

## THE ECONOMIC NECESSITY OF ISLAMIC MICROFINANCE ORGANIZATIONS IN POVERTY REDUCTION

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**ELSEVIER**



**Abstract:** Poverty is one of the problems of the global world. One of the main reasons for this is the limited access to financial services. Indeed, it is natural that the poor need not only loans, but also various banking services such as credit, savings, remittances and insurance. Since commercial banks mainly specialize in big cities, microfinance organizations come to the rescue. Microcredit organizations are also divided into two groups according to their formation and operation. These are traditional and Islamic microcredit organizations.

Microloans offered by traditional microfinance organizations contain an element of *riba*, which is prohibited by Islamic Shari'a, due to the fact that the Muslim population and entrepreneurs in the country are prevented from using them. Therefore, the establishment of Islamic microfinance organizations plays an important role in eradicating poverty, especially in many countries with Muslim populations.

**Keywords:** isogeometric analysis, Galerkin boundary element method, quadrature formulae, quasi-interpolation. Islamic Microfinance Organization, *ribo*, Islamic financial services, *zakat*, *waqf*, *murabaha*, *musharaka*, *mudaraba*

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Microfinance is emerging as a powerful financial mechanism in the fight against poverty around the world. The concept of microfinance was first implemented in 1976 by Nobel laureate Professor Muhammad Yunus. Since then, it has been adopted by many, improved, and used by organizations in various countries, mainly in the developing world, as one of the main financial tools to fight against poverty and improve the rural economy. The main reason for the emergence of microfinance was to reduce the level of poverty, to create an opportunity for the population with low income to use financial services, but it was later redirected as a mechanism aimed at making a profit and was used for various purposes [2]. Until now, it is actively used not to reduce poverty, but to make financial services available to the general public. It has been recognized internationally that Islamic microfinance is more effective in reducing poverty than traditional microfinance.

In 2020, the assets of Islamic microfinance institutions were estimated at USD 156.7 billion and this figure is projected to reach USD 304.3 billion by 2026, with an annual growth rate of 11.9% during the analysis period [3]. As a result of the introduction of this financial mechanism, it is possible to reduce poverty by

creating job vacancies and increasing the financial literacy of the population, and the use of financial services by the low-income population.

Microfinance institutions have been proposed as a way to provide financial services to low-income households that do not have access to commercial banks. Microfinance is primarily the provision of financial services in the form of savings and loans to low-income people, as well as other forms of service provision such as insurance, social mediation, financial literacy, and entrepreneurship training.[8] It is an effective tool to combat poverty, especially in developing countries.

Brandsma and Bourgeoisie (2004) describe microfinance as:[9]

1. Focusing on low-income entrepreneurs who do not have access to commercial banks;
2. Creating simple and convenient access to small, short-term and recurring loans to borrowers using informal assessment that replaces collateral and investments;
3. Provides voluntary savings services that facilitate small deposits, convenient deposit and quick liquidation.

Microfinance organizations operating on the basis of Islamic Sharia rules are called Islamic microfinance organizations. Islamic Microfinance involves providing financial services to clients using Islamic principles such as brotherhood, solidarity and partnership. In addition, business is financed on the basis of partnership between institutions and clients [6].

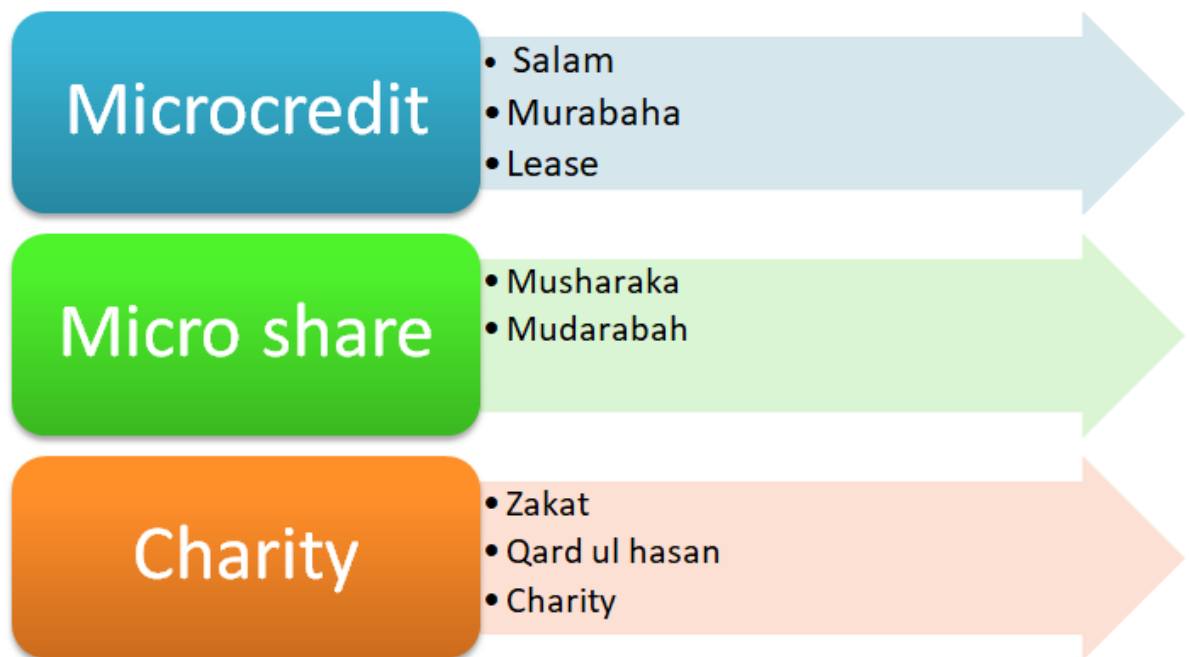


Figure 1. Structure of Islamic Microfinance.<sup>227</sup>

<sup>227</sup> Source: Compiled by the author based on research results.

Islamic microfinance organizations are divided into two groups: commercial and non-commercial. The business form includes microcredit and microshare (business based on partnership). Non-commercial forms include Waqf funds.

In addition to the above, Islamic microfinance organizations can issue microloans only in ways permitted by Sharia (halal). Prohibited activities include: raising pigs, selling tobacco, selling alcoholic beverages or their transportation, storage, human trafficking, computer games, and other similar activities that are dangerous for society.

The introduction and development of Islamic financial services remains an urgent issue for Uzbekistan, where the majority of the population is made up of Muslims [7]. The law "On non-bank credit organizations and microfinancing activities" (ORQ-765, 20.04.2022) was adopted. The signing of this law is one of the major steps taken for the development of the sector. In Article 4 of this law, Islamic financing services are defined as Islamic services. Financial services provided by the Central Bank of the Republic of Uzbekistan in accordance with the rules of international organizations that define the standards of financing are indicated[1]. It is also important to develop the forms based on it.

Islamic microfinance provides services based on Sharia rules and shares profits and losses with the entrepreneur. The question arises, why does Uzbekistan need Islamic microfinance?

Widespread introduction of Islamic microfinance organizations provides the following opportunities for the country:

1. to ensure the maximum participation of free funds available to the population and business representatives in the development of the economy; (If deposit option is given)
2. development and diversification of financial services for the low-income population in the country;
3. create many new jobs;
4. increase the activity of the population in the financial market by increasing the financial literacy of the population;
5. Coordinate and upgrade infrastructure in the country by establishing a new microfinance industry providing Islamic financial services;
6. contribute to the implementation of the state program to combat poverty;

Summarizing the data collected during the scientific research, microfinance refers to the provision of financial services to poor and disadvantaged people, whose economic status due to low income limits their access to existing financial systems. Provides micro-scale financial services for people with limited access to services such as credit, venture capital, savings, insurance, money transfers. Providing financial services to the poor can help reduce poverty by increasing household income and assets and economic security.

Islamic microfinance provides financial services based on Sharia principles. Its superiority over traditional microfinance is characterized by the prohibition of *riba* and *gharar*, as well as the inclusion of services such as *zakat* and *sadaqah*, which are given to the extremely poor population on the condition of non-repayment. The conducted studies show that Islamic microfinance is more effective in reducing poverty and increases the welfare of the society than the traditional one.

Summary. In the world, Islamic microfinance organizations have passed the stage of establishment and formation, and it has been proven that they are more effective than traditional microfinance organizations in fighting against poverty. The introduction of Islamic microfinance organizations primarily serves to combat poverty and create jobs. The establishment of an Islamic microfinance institution will be an important factor for the bright future of Uzbekistan, as well as a foundation and development prospect for the establishment of an Islamic window and Islamic banks. reaches full use in development.

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