Innovative Finance for Inclusive Growth

The Millennium Development goals of reducing the number of people living below poverty lines to 15 percent or less was achieved a few years ahead of the target date. At the same time it had also become apparent that income inequalities have intensified during this period of rapid growth, the fragility of those hovering around the poverty line remains a matter of concern and the prosperity of bottom 40 percent of the income distribution has assumed a new challenge.

Consequently, the international community itself to achieving 17 Sustainable Development Goals by 2030. Financing for achieving these goals has become a critical success factor and therefore innovative means of financing have to be explored as the traditional sources such as official development assistance are coming under severe pressure. The slowdown of Chinese economy, the sharp decline in oil prices and the refugee problem facing a divided Europe do not augur well for future.

One of the rapidly growing and innovative mode of financing in the last decade has been Islamic Finance (IF). This paper explored the possible role of IF and the risks and gaps that need to be filled to realize its potential. Islamic finance is characterized by four main features

(i) All transactions are based on real assets.
(ii) There is a risk sharing rather than risk transfer
(iii) No predetermined return is assured to the depositors or investors
(iv) Unproductive and illegal activities are debarred from financing

These key tenets of Islamic Finance can help in promoting financial stability, financial inclusion, infrastructure financing and shared prosperity and can make significant contribution in the successful implementation of policies on ending poverty (SGD-01), zero hunger (SDG-02) and infrastructure development (SGD-06 to SDG-11).

The global financial crisis of 2008/09 has triggered a lot of soul searching, new thinking and revisionist analysis in search of an alternative paradigm under which the positive aspects of the international financial system can be preserved and promoted while the destabilizing and negative dimensions are averted, or at least their adverse impact is minimized. Islamic banking has shown resilience, stability and growth during and after the recent global financial crisis.

The kinds of toxic assets' that are a threat to conventional funds are not permissible for Shariah compliant funds. The purpose of Islamic Finance can minimize the severity and frequency of financial crisis by introducing greater discipline into financial system and requiring the financier to bear or share in the risk of the underlying economic activity. IF also requires the creditor to bear the risk of default by prohibiting the sale of debt, thereby creating a proper and sound diligence by those who extend credit.

Islamic banks can help in financial inclusion by providing a compliant set of financial services to include voluntarily excluded households in the financial network. Their vision and link with ethical precepts of Islam create an additional expectation for making an egalitarian society.

Islamic banks are expected to offer products and services that are likely to cater to the bottom 40 percent of people in income distribution -- a segment of the population that is underserved by the conventional banks as they are considered high risk customers. These products can enhance socio-economic mobility as the scope extends to fulfilling people's financial needs for commercial expansion as well as financial needs for necessary personal consumption smoothing and other expenditures such as Education and Health.

Risk sharing aspects of Islamic Finance also gives a clear advantage as a funding instrument for infrastructure. In the conventional mode, there is concentration of risk in the equity tranche with limited flexibility to handle unforeseen events. Sukuks spread the risk more broadly . Payments are tied to underlying returns instead of a predetermined fixed schedule. If there are delays in the construction of the project the conventional bankers would still insist on payments from the project sponsors according to the schedule. In Islamic Finance the project sponsor won't be under any pressure and would begin making payments only when the construction is completed and the project starts earning revenues. Large cost overruns, abandoning of projects mid-stream and bankruptcy of project sponsors and promoters can thus be averted in this risk-sharing arrangement. Sukuk in fact resemble Private-Public partnership i.e the investors finance the assets, own them and transfer them back to the government at maturity. Thirty two developing member countries of Asia and Pacific Region require $ 800 billion annually for infrastructure development—68 percent for new capacity and 32 percent for replacement. Sukuks can be issued to meet a substantial part of their financing requirements.

It is in this larger context that the possibility of advancing Islamic Finance as a possible alternative or supplementary means of financial intermediation and a reliable instrument of promoting inclusive growth and reducing income inequalities and financing infrastructure in Asia and the world needs to be explored. The possibility of advancing Islamic finance as a possible alternative means of financial intermediation and a reliable instrument of promoting inclusive growth and reducing income inequalities in Asia and the world needs to be explored.

Islamic financial service industry (IFSI) has been growing 50 percent faster than the traditional finance. The average annual rate of growth of Islamic financial assets has been about 20 percent. But the total volume of these assets i.e. $ 2 trillion accounts for an insignificant proportion of the global financial assets. It has a long way to go before it makes an appreciable dent.

Islamic Finance is still dominated by banking as 80 percent of total assets are held by Islamic banks (IBs); 15 percent Sukuk; 4 percent Funds and 1 percent Takaful. It is estimated that by 2020, the Islamic Financial assets would more than triple to reach $6.5 trillion – still a negligible proportion of global financial assets.

Table I

Islamic Financial Assets 2014

US$ million

	Banking assets	**Sukuk outstanding**	**Islamic Funds**	**Takaful**	**Total**
MENA (excluding GCC)	633.7	0.1	0.3	7.7	641.8
GCC	564.2	95.5	33.5	9.0	702.2
Asia	203.8	188.4	23.2	3.7	419.1
Sub- Saharan Africa	20.1	1.3	1.8	0.6	23.8
Others	54.4	9.4	17.0	0.3	81.1
	1476.2	***294.7***	***75.8***	***21.4***	***1868.1***

Strong Performance of Sukuk market in terms of spread resilience, efficient distribution and their exposure to new markets and revenue streams have made them an attractive solution for Western institutional investors. Regular sovereign issuance at difference maturities can depth to the market by increasing participation and establishing a yield curve as a benchmark for Corporate Sukuk. For the investors, diversification into multiple asset classes and different techniques to structure medium to long term instruments are the points of entry.

The categories of Islamic Finance consumers include (a) Religious conviction group (b) Ethical observant group (c) Economic rationality group – those maximizing personal financial gain. For the third category the pricing, return and service quality are important considerations.

Activity in the global Sukuk market is closely tied to sentiment on global economic and financial conditions. Lower oil prices are positive for global economy but the prospects are subdued for oil producing countries. Sukuk issuances, dominated mainly by oil exporting countries have been affected since first quarter of 2015. The average quarterly issuances of $30 billion have declined to $ 18 billion.

There are some inherent attractive characteristics in Islamic finance that promote stability: (a) the financing is backed by real assets, (b) the general absence of fix, pre-determined rate of return, with investors' return depending on the performance of the underlying asset. Furthermore, there is (c)risk sharing rather than just risk transfer and (d) prohibitions on financing socially unproductive or illegal activities or speculation. However, this does not yet provide a counterfactual to test the hypothesis of relative financial stability of the Islamic system. Unless Islamic finance emerges out of the niche market status as the dominant mode of finance in any country it is difficult to go beyond theoretical assertions claiming the relative superiority of the Islamic system. However, some preliminary empirical evidence has begun to trickle in. A recent IMF study highlights the factors related to Islamic banks' business model that helped limit the adverse impact of the global crisis on their profitability in 2008. According to the authors, Islamic banks' credit and asset growth was higher than that of conventional banks in 2008 and 2009 contributing to stability. The external rating agencies' assessment of Islamic banks' risk was also generally more favorable than that of the conventional banks.

Islamic finance is still in its early stages and the real momentum in IFSI has gathered some speed only in the last decade. The establishment of supporting institutions such as IFSB, AAOFI etc., the infrastructure such as Shariah Boards, short term liquidity arrangements, Islamic indices, rating agencies, and national regulators are still in their nascent stage. Innovation in products has been focused on making the existing products Shariah compliant rather than manufacture and distribute new products with unique characteristics of their own are excluded.

Islamic Finance should form an integral part of the Global Financial system and gradually enlarging and extending its share by proving its usefulness to the stability and inclusive growth outcomes. It cannot remain an isolated, disconnected and fragmented asset class covering a small space in the vast landscape of international finance. Unless the non-Muslim countries begin to accept and adopt it as a part of their mainstream financial systems the future of IFSI will remain bleak and highly constricted.

It is therefore a welcome development that the UK Government was a cohost of the recently concluded World Islamic Economic Forum in London. The British Government has committed to make London the global hub of Islamic Finance. UK Treasury is issuing a sukuk worth 200 million pounds becoming the first sovereign to issue an Islamic bond outside the Islamic world. As the Chancellor of Exchequer pointed out this will act as a catalyst for corporate institutions to follow suit—further expanding the use of sukuk as an asset class in the global capital markets. If the UK example proves successful there would be a multiplier effect in the international sukuk market providing depth to the market.

In Asia characterized by rapid economic growth and alleviation of poverty there is growing concern including voiced by the ADB in its analytical and country work about Income inequalities and their pernicious effect on social cohesion. Therefore, Inclusive Growth that is a strong pillar of Islamic finance presents itself as an attractive candidate to address this widespread concern. There are three different ways in which the Islamic Finance can make a contribution in resolving this issue.

The principal tenet of Islamic Finance as enjoined by Quran is justice and Equity. The rules governing property rights, contracts, distribution and transfers of wealth, use of excessive wealth by individuals beyond moderate limits, entitlements of the poor and downtrodden are all aimed at ensuring outcomes that ensure justice and equity. The challenge therefore is how to translate this built in feature of Islamic economic system into action and operations. Individual, Societal material and physical wellbeing along with spiritual wellbeing are to be maximized rather than individual self-interest that forms the sole basis of the capitalistic system and guides the financial architecture. An individual, an enterprise or a group, when it borrows from the banks is obliged to repay a fixed amount as interest at a certain given interval of time. It is immaterial whether the borrower's underlying business is making profit or loss. The risk is concentrated solely in the borrower and the fruits of adversity or good fortune are borne by the individual, firm or the group that has borrowed the money from the financial institution.

The origin of inequity can therefore be traced to this particular feature of the conventional system of finance. Under Islamic finance, the supplier of funds or the investor demands the return on investment, ex-post after the business transaction has produced the outcome. As the risk of business in Islamic finance is shared between the supplier and the user of funds the returns on investment whether positive or negative are shared equitably between the two parties in the proportion they had agreed upon. The burden of misfortune of adversity does not fall upon the borrower only and the winner i.e. the supplier of fund does not take it all while the loser i.e. the borrower of fund does not become financially insolvent.

The other distinguishing feature is that the rules governing the Islamic financial system are derived from the Quran and not made and changed by the man or assemblies of men at their discretion. One of the major difficulties in the existing conventional economic system is that the political power in most developing countries has been vested in the hands of a dictator or group of elected leaders who are more interested in their self-aggrandizement rather than the larger collective interest of the majority of the population. This inherent conflict between individual interest of these who wield power and make the rules and the collective interest of the society is a major source of economic and financial exclusion and thus inequality. In Islamic system on the other hand, the collective interest of the society is embedded in the rules in accordance with the teaching of Quran that provides the structure and operation of ideal Islamic economy and its financial system. Islamic jurisprudence is only concerned with the interpretation and not formulation of these rules and that too within the fundamentals of Quran and Sunnah. The discretionary powers of man are therefore highly circumscribed and the scope for any mischief to benefit an individual at the expense of the larger community would always remain limited.

In Islam any amount of wealth that has been accumulated by the efforts of an individual and the family but exceed its moderate needs has to be shared with others who are not able to do so for some reason or the other. It may be due to lower human ability or absence of useful skills or ill health or any other unforeseen tragic circumstances. Redistribution and social transfers in form of Zakah and Sadaqah are the rights to which the poor, unemployed less privileged and handicapped are entitled. These transfers compensate for lack of adequate income to meet their day to day expenses. Income inequality is therefore mitigated under the Islamic system through the rights of transfer from the well to do and the entitlements of the poor to live a decent life and take care of their basic needs. Distributive justice and maximization of social welfare through the institutions of transfers are the pillars of the Islamic economic system.

This is another matter that an ideal economic and financial system in accordance with the teaching of Quran has yet to take roots as the rest the world is groping to lay its hands on an equitable system of economic production and distribution, the Islamic alternative if implemented in its the letter and spirit can be of interest to non-Islamic word too.

Islamic Finance is still a small player in Global Financial System with a share of less than 2 percent. The growth has been impressive but the takeoff has been bumpy.

If Islamic Finance can demonstrate in practice that its unique and distinctive features and asset-backed transactions are able to reduce the fragility and volatility of the financial system in a convincing manner then there would be a lot of interest generated in Islamic Finance among other players in the world. To reassure the rest of the world and gain credibility in international financial markets as a serious alternative to conventional finance we have to focus on the existing risks and the gaps in the whole spectrum of Islamic finance in an objective and dispassionate manner.

There are at least twelve main risks and gaps that have to be mitigated or bridged before the robustness of Islamic Finance as a universally accepted dominant mode of financing can be proved. [1][2]

First, there are serious misconceptions, misunderstandings and misplaced notions as to what Islamic Finance is all about. There is hardly any common or shared understanding about its objectives, underlying principles, mechanics and outcomes. Some of the practitioners believe that profit maximization by Islamic Banks is antithetical to the precepts of Islam and they should engage only in Social Justice without realizing the repercussions of such an assertion. Banks can play an important role, along with the state, charity, zakat, waqf and other instruments in contributing towards this goal but to assign this sole responsibility to Islamic Banks is highly unrealistic. This view does not take into account that banks exist for financial intermediation – mobilize savings for which they remunerate the depositors by financing

[1] Husain, Ishrat (2013) " Islamic Finance for Development: Prospects for Inclusive Growth" , A paper presented at the Asian Development Bank-IFSB Conference held at Manila on Nov 4, 2103
[2] Husain, Ishrat (2013) " An agenda for Reviving Islamic Finance" , Key note address at Global Forum on Islamic Finance organized by COMSATS Institute at Islamabad on March 13, 2013

investment for which they charge the borrower. Therefore, the communication gap that exists between the various stakeholders and the public at large has to be filled in.

Second, there is a Trust gap between the borrowers, depositors, investors and managers. As Social Capital has dissipated fast in our society, the virtues espoused by our religion such as Truth, Honesty, Fair play have also become rare commodities. The transaction costs of Islamic Finance would have been much lower compared to other forms if Trust had prevailed, Islamic values were practiced in true spirit and obligations assumed by each party were carried out according to the commitments made by them. Protracted litigation, non-recovery of loans, high rates of default would have been avoided and this would give an advantage to Islamic Finance providers. Pakistan and other countries in the Middle East and North Africa Region have reported that the non-performing financing by Islamic Banks (IBs) has continued to rise while return on assets and return on equity has witnessed a decline. Risk aversion on the part of Islamic banks can also be detected as in Pakistan 71 percent of overall investment was made in Federal Government Securities. On the other hand, financing to private sector registered no growth. So the Islamic banks are behaving no differently from other conventional banks in providing negligible financing for productive activities that generate employment and economic growth. This combination of heightened risk aversion by playing safe and avoiding financing of productive activities is a manifestation of Trust Deficit. To play its assigned role in real capital formation Islamic Banks have to reverse their financing pattern and this cannot be done unless Trust Gap is filled.

Third, IBs have been too much obsessed with the tendency to replicate conventional banking. It seems to many critics, Islamic Banking is nothing more than bells and whistles wrapped around conventional banking assets and services. It is believed that making these assets Shariah Compliant through financial reengineering the job has been done. It is not realized that some of the sectors and sub sectors neglected by traditional banks such as Agriculture, Agri-Business and Produce Marketing, Small and medium enterprises, Low Cost Housing offer enormous opportunities for Islamic Banks to step in and meet this unmet demand of the economy. But in their quest to mimic the established banks no effort on Research and Development has been made in a systematic manner. The dearth of new products and services by Islamic Bank stares so starkly in our face. Unless this 'Innovation Gap' is filled and we desist from the temptation of blindly following what is happening on the other side Islamic Banking would not be able to translate its competitive advantage into real gains. Assertions about the superiority of Islamic Finance the diversification of asset portfolio away from

Murabahah and commodity financing has to take place. Musharakah, Mudarabaha and Ijarah have to be promoted more vigorously. The associated costs of monitoring such transactions and lack of transparency in markets – the risk within which Islamic banks are operating are impeding this movement. Innovative products and services meeting the requirements of the productive economic agents particularly in neglected sectors are the only tangible answer to this.

The reason for fewer new products in Islamic finance is that the current growth rates of 15-20 percent annually have lulled all of us into a false sense of complacency that the market demand is being adequately met by the current supply off-the-shelf. But if we analyze closely, most of the Islamic Financing products are based on Contracts of Exchange dominated by Murabaha which is cost plus based. The contracts of participation that form the essence of Islamic finance are only about 20 percent of all transactions. But we haven't focused on the buildup of a pipeline of new contracts of participation that are badly needed to give a distinctive flavor to Islamic Finance products. After all, starting with a low base the potential for picking low hanging fruits has not yet been exhausted. But if Islamic finance has to assert itself for presence in the international financial market space on a sustained basis then not only the wrappings and packaging but the contents have to be continuously changed to suit the demands of the buyers and meet its true competitive advantage.

The fifth and most pinching and piercing effect felt throughout the Islamic Financial Services Industry is the inadequate supply of qualified, skilled well trained and competent human resources. Either we have imported conventional bankers, who by their background and training, are unable to comprehend the differentiation between the two and therefore perpetuate the re-engineering and adaptive approach to the products. Or we are bidding up the compensation package of those who have gained some hands-on experience in the industry and luring them away from other established IF poroviders. This may be beneficial in the short term to an individual institution but it has very detrimental long term consequences for the industry as a whole. By doing so we may unwittingly out price the Islamic Banking products and services and make them non-competitive compared to the rival banks. Alternatively, we may compromise on the quality of professionals by relaxing standards of recruitment. Unless we take measures to bridge this 'Talent Gap' the Islamic Financial service industry would not be able to make the leap it is aspiring to.

Sixth, ethical values are embedded in Islamic Finance. These are not add-ons as being practiced in many parts of Europe. The Ethics based assets class has expanded globally to $8 trillion and is growing rapidly. The ethic embedded Islamic Products have transformational features that are relatively more attractive. For example, the asset based nature of Islamic Finance can reduce the volatility inherent in contemporary complex and advanced financial products. But the investors will only opt for Islamic products if they are assured that corporate governance, Risk Management, Transparency and disclosure, Internal Cost Control requirements while adapted to meet the specific needs of Islamic Banks and compliant with Shariah Principle are atleast as stringent as followed by other providers. The opportunities for unscrupulous elements to take advantage of any arbitrage should be minimized.

Seventh, the current group of Shariah scholars advising the industry is very small in size. They have the unique distinction of familiarity with English language, mastery over Islamic jurisprudence and knowledge of modern banking. But their horizon is restricted to the traditional modes of financing – musharaka, murabaha, modaraba, ijrah, salam etc. – and has not extended beyond this limited range of product offerings. In today's world where the conventional finance is coming up almost every month with new products, hedging instruments, more refined risk management techniques the response of the Islamic finance has not been equally forceful. The way forward is that the basic restrictions imposed by Islamic finance on both asset as well as liabilities should be taken as a starting point and without violating those restrictions the Shariah scholars should encourage the practitioners to experiment and innovate. The growing competition in the industry and the attraction of the big players towards Islamic finance provide some assurance that if they are given this kind of guidance the manufacturing of new Islamic products and techniques will be accelerated. In my view the large uncertainty about the Shariah compliance or the huge costs of investment in innovation without any reasonable assurance that these will bear fruits have retarded the progress.

Eighth, a related issue is the training and intake of new Shariah scholars. There are no systematic plans for the training and production of these scholars. While a lot of efforts are being made in training Islamic finance professionals for front office and back office operations an International Institute of quality should be set up to produce the Shariah scholars who are well versed in modern finance, accountancy, taxation, economics, law and Islamic jurisprudence and are of high caliber. These individuals are our best hope for a continuous supply of new Shariah compliant products. As long as this challenge is not met it is likely that the Industry would remain trapped in this low level equilibrium despite the impressive growth rates. Perhaps the emergence of London as the global hub of Islamic finance and consequent pressure on the universities, research institutes etc. in the U.K will help us move in this direction.

Ninth, another question about the Shariah Boards that stands unresolved is: What is the nature and the legal force behind Shariah boards? Are they part of the governance structure because they protect the rights of depositors/ investors and borrowers who have put their faith and trust in the financial institutions to perform activities according to their beliefs. But the issuance of transaction based fatwas by the Shariah Boards leads to lack of transparency and unpredictability. As stated earlier, Investment Account Holders (IAHs) occupy a peculiar position in the Islamic financial institution. They are neither shareholders in the traditional sense nor are they passive depositors. They are however not represented in the governance of the IFSIs and thus they do not have much of a voice in the governance of IFSI institutions. So any corporate governance structure for IFSI should incorporate these stakeholders as well define the role of the Shariah Boards. How can the regulators perform customer protection functions when the rights and obligations of this category of stakeholders remains shrouded in obscurity.

Tenth, the legal infrastructure for Islamic Finance is evolving as it is based on case laws and precedents. The Islamic principles of property rights, true sale, bankruptcy, insolvency, foreclosure, collateral security, sanctity of contracts and incentive to enforce Shariah have to be incorporated in the legal entity model for Islamic Finance. Companies Law, Banking Companies Laws and other statutes available under English legal system do not fulfill these principles. Shareholder or owner-centered governance system dominates the English Commercial Law. Inclusion of other stakeholders – the individuals, the firm, community and the state in the governance structure does not figure in it. In Islamic Finance, the rights of Investor Account holders have to be given protection and legal recognition. There is no need to undermine the rights of shareholders to maximize profits but the legal arrangements should also allow the rights of other stakeholders particularly the IAHs in legal arrangements in Civil Code jurisdictions. The incompatibility of the existing commercial laws and codes with the Islamic principles poses a fundamental conflict between what ought to be and what is in place. The regulators will be at a loss to design adequate prudential regulations for Islamic finance if the legal foundations are weak or unclear.

Shariah reports are not available to the public or they are full of inconsistencies across sectors and across jurisdictions. This situation is antithetical to one of the principles of good governance i.e. disclosure. How can this problem of inconsistency in disclosure or less than full disclosure be handled to maintain the integrity of the corporate governance structure of Islamic financial system?

Eleventh, Islamic bank is a hybrid of the commercial and investment types of bank just like conventional universal banks but there are no firewalls to separate legally, financially and operationally – their investment and commercial banking services. Co-mingling of funds leads to difficulty in identifying the sources of funds invested at the time of distribution of profits and losses. Although the regulators have succeeded in separation of funds of conventional and Islamic banking windows and subsidiary the further separation between investment and commercial banking operations requires scrutiny. This blurring of boundaries is more apparent in case of liabilities. Money deposited as amanah is repayable on demand and is backed by 100 percent reserve requirement. The money held by investment account holders (IAHs) on profit and loss sharing basis and deployed in riskier business is not guaranteed and is not strictly a liability. This is not fully recognized by ordinary Customer thereby serving as a limitation to business expansion.

Finally, the spread of Islamic financial services industry has so far been uneven across industry segments, products and geography. It is highly encouraging that the momentum has indeed been accelerated in the GCC countries in the last couple of years and that augurs well for the industry. But the concentration so far has been on Islamic banking and asset management funds. The other complementary parts of the financial services value chain such as Takaful, Capital markets, micro finance, non-bank financial institutions have not made much headway so far. Across geography Malaysia, Bahrain, Pakistan, Iran and Sudan are the early movers but the coverage ratios in the first three countries are still low although the growth rates are impressive. I expect Islamic Capital markets to grow more rapidly in future as the issues of Shariah compliant Sukuks are becoming more standardized and their transaction costs lowered with the passage of time. The Debt Capital market in Islamic Finance is making some headway but there is a need to nurture and develop Equity Capital markets as Islamic Finance is more akin to the latter form of Capital.

These are some of the gaps that are hindering the rapid spread of Islamic Finance. Unless we work together to resolve these issues we may have lot of talks, conferences and Forums but very little tangible results.

Then there is an unsettled question of uniformity of treatment across jurisdiction in terms of legislations, regulations, licensing and Shariah compliance. Shamshad Akhtar, former Governor of State Bank of Pakistan (SBP)[3] has argued that the regulators have adopted varying approaches to develop Islamic Finance system. In some jurisdictions regulators have allowed dual systems whereby it issues some additional policies and regulations for IFIs over and above the prudential regulatory framework for conventional banks. Some countries have declared the entire financial system to be Islamic and in others no distinction is made between Islamic or Conventional financial systems and the decision to establish Islamic bank is with the owners. As distinct from these, some advanced countries are introducing specific legislations and regulations to facilitate Islamic Finance transactions.

Social Finance sector

Among the ESCAP member countries, three large populous countries have combined population of _about 600 million people. Bangladesh has 81 percent of population living below the poverty line of $ 2 a day , Pakistan 61 percent and Indonesia 51 percent. The whole bouquet of Islamic Social Finance Sector consisting of Islamic Finance, Zakat, Auqaf, Microfinance, Not-for-Profit Philanthropy and Sadaqah can be used for poverty alleviation and financial inclusion. Recent studies by JPAL at MIT have concluded that holding of assets, return on these assets, conditional and unconditional cash transfers during the period that assets start producing returns, skills to earn livelihoods, access to education and health do contribute to poverty reduction.[4]These instruments can be integrated to provide livelihoods, asset creation, skill enhancement, business development, safety nets, and economic empowerment. For example, Islamic Micro finance provides the poor interest free Qarz e Hasna loans which are repaid along with some additional margin to keep the loan program sustainable. The initial funding for these loans can come from Islamic Financial institutions and the mark up and administrative expenses paid from Charity, donations from the well to do segment of the population from Sadaqah, Auqaf income and for education and health from zakat. The present indictment against the high interest rates charged on micro credit by the conventional providers

[3] Akhtar, Shamshad (2009) Governor's speeches, www.sbp.org.pk
[4] Banerjee,A.V. and Esther Duflo (2011) Poor Economics. Random House India

can thus be muted through this mechanism. The outreach to the poor can be effective by the use of this innovative mode of financing. In fragile states, these hybrid instruments can also be used for relief, rehabilitation and reconstruction. In this integrated framework the possibility of over-indebtedness is reduced significantly and the trade-off between profitability in a competitive environment and sustaining social responsibility is minimal. [5]

Islamic economic system encourages hard work and investment for earning the livelihood. For extremely poor who have no means to meet basic needs, voluntary and compulsory endowments (Zakat. Waqf, Sadqa) are available for catering to the needs of different segments of the poor population – from destitute no less poor and transfer of a portion of wealth from the well to do to the poor. These endowments and transfers not only help in poverty reduction and destitution but also lay the foundation for harmonious, socially cohesive society with stability. The Western economic system does promote competition which can bring about efficient allocation and utilization of resources and therefore creation of wealth and prosperity but it has no social safety values. The State may or may not be so responsive and pro-active under this system to adopt polices of re-distribution of income through taxation and public expenditures or a well-developed mechanism of social safety nets but in the Islamic economic system these features are in-built and are mandatory obligations of the State. Voluntary contributions by the well-to-do argument the pool of resources that is available to augment the pool of resources that is available to take care of the needs of the poor.

Lipton and Ravallion (1993) [6] argue that poverty exists when people fall short of a level of economic welfare, deemed to constitute a reasonable minimum, either by the standards of a specific society or in some absolute sense. “Reasonable minimum’ is defined by pre-determined basic consumption needs’ especially nutrition. In the Western economic system, economic welfare mainly connotes consumption of goods and services by an individual. Adverse consequences of the collective consumption of goods and services by a large group of population on the environmental sustainability and societal stability are not taken into account. UNDP has introduced concept of human poverty meaning ‘deprivation of essential capabilities such as long and healthy life, knowledge, economic resources and community participations’.

[5] Tariq Khan, Historical Role of Islamic Waqf in Poverty Reduction in Muslim Society PDR 54.4 Winter 2015, pg. 979-996

[6] Lipton, Michael and Martin Ravallion (1993)

Adequate levels of health, education, water, sanitation and social objectives are therefore the social progress objectives of human development.

In recent years, the multi-dimensionality of poverty has been recognized as the appropriate metrics to gauge progress on inclusions of people so that they can enjoy socially adequate living standards. The dimensions now cover many distinct aspects of human capabilities, economic capabilities (livelihood, income, decent work), socio-cultural (status, dignity), political (rights, empowerment, voice) and protective (vulnerability, risk, insecurity). Both Millennium Development goals and Sustainability Development goals have accepted this multidimensional nature of poverty as the basis of social and economic exclusion, unacceptable human deprivation and lack of empowerment and security.

Waqf

Al-Kasani, the Aleppan legal scholar in the 20th century defined the endowment (Waqf) as "The Waqf is a continuous charitable act for the sake of God. He is exalted".

As a part of Islamic law, Waqf is established by a legal deed that names the owner of the endowed property, the substance of the endowment and the beneficiary. Islam views charity as a means of transfer of wealth from the rich to the poor as well as a mechanism for self-development and Waqf is an instrument to achieve this objective.

Waqf and Zakat have played a highly supportive role in the reduction of poverty. Properties such as agricultural land, farms, gardens, apartment buildings, houses, hotels, warehouses, shops, mills, bakeries, looms, paper works, oil and sugar presses, stables and post houses have been converted into Waqf. Except the money needed to repair the basic corpus of the Waqf itself the proceeds of Waqf property is to be spent on the object of the Waqf such as the Socio-Economic relief to the needy segment i.e. the poor, provisioning of education, scientific, environmental and other services. Hasan (2006) [7]tracing the history of the practice of actual Auqaf has found that proceeds have been dedicated mainly to three social and human development related purposes, health and hygiene, education and urban services. In modern times, shelters, water supply and nutrition for Children have also received income from Auqaf. One of the scholars argued that in Islamic World, most hospitals were financed from the revenues of Waqf. Al-Azhar University in Cairo was founded and financed by its Waqf

[7] Hasan, Kabir (2014) Islamic Finance, Sustainable Development with financial inclusion

revenues. Waqf funded medical schools and covered expenses such as the payment of teachers and students

Zakat

Zakat is an annual religious levy that is collected from rich Muslims and its proceeds are distributed among poor people of the society. It bridges the social gap between 'haves' and 'have nots'. Zakat is levied on gold, silver, cash, bank deposits, cattle, agriculture produce, mines and treasure troves. The exemption limit is fixed in terms of gold- approximately 84 grams. The rate is 2.5 percent for gold, silver, cash and bank deposits, 5 percent on the produce of non-irrigated land. Zakat is therefore both a net worth levy and a production levy.

In a recent study[8], Azam et al (2014) in an empirical study for Pakistan establish that Zakat significantly enhances the Welfare of the households. M. Akram and Afzal (2014) in an empirical study for Pakistan argue that Zakat disbursement among the poor, needy, destitute, orphans and widows has played a significant role in poverty alleviation. Their results show that there is an inverse relationship between poverty and Zakat disbursement both in the short and in the long. An empirical study on Malaysia reveals that Zakat distribution reduced income inequality, the extent of poverty and the severity of poverty.

Some Empirical studies have also shown that finance causes growth through both capital accumulation and total factor productivity growth. There is evidence of feedback effect from finance to growth.

There are several channels through which financial development can affect economic growth. The structuralisms contended that the quantity and composition of financial variables induce economic growth by directly increasing saving in the form of financial assets, thereby encouraging capital formation. It may also help increase productivity of capital and thus help growth raising total factor productivity. The repressionists' view led by McKinnon and Shaw[9] asserted that maintaining a low or negative real interest by financial repression is not an

[8] Azam,. M. N. Iqbal and M. Tayyab (2014) Zakat and Economic Development, Evidence from Pakistan Bulletin of Business and Economics 3.2, 85-95.
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[9] Mckinnon,R (1973) Money and capital in Economic Development , Washington Brookings Institution
Shaw, E. (1973) Financial Deepening in Economic Development , New York, Oxford University Press

efficient one as it discourages savings. Financial liberalization that ensures an appropriate rate of return on real cash balances encourages savings and enhances the availability of loanable funds. This in turn help augment investment and efficiency of Capital allocation that promotes economic growth. Thus financial development may promote economic growth by enhancing Capital accumulation and by enhancing productivity that comes out of increasing efficiency or technological innovation.

Cross country study[10] by King and Levine (1993) found that higher level of financial development are positively associated with faster rate of economic growth, Capital accumulation and economic efficiency improvement. Similarly, Benhabib J. and M. Spiegel[11] (2000) found that indicators of financial development are correlated with both total factor productivity and investment.

Conventional Monetary and Financial policy approaches focused on Short term business cycles are failing to address the long term needs of inclusive and sustainable growth pursuits and foster financial and social instability. Inclusive and sustainable initiatives facilitates equitable distribution of resources and environmental protection that generate financial and social stability.

[10] King, R.G. and Levine R. (1993), Finance, Entrepreneurship and Growth: Theory and Evidence. J. Monetary Economics 32(3), 513-42
McKinnon R. 1973, Money and Capital in Economic Development, Washington, US Brookings Institution.
Shaw E. 1973 Financial Deepening in Economic Development in Economic Development, NY, USA, Oxford University Press.
[11] Benhabib, J, and M. Spiegel (2000) ,The role of Financial Development in Growth and Investment. J. Economic Growth 5(4), 341-360