

Income Inequality Reduction

THROUGH ALTERNATIVE FINANCIAL INSTITUTIONS TO RIBA (AN ISLAMIC APPROACH)

By: Magda Ismail Abdel Mohsin (INCEIF)

**This research project is funded through INCEIF-UM Research Collaboration Fund*

CURRENT SCENARIO ON INCOME INEQUALITY

According to the World Bank Statistics (2012) more than 80% of the world's population live in countries where income inequality is very wide. The latest Oxfam report shows that the richest 1% of the world population holds over 50% of the world's wealth. This means that 62 richest people own an estimated wealth of US\$1.76 trillion which is equivalent to the wealth of 3.5 billion people who make the poorest half of the world population (2015). The failure of the capitalist system in reducing this income inequality encourages economists to provide justification for this huge gap between the rich and the poor. Some economists believe that the main causes of this income inequalities is due to the unjust financial system which is based on interest/Riba while others tried to provide solution to this problem.

For example according to Wolff, R. D. (2010) the current global crisis persists as a result of the capitalism system in financing with interest. He provides evidence showing that the current financial crisis started in early 1970s as a result of the introduction of technology and the

// This means that 62 richest people own an estimated wealth of \$1.76 trillion which is equivalent to the wealth of 3.5 billion people who make the poorest half of the world population (2015). //

1. World Bank Statistics (2010): <http://www.globalissues.org/article/26/poverty-facts-and-stats>.
2. Oxfam report (2015): <https://www.weforum.org/agenda/2016/01/3-charts-that-explain-global-inequality/>
3. Wolff, R. D. (2010). Capitalism hits the fan: The global economic meltdown and what to do about it. Northampton, Mass: Olive Branch Press.
4. Van Saten, Rienke M. (2010), Microfinance as a Poverty Reduction Policy, view at: <http://www.microfinancegateway.org/gm/document1.9.44607/Microfinance%20as%20a%20Poverty%20Reduction%20Policy.pdf>
5. Turner, A. (2017). Between Debt and the Devil: Money, Credit, and Fixing Global Finance, Princeton: Princeton University Press
6. Thomas Piketty (2013). Capital in the twenty-First Century, translated by Arthur Goldhammer, Harvard College USA.
7. WDR 2000/2001: https://openknowledge.worldbank.org/bitstream/handle/10986/11856/9780195211290_ch07.pdf?sequence=13

increment of the employers' profit to the extent that they deposited it in banks to be lent to the employees whose wages remained stagnant. This act continued to widen the gap between the employers and the employees since the latter have to repay the loan with interest. Similarly and according to Van Saten (2010) he realised that financing with interest does not stop only in financing the employees but it extended to the financing of the anti-poverty and microfinance programmes- a matter which again resulted in a wide gap between the rich and the poor.

On the other hand to solve the problem of inequalities, Turner A. (2017) suggested to abolish banks and to call for an economy without banks calling it the Strange Amnesia of Modern Macroeconomics. Moreover, Piketty (2013) proposed a redistribution system through a progressive global tax on wealth. The World Development Report (WDR 2000/2001) devoted a whole chapter on explaining how removing social barriers and building social institutions could help in reducing income inequality.

From the above, it seems that one of the main causes of this income inequality is the current Mono-Financial System that finances with interest. This will bring the following questions; if this interest-based system is the main cause for this huge gap between the rich and the poor, then what are the other alternatives? This will be answered below:

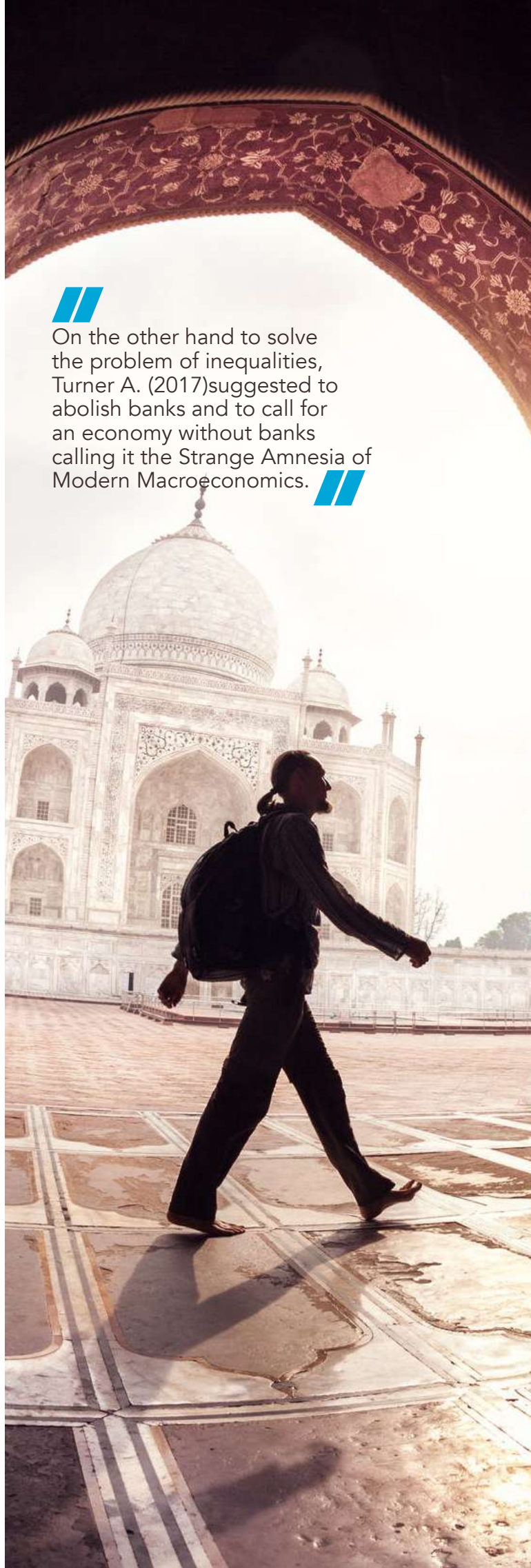
INCOME INEQUALITY REDUCTION: AN ISLAMIC APPROACH

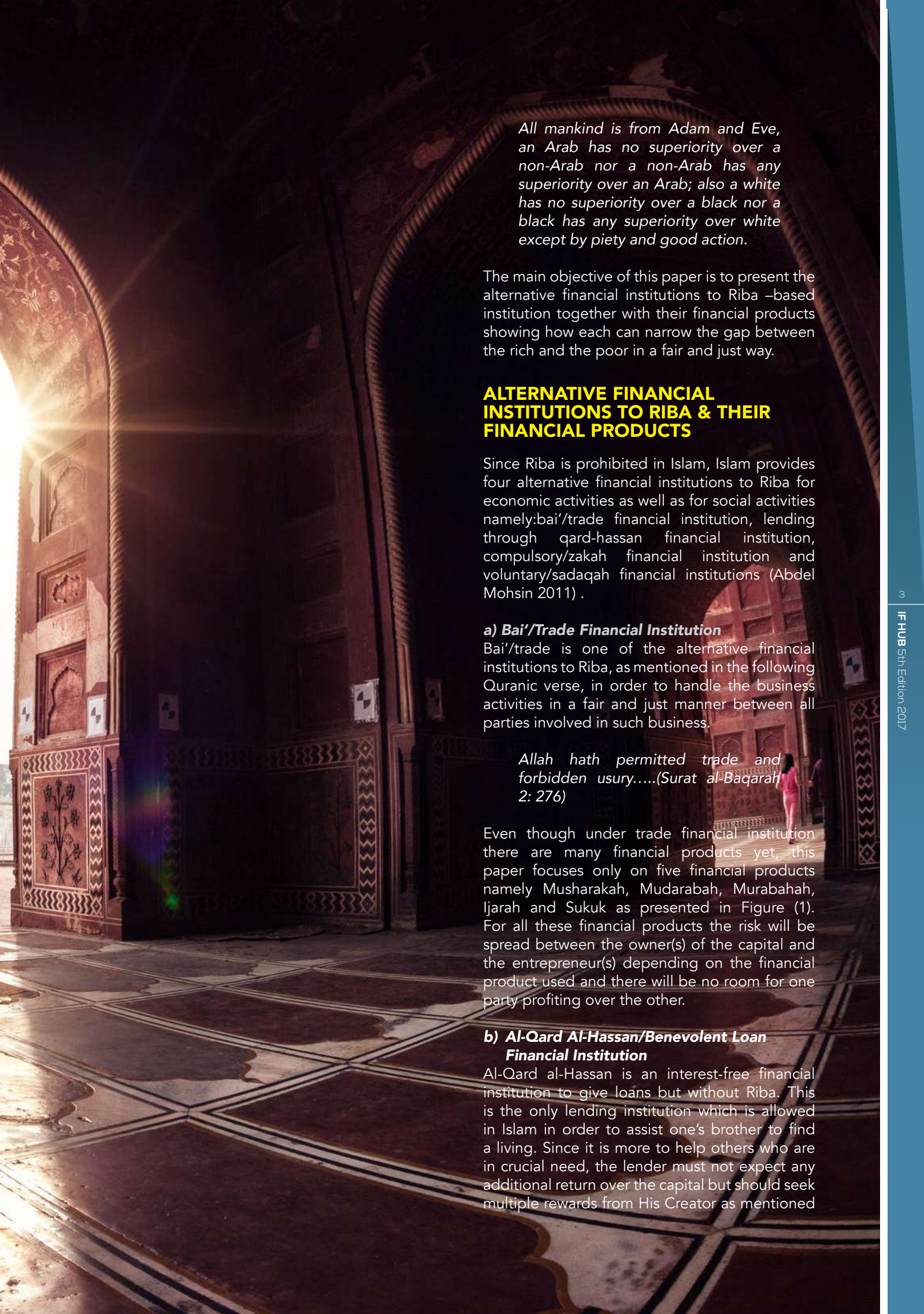
Islam is not just a religion of worship. It is a comprehensive discipline that includes all aspects of sciences including economics. It provides many institutions that have to function in parallel in order to enhance a just and a welfare society for all. The current global financial crises urge Muslim economists to revive the alternative financial institution(s) to Riba/interest-based institution which is prohibited in Islam.

In Islam, removing social barriers and building social institutions is much recommended since all human beings are equal and constitute one single community. This is reflected very clearly in the following hadith of the Prophet (PBUH) whereby there is no difference between man and man due to race, colour, country or language with the exception of piety and good action, hence all human beings deserve to be treated in a fair and just ways.



On the other hand to solve the problem of inequalities, Turner A. (2017) suggested to abolish banks and to call for an economy without banks calling it the Strange Amnesia of Modern Macroeconomics. //





All mankind is from Adam and Eve, an Arab has no superiority over a non-Arab nor a non-Arab has any superiority over an Arab; also a white has no superiority over a black nor a black has any superiority over white except by piety and good action.

The main objective of this paper is to present the alternative financial institutions to Riba –based institution together with their financial products showing how each can narrow the gap between the rich and the poor in a fair and just way.

ALTERNATIVE FINANCIAL INSTITUTIONS TO RIBA & THEIR FINANCIAL PRODUCTS

Since Riba is prohibited in Islam, Islam provides four alternative financial institutions to Riba for economic activities as well as for social activities namely: bai'/trade financial institution, lending through qard-hassan financial institution, compulsory/zakah financial institution and voluntary/sadaqah financial institutions (Abdel Mohsin 2011) .

a) Bai'/Trade Financial Institution

Bai'/trade is one of the alternative financial institutions to Riba, as mentioned in the following Quranic verse, in order to handle the business activities in a fair and just manner between all parties involved in such business.

Allah hath permitted trade and forbidden usury.....(Surat al-Baqarah 2: 276)

Even though under trade financial institution there are many financial products yet, this paper focuses only on five financial products namely Musharakah, Mudarabah, Murabahah, Ijarah and Sukuk as presented in Figure (1). For all these financial products the risk will be spread between the owner(s) of the capital and the entrepreneur(s) depending on the financial product used and there will be no room for one party profiting over the other.

b) Al-Qard Al-Hassan/Benevolent Loan Financial Institution

Al-Qard al-Hassan is an interest-free financial institution to give loans but without Riba. This is the only lending institution which is allowed in Islam in order to assist one's brother to find a living. Since it is more to help others who are in crucial need, the lender must not expect any additional return over the capital but should seek multiple rewards from His Creator as mentioned

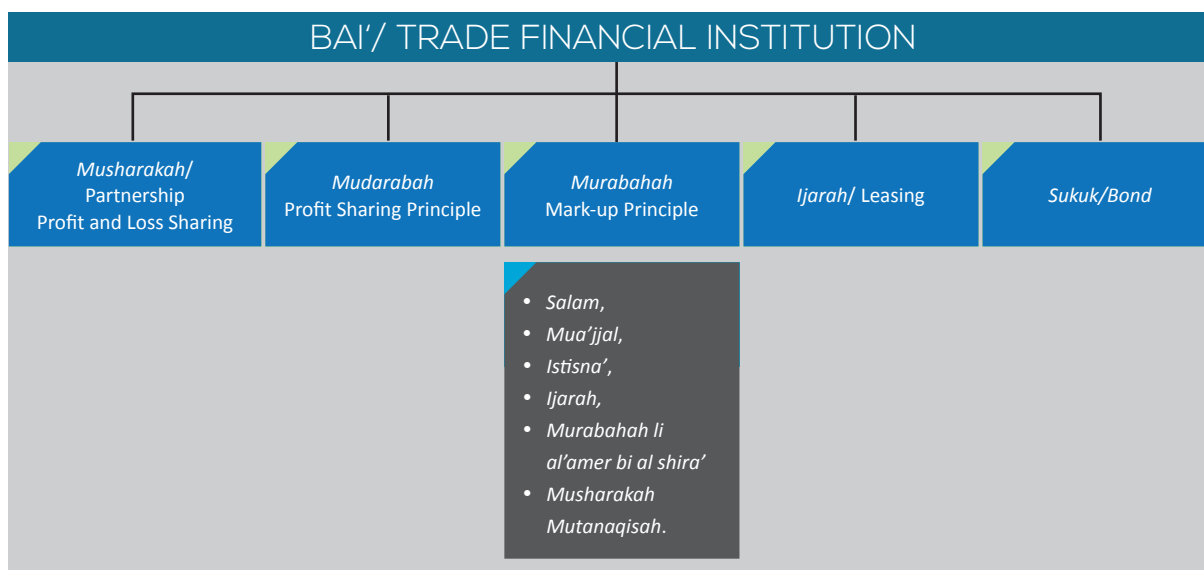


Figure (1) Al-Bai'/ trade financial institutions for economic activities.

in the following Quranic verse:

Who is he that will loan to God a beautiful loan, which God will double unto his credit and multiply many times? (Surat al-Baqarah 2:245)

Hence, this will help the borrower to repay only the borrowed amount without burdening him with the payment of any additional amount.

c) Zakat Financial Institution

Zakat financial institution is also one of the alternative financial institutions to Riba as mentioned in the following Quranic verse:

"And that which you give in gift (to others), in other that it may increase (your wealth by expecting to get a better one in return) from other people's property, has no increase with Allah; but that which you give in Zakat seeking Allah's Countenance, then those they shall have manifold increase." (Surat al-Rum, 30:39)

Hence, zakah is a compulsory due to be collected from all eligible Muslims and from all types of wealth and to be redistributed to eight zakah recipients, as highlighted in the following Quranic verse;

"Zakat is for the poor, and the needy and those who are employed to administer and collect it, and the

new converts, and for those who are in bondage, and in debt and service of the cause of Allah, and for the wayfarers, a duty ordained by Allah, and Allah is the All-Knowing, the Wise" (Surah al-Tauba, 9:60)

The distribution can be done through establishing eight financial products, each according to its zakat recipients as shown in Figure (2).

As explained above through supporting these eight recipients with zakat money, this will improve their situation and will empower them to be zakat givers rather than zakat receivers hence it reduces the gap between the rich and the poor.

d) Sadaqah Financial Institutions

Sadaqah financial institutions are voluntary in nature and they are also alternative financial institutions to Riba as mentioned in the following Quranic verse:

Allah will deprive usury of all blessing, but will give increase for deeds of charity...(Surat al-Baqarah 2:276)

Both Muslims and non-Muslims living in an Muslim country have to fulfil their responsibilities in contributing voluntarily to their society. This voluntary financial institution includes sadaqah & sadaqah Jariah/waqf financial institutions, as seen in Figure (3). They are meant to generate funds from many financial products in order to

1. Abdel Mohsin Magda (2011). "x of Zakah and Waqf as community empowerment for economic transformation of Muslim societies", in: the Life-3 INSANIAH International Conference Islamic Finance and Economic, organized by INSANIAH & IRTI, Langhawi, 28-31 October 2011.

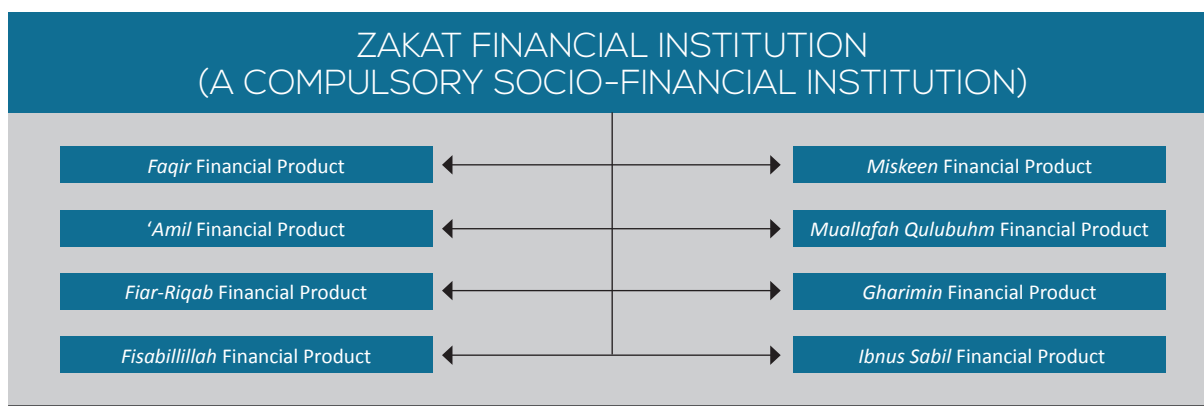


Figure (2) Zakat financial institution for social activities.

provide the different goods and services needed in the different societies without burdening governments and forcing them to borrow with interest for economic development projects.

Sadaqah is a voluntary act of giving alms for the cause of Allah or fisabillilah by individuals who want to contribute more than the compulsory due. There are two types of Sadaqah Financial Products:

- General Sadaqah Financial Product
General Sadaqah is a type of charity financial product which can be given openly either in cash

or in kind to individuals or group of people who are financially in a difficult situation e.g. people facing natural disasters or lacking some goods and services in some villages. The main objective of this sadaqah financial product is to finance these categories of people rather than forcing them to borrow with interest when they are in crucial needs of the capital.

- Specific Sadaqah Financial Product
Specific Sadaqah is a type of hidden charity to be given in secret to relatives, friends or neighbours in situation where they face sudden and crucial needs. The main objective of this hidden sadaqah

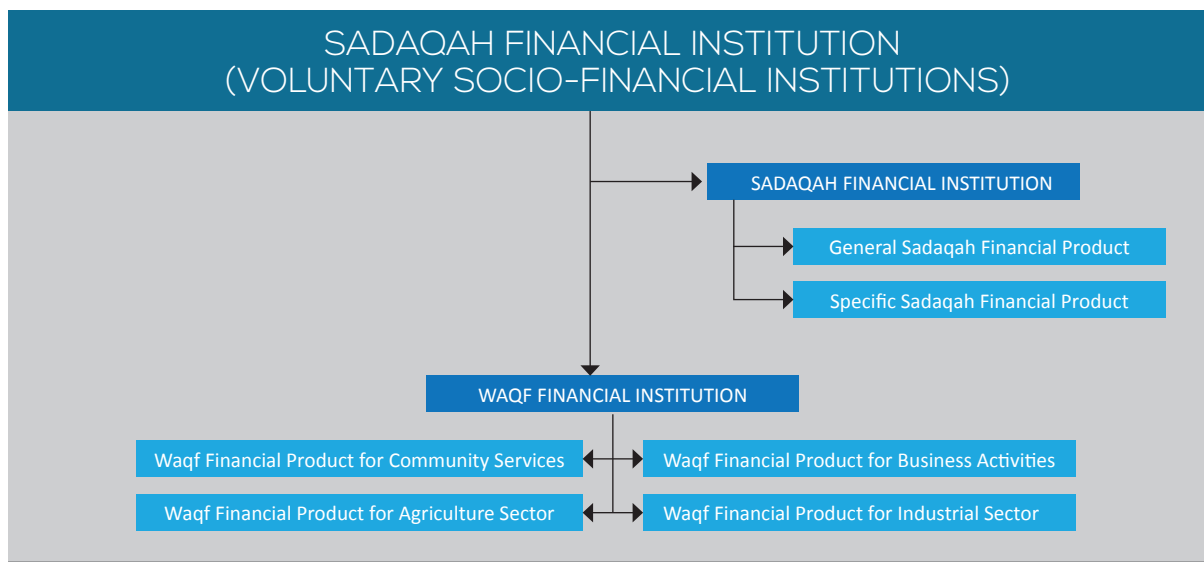


Figure (3) Sadaqah financial institutions for social activities.

is to prevent these people from borrowing with interest when they are in this crucial situation.

e) Waqf Financial Institution

Waqf is another voluntary institution which is strongly recommended in Islam as mentioned in the following Quranic verse:

"By no means shall ye attain righteousness unless ye give (freely) of that which ye love" (Surah Al-i-Imran 3:92)

This waqf financial institution finances perpetual goods and services needed in every society, besides providing continuous rewards to its

founder as mentioned by the Prophet (PBUH) in his following hadith;

The Prophet (s) said: When a man dies his acts come to an end, except three things, recurring charity, knowledge (by which people benefit), and pious offspring, who pray for him.

The beauty of this institution is that once a property is created as waqf it becomes perpetual, explicitly it must not be sold or inherited or given away as a gift. This will ensure continual supply of different goods and services within the society for many generations to come without burdening the government or resorting to borrowing with interest to provide such services. Even though there are many waqf financial products yet, in this paper the focus will be only on four financial products (Ismail, 2013)

Waqf Financial Product for Community Services

This voluntary financial product finances buildings which is most needed in each society such building schools, colleges, universities, hospitals, clinics, orphanages houses etc, hence opening jobs for the majority of people besides, providing the goods and the services needed in each society in a just manner.

Waqf Financial Product for Business Activities

Similarly, this voluntary financial product finances commercial buildings such as offices, stores, bakeries, butcheries, pharmacies, goldsmiths, restaurants, stables, tailors, shoemakers, carpenters, money changers, hotels, baths etc. Equally opening jobs for the majority of people besides providing the goods and the services needed in each society in a just manner.

Waqf Financial Product for Agriculture Sector


Again, this voluntary financial product finances the agricultural sector hence feeding the masses besides opening jobs for the majority of farmers in a just manner.

Waqf Financial Product for Industrial Sector

Likewise, this voluntary financial product finances the buildings of different factories which is needed by the different societies. Again this financial product provides jobs for the majority of people besides providing the goods and the services needed in each society in a just manner.

As presented above, Islam provides many alternative financial institutions to Riba together with their financial products. All these financial institutions are meant to finance not only the different categories of people within a society but to finance all sectors at large in just ways. Hence, we believe that if all these alternative financial institutions are practiced today, it will not only eliminate dealing with Riba from the different societies but will reduce the gap between the rich and the poor in an equitable and just way.



The beauty of this institution is that once a property is created as waqf it becomes perpetual, explicitly it must not be sold or inherited or given away as a gift. This will ensure continual supply of different goods and services within the society for many generations to come without burdening the government or resorting to borrowing with interest to provide such services. Even though there are many waqf financial products, yet in this paper the focus will be only on four financial products. 

1. Sahih Muslim, narrated by Abu Huraira, No. 1631

2. Ismail, M. (2013). Towards understanding the structure of Islamic economic system in solving the current economics and financial crisis. Journal of Business and Economics, 4 (4).