one of them and hand it to your family, and buy an axe and bring it to me.” He then brought it to him. The Apostle of Allah (peace be upon him) fixed a handle on it with his own hands and said: “Go, gather firewood and sell it, and do not let me see you for a fortnight.” The man went away and gathered firewood and sold it. When he had earned ten dirhams, he came to him and bought a garment with some of them and food with the others. The Apostle of Allah (peace be upon him) then said: “This is better for you than that begging should come as a spot on your face on the Day of Judgment. Begging is right only for three people: one who is in grinding poverty, one who is seriously in debt, or one who is responsible for compensation and finds it difficult to pay” (*Sunan Abu Dawood, Kitab al-Zakah, Book 9, Number 1637*).

[Source: Ubaidullah and Khan, 2008, *infra*, p. 16]

### **Victims of history?**

- True ..once upon a time... parts of the Islamic world also a beacon (or a symbol) for economic development and social justice – what happened?
- Timur Kuran’s thesis (2003, 2004, 2010) – necessary consequence of the strictures of Islamic law (fixed inheritance rules; no provisions for ‘body corporate’; permanence of Islamic trusts) - meant Islamic societies didn’t produce organizations large enough to compete with the Western corporation. Difficult to test his thesis empirically (too many variables). But did Islamic societies truly want this form of economic development anyway?
- Was Islamic underdevelopment *because of* a ruling elite imitating western economic and legal models? Wael Hallaq’s argument (2009) – systematic destruction of the Islamic trust (*Waqf*) across the Middle East deprived women of their financial rights and endowments: it was the process of modernization (westernization) that contributed to their marginalization and social exclusion. Pertinent to development context because Muslim women were prevalent in the business world as investors and traders.
- Post-independence, widespread Muslim poverty more the product of failed socialist and Stalinist experiments. Another imitation gone wrong? Causes too complex

- It should be noted that most modern day ‘Islamic’ societies are not run on Islamic lines

There are elements of truth in all of these observations- but I doubt it’s helpful raking over the entrails of history nor blaming everything on legal interpretation and formulation. Playing the blame game is rarely productive and diverts attention away from correctly describing the beliefs, practices and approaches of particular peoples in our time, and from accurately diagnosing their needs and problems. Notwithstanding good intentions, development policies should be based on empirical research rather than assumption and prejudice.

### **Addressing the problems of the present**

- Is there a disjuncture between materialist notions of economic development, operating assumptions of NGOs and aid agencies, and the spiritual development urged in local mosques and by village elders? (cf Umer Chapra, “Islam and Economic Development within the Framework of Ibn Khaldun’s Philosophy” in *Islamic Finance into the 21<sup>st</sup> Century* (1998), CUP, pp 23-30)

The regional economic development of Malaysia provides a good example of this disconnect. In spite of consistent economic ‘sweeteners’ offered by the Federal government of Malaysia to its electorate and clear economic disparities between its economic growth and that of states governed by the same party heading the Federal Government, the Malaysian state of Kelantan has continued to vote into power an ‘Islamist’ party (‘PAS’) in free and democratic elections. PAS has ruled Kelantan for 18 years. This suggests some Islamic populations do not support or approve of common notions of economic development.

- Popular poverty alleviation models, such as Grameen Micro-finance, are interest-based (high levels in some cases) and provide disincentive for Muslim entrepreneurs and borrowers (even if no threat of legal action should projects fail and ‘soft loans’ in practice). Grameen fails to reach the poorest and most isolated (possibly widening the gaps between different social strata)
- Problem compounded by geographical isolation in rural areas and lack of education. Pakistan, Bangladesh, Yemen, Nigeria (and those countries below them in the HDI from the OIC) have >75% of their adult populations aged 25 or above with ‘low’ educational attainment

[Source: UNDP, UDR 2009]

- Majority of the Muslim world isolated (in practice) from the financial and banking sectors (see earlier slides); massive potential for trade and investment if their capital can be mobilized, especially in Africa; but how?

### **Is IBF (Islamic banking and finance) the answer?**

“The overall goal of the strategy is to develop a microfinance industry that is institutionally and financially sustainable, and integrated within the broader formal financial sector and that respects the cultural and religious sensitivities of a Muslim society. This strategy views Islamic microfinance as an essential tool of intervention within the broader approach for poverty alleviation and socioeconomic development in Muslim societies.”

[Source: Obaidullah, M. and Khan, T. (2008), *Islamic Microfinance Development: Challenges and Initiatives*, Policy Dialogue Paper No 2, Islamic Development Bank, Jeddah]

- Theoretically appealing: traditional resistance to conventional banking and finance because of interest-based mechanisms prohibited in Islam (*ar-riba*), too much uncertainty (*gharar*) and practices perceived as akin to gambling (*maysir*). Sustainable and thriving business community v. difficult without access to banking and financial services (irrespective of the reason)
- Savings, loans, transfers, investment and insurance services organized on ‘Islamic’ lines through concepts of *Wadi’ah* (safekeeping), *Murabahah* (cost-plus trade sales), *Qard al-Hasan* (interest-free loans), *Hawala* (remittance with fee), *Mudaraba* (profit and loss sharing with a sleeping partner; the traditional *commenda*), *Musharakah* (profit and loss sharing based on joint contribution, losses fixed according to percentage contribution) and *Takaful* (cooperative safety nets based on mutual guarantees and common fund).
- Link with global Islamic banks and capital markets to ensure sustainability and liquidity
- Target the ‘poorest of the poor’ through Islamic tithes (*zakat*), voluntary donations (*sadaqah* and *tabarru’*) and Islamic investment trust funds (*awqaf*) (cf. Ubaidullah and Khan, 2008)
- ‘Cottage IBF’ could be administered through the local mosques by community leaders and elders. Participative structure similar to the Grameen.

### **Islamic Micro Finance: a Successful Middle Eastern Case Study**

- “In Jabal Al-Hoss, in Syria’s poor northeastern region, UNDP supported a project to promote local development and empower vulnerable groups through microfinance.

The project set up a network of 32 Village Development Funds in over 40 villages to administer microloans over the short-term, with the longer-term goal of developing and sustaining microfinance institutions to serve the area. To date, the project has led to almost 13,000 loan disbursements to over 7,800 households, which saw their incomes rise by 20 percent. Nearly half of the borrowers were women, who also account for 46 percent of the 1,000 jobs created as a result of the initiative. At the same time, 25 adult literacy programmes have been set up throughout the area, along with two new kindergartens that allow women to attend classes while their children are being cared for. The initiative has created a socio-economic database to track progress in the region in key areas including population growth, household size, size of livestock, amount and percentage of arable land, and literacy rates. Inspired by the project and other similar initiatives in the country, a decree has been passed allowing for additional microfinance institutions to be established and maintained in Jabal Al-Hoss and beyond.”

(Source: UNDP Annual Report 2008,  
<http://www.undp.org/publications/annualreport2008/poverty.shtml>)

Although the UNDP Report does not refer to it, the Jabal Al-Hoss ‘Sanadeq’ programme is a form of Islamic Microfinance (carried out with the assistance of UNDP which provides grants matching the sums collected by Village Development Funds) and utilizes *Murabahah* (cost plus trade sales) financing. Villagers become members of the development fund by buying shares – through the concept of *Musharakah* and thus become owners of the development programme itself. There are still some problems with this project as it has required its members to take out conventional life insurance to cover losses if one of their members dies – and conventional insurance is seen as akin to gambling. ‘Micro-takaful’ products have not yet been developed but would be the next stage to perfect this product in Shari’ah terms (cf ‘Ubaidullah and Khan, 2008, p. 22). The problem has been that the borrowers are seen as ‘sub-sub prime’ and so represent a very high risk. It’s difficult to convince financial institutions – even Islamic financial institutions – to support them. ‘Ubaidullah, *ibid*, suggests developing safety nets based on guarantees provided by a third party (*kafalah*) is the way forward.

### **Islamic Micro Finance in Indonesia**

“Indonesia has a long history of microfinance. Its strong emphasis on its Islamic roots has enabled itself to experiment with a dual system of Islamic finance and a system of microfinance that is not just Shariah-compliant, but actually uses Islamic “spiritual treatment” along with financial and technical assistance to develop its micro enterprises and work towards elimination of poverty. A recent pilot study conducted by Bank Indonesia (BI) divided beneficiaries into groups based on those receiving:

- (i) Financial assistance only;
- (ii) financial and technical assistance only;
- (iii) financial and technical assistance along with spiritual treatment.

It was observed that group (iii) outperformed all other groups highlighting the importance of spiritual treatment. BI plans to use the findings to develop a model of microfinance that is not only integrated but also uses spiritual treatment as an important intervention.”

[Source: Obaidullah, M. and Khan, T. (2008), *Islamic Microfinance Development: Challenges and Initiatives*, Policy Dialogue Paper No 2, Islamic Development Bank, Jeddah]

These institutions in Indonesia are known as *Baitul Maal wal Tamweel* (BMTs). They have proved to be relatively robust and able to withstand financial crises largely because they operate outside the financial regulatory system and are less vulnerable to systemic risk (as they do not depend upon governmental assistance). But by the same token, their independent status makes them problematic for the regulator.

### **Should Islamic microfinance be the default model rolled out in Muslim countries to finance a more ‘Islamically sensitive’ economic development?**

#### **Challenges:**

- Many developing countries with predominantly Muslim populations do not have the relevant banking and finance regulations to comply with Shari’ah nor the human resources to make it work. Regulations and development in human capital necessary before the big IBF institutions prepared to invest large scale funds.
- IBF is a reputation-based industry which depends on the standing of the Shari’ah Supervisory Board. Islamic microfinance projects do not have SSBs. Too expensive. Pooling of resources for a centralized SSB for IsMF?
- As with the IBF industry more generally, more standardization and harmonization required - possibly through regional codification. The Islamic legal variety even more pronounced at village level – how to balance flexibility and sensitivity with need for harmonization?
- Microfinance and Islamic microfinance very expensive to administer as tighter supervisory frameworks required.

- More involvement from the Islamic private sector essential – can't leave all development projects to the Islamic Development Bank. Currently, very few Islamic banks and financial institutions have Islamic microfinance divisions. How to get them 'on board'?
- More market research required to assess and evaluate community knowledge of and attitudes to IBF products. Not all Muslims accept the current approaches of the IBF industry (Islamic communities are *very* diverse and heterogeneous)

## Conclusion

### Microfinance not an answer to everything

- Infrastructure. Islamic developing countries need huge investment in roads, public transport, power plants, hospitals, schools, etc. Large scale funding necessary – Islamic bonds (*sukuks* – certificates representing profit shares in underlying physical assets) the answer? IDB and ADB in the process (as of September 2010) of issuing sukuk to finance major infrastructure projects
- Education. Many intended recipients of development assistance have difficulty understanding Islamic or conventional banking and finance products.
- Long-term community investment in education required more generally to expand middle class and generate stronger civil society.
- **Enhancement of Rule of law:** independent judiciaries, better enforcement, more transparency and accountability, effective anti-corruption agencies. These reforms are necessary to generate flows of FDI (from a wide variety of sources) and promote private investor confidence. They can be *Islamic* as Islamic history itself bears witness. The Abbasid Caliph Harun al-Rashid appointed Abu Yusuf as the Head of the Islamic Judiciary – and he alone was given the power to appoint the rest of the judges. The traditional “Wilayat al-Madzalim” or the Board of Grievances – was in operation for many years as a method of bringing senior public servants to account. But that was a long time ago and a revived Islamic administrative law needs to take root.

Countries like Malaysia (with greater familiarity of Common Law notions of due process and a culture of 'Islamisation') can help lead the way.