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Clement Tisdell, Shabbir Ahmad,

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Microfinance: economics and ethics

Clement Tisdell
School of Economics, University of Queensland, St Lucia, Australia, and
Shabbir Ahmad
UQ Business School, University of Queensland, St Lucia, Australia

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Abstract

Purpose – The aim of this study is to examine arguments about the economic and ethical worth of microfinance.

Design/methodology/approach – This study draws on the available literature to provide a balanced discussion of different views about the economic and ethical desirability of microfinancing. The discussion is reinforced by the use of secondary data (statistics) on the attributes of microfinancing and by reference to a case study in rural Pakistan.

Findings – Microfinancing is less virtuous than commonly portrayed. Its economic inefficiency consequences are identified, and it is found only likely to make a small contribution to economic growth. The economic efficiency criterion for moral worth (promoted by Becker and Posner) is found to be wanting. From an ethical point of view, microfinance needs to be supplemented by charity to assist the poor. The supply of Islamic microfinance has grown rapidly, but it remains absolutely quite small. It still has some way to go to overcome the ethical and economic shortcomings associated with the supply of microfinance. Supplying microfinance to vulnerable female borrowers can put them under considerable psychological stress. Possible beneficial effects of microfinance are also identified.

Originality/value – This study is unique because it systematically draws on recent literature and data to provide a novel and balanced review of the economic and ethical worth of microfinance.

Keywords Microfinance, Economic development, Pakistan, Islamic microfinance, Poverty alleviation, Gender inequality, Financial ethics

Paper type General review

1. Introduction

The provision of microfinance for the poor (especially poor women) involved in agriculture in developing countries is widely welcomed as being virtuous and is seen by many as making a valuable contribution to economic development. However, these views have not gone unchallenged. For example, they have been challenged by Becker and Posner (2009). The main purpose of this article is to systematically assess their views. A secondary aim is to consider the role of Islamic microfinancing – its ability to overcome some of the problems raised by Becker and Posner, as well as various moral issues that are associated with some types of microfinancing.

The ethical considerations such as honesty, trust and fairness are imperative to ensure social justice and welfare of society while dealing with financial transactions. Ethics are often ignored in financial markets, which, in turn, lead to moral hazards and adverse

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selection issues (Aragon, 2014). The foundation of Islamic financing is based on ethics. It is drawn from *Sharia'h* objectives (also called *maqasad al-sharia'h*), which emphasise the prohibition of implicit or explicit interest and excessive risk-taking (see for details, Choudhury, 2016). Islamic finance denounces *ex-ante* return and encourages risk-sharing instead of risk transfer. Various modes of Islamic financing have been suggested by Sharia'h scholars, which will be discussed later (see, for instance, Siddiqi, 2006; Ayub, 2007).

Some useful statistical data on microfinancing are available in the Global Islamic Finance Report (GIFR; 2016). These statistics indicate that magnitude of microfinancing has increased considerably in recent decades. It is estimated that the amount of microfinance on loan globally in 2013 exceeded US$95 billion. This finance was supplied by 1,391 providers and lent to about 106 million people, of whom 81 per cent were women. Two-thirds of those financed were rural borrowers.

These statistics varied by major geographical regions. In South Asia, for example, 93 per cent of these loans were made to women and 77 per cent were supplied to rural borrowers. In East Asia and the Pacific, loans to females also predominated (74 per cent to women) and the majority were for rural borrowers (75 per cent). However, in Latin America and the Caribbean, while most micro-loans were made to women (65 per cent), the proportion was lower than in the abovementioned regions and most were not supplied to rural borrowers – they received only 35 per cent of these loans. Table I summarises relevant data on the nature of microfinancing in 2013 by geographical regions. Although the global statistics indicate that microfinance is mainly provided to women and to rural dwellers, this is not so in all geographical regions. More males than females obtained finance in Eastern Europe and Central Asia, and fewer rural dwellers than urban ones were financed in Latin America and the Caribbean, and in Eastern Europe and Central Asia.

The largest number of microfinance borrowers by far is located in South Asia, but the average size of these loans is much smaller than elsewhere. Suppliers of micro-loans include banks, NGOs and non-bank financial institutions. Banks have significantly increased their presence in making micro-loans in the recent years, but the average size of their micro-loans is higher than that of other providers. The total global value of the portfolio of micro-loans increased by 9.2 per cent in 2014, a decline compared to a 10.3 per cent increase in 2013. This may indicate that it is becoming more difficult to find new borrowers. Nevertheless, the global growth rate in microfinancing remains quite high.

The above information will be helpful in considering several of the issues raised in this article. Topics considered, in turn, are the economic efficiency of microfinancing, the empowerment of women in the family as a result of their receipt of microfinance, the optimality of microfinancing versus the provision of philanthropy, alternative forms of

Table I. Features of microfinance in 2013 by regions

Region	No. of borrowers (millions)	Female (%)	Rural (%)	Total portfolio ($US billions)
World	105.9	81	66	95.1
South Asia	56.7	93	77	10.7
Latin America & Caribbean	21.9	65	35	38.1
Africa	8.7	62	54	8.3
Eastern Europe & Central Asia	3.1	44	61	14.1
Middle East & North Africa	2.0	59	54	1.8

Source: Based on *Global Islamic Finance Report* 2016, Figure 1, p. 227

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finance to microfinance, Islamic microfinancing and preference for providing micro-loans to females rather than males. Several other relevant issues not mentioned by Becker and Posner are also raised, such as exploitation of the poor by local money lenders and others. The discussion is related to the results obtained from focus group discussions with women from four rural villages in the Sindh District of Pakistan (Tisdell *et al.*, 2017). These women all worked in agriculture and their households owned little or no land and few other assets.

2. The economic efficiency of microfinancing

Becker and Posner (2009) argue that microfinancing is a relatively efficient means for assisting the poor. Both he and Posner point out that the interest rates on micro-loans are high, even though they are not as high as those charged by commercial lenders. The high interest rates charged for microfinance are seen by Becker and Posner as a positive mechanism for rationing the limited amount of aggregate microfinance available to borrowers. They argue only those borrowers who feel confident that they are likely to obtain a sufficient return to cover the interest on a loan plus the repayment of principal are likely to want to borrow. In practice, however, this self-selection process is far from perfect. Sometimes, the poor borrow in desperation and become locked into a vicious cycle of indebtedness. Moreover, they are frequently ignorant about returns on their investing (GIFR, 2016, p. 231). In addition, loans may be used to fund consumption rather than income-generating activities, even though the borrower sometimes purports otherwise. The latter is a moral hazard problem.

Becker overlooks the fact that poor local households are likely to be more dependent on local money lenders and other commercial local sources of finance in the absence of microfinancing institutions. These local markets are imperfect and can result in monopolistic or oligopolistic behavior on the part of lenders and are likely to be more exploitative of borrowers than microfinance "markets" (Meyer, 2002). An increase in the number of providers of microfinance should, in principle, result in greater competition and economic efficiency in their supply, according to neoclassical economic theory, that is, reduce the monopolistic power of local money lenders. However, perfect competition is not assured by this development. Because of transaction costs, local money lenders can retain significant monopolistic power. However, they can be very flexible in enforcing loan conditions and often do not impose extra charges for late payment. Furthermore, high interest rates are still charged by many microfinance institutions and these, in some cases, have resulted in social distress and trapped borrowers into a vicious cycle of poverty owing to indebtedness, which has ultimately led to many suicides (Banerjee and Jackson, 2017; Associated Press, 2012).

Becker in Becker and Posner (2009, pp. 348-349) states:

> If private groups want to make gifts to rural women in poor countries, making them through micro-loans is a much better way than many alternatives. Loans at considerable interest rates help donors select from a large number of persons who believe they deserve help. By requiring recipients to engage in productive activities that yield enough returns to pay interest and repay principal, micro-loans in effect help those with ideas and willingness to work hard. What better way to choose among too many people who are really poor?

He points out that he believes it always to be best to reward people who are willing to help themselves. However, this overlooks the fact – as is evident from Tisdell *et al.* (2017) – that those who are the poorest:

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- often lack the means to help themselves and to engage in economic entrepreneurship;
- cannot afford to assume the risks associated with economic entrepreneurship; and
- often spend so much time in ensuring their survival that they have little or no time left for social forms of entrepreneurship, such as establishing social networks, that may bring them economic advantages. Their scope for social entrepreneurship is restricted by their economic poverty.
- In addition, they are often quite ignorant about their productive and economic opportunities.

Also, Becker's statement overlooks the fact that many micro-loans are either used overtly or surreptitiously for consumption. The question also arises of the extent to which economic efficiencies should be tempered by the needs of the very poorest households. For example, should some of the extremely poor who possess very few resources be given loans at a more favorable interest rate than the less poor, or even gifts? How can other financial instruments such as charity and ethical financing (e.g. interest-free and risk-sharing financing) improve economic efficiencies through various innovative financial products, which are equity-based, such as profit- and loss-sharing (see, for example, Kustin, 2015; Ahmed, 2014; Obaidullah, 2015; Hassan, 2014; Rahman, 2013)? This will be discussed in a section about philanthropy versus microfinancing.

Unlike NGOs, banks and many financial institutions are unable to show much compassion in making microloans because of their obligations to shareholders or owners. They are basically profit-making bodies.

3. The empowerment of women within the family as a result of their access to microfinance

Posner in Becker and Posner (2009, p. 348) states that the available evidence indicates that women who obtain microfinancing improve their status in the family and increase their bargaining power. He asserts:

> [. . .] this shows up as an increase in the education of daughters and also sons, greater spending on medications and on women's assets, like gold, in families who have women who borrow under [. . .] [microfinancing] programs.

This may be so, but it is unlikely to be the case when women take loans as fronts for husbands and other male relatives of their family, as did women from Sanwalo Khan Jamali village in the Sindh Province of Pakistan, as reported in Tisdell *et al.* (2017). On the other hand, they found that the women from Gagri village in Sindh Province took loans, which they themselves used for productive agricultural purposes. In all probability, this raised their status within their families. Nevertheless, the possibility should not be dismissed that some males in the household of women who are able to improve their economic situation may resent the growing empowerment of these women and react negatively to it. On the other hand, if micro-loans taken by women are unprofitable and result in greater financial stress in the family, this can have similar effects.

In fact, in strongly patriarchal societies, such as that of Pakistan, it has been argued (in contrast to Becker's assertions) that the availability of microfinance tends to disempower women (Zulfiqar, 2017, p. 161). Banerjee *et al.* (2015) concluded from an empirical study in India that increased access to microfinance did not improve the health and educational status of women, nor increase the availability of consumer goods to them, and failed to

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enhance their role in decision-making within the household. Possibly, however, one should not generalise from these results. The relationships involved may be situational. They are likely to depend on the nature of the patriarchy in the society concerned. If men have strong control over all the finances in the household (including loans to its female members and income earned as a result), then micro-loans are likely to do little to empower women. Nevertheless, in some cases, they do increase their self-esteem and confidence. However, this is not always the case. The situation needs closer examination at the grassroots level.

4. Economic efficiency of microfinancing versus the provision of philanthropy

Like Becker, Posner also believes that microfinancing is preferable to philanthropy, that is, it is better than the provision of gifts and grants to assist the poor (Becker and Posner, 2009, p. 350). He adopts the same type of selective efficiency argument as Becker, namely, only those with sufficient economic prospects will seek microfinance. There is evidence from a survey of rural women in Pakistan that self-selection by borrowers does occur (Tisdell *et al.*, 2017). Nevertheless, it is not a perfect process. Some who may benefit from such loans may fail, for example, to apply for them because of their lack of knowledge of the profitability of opportunities available to them. Furthermore, as pointed out above, other deficiencies in self-selection occur, for example, some loans are applied for to finance unprofitable projects, often because of the ignorance of borrowers.

It is important to note that many different forms of philanthropy or charity are widely used as microfinance tools in developing economies (such as Malaysia, Indonesia, Pakistan and Sudan) and the popularity of these financing schemes is increasing rapidly (Kustin, 2015). Whether and to what extent these emerging financing models fulfill the efficiency criteria still needs to be explored.

We should also distinguish between two types of economic efficiency, namely, the efficiency of the sorting process for those demanding loans (transaction costs), and the economic efficiency in the allocation (distribution) of the limited amount of available funds. The main focus of Becker and Posner is on the efficiency of the allocation process. From a resource allocation point of view, in a perfect market for microfinance (according to neoclassical economic theory), the rate of interest on micro-loans ought to be the same for all such loans involving the same degree of risk. At least, this is so if the Kaldor–Hicks (also known as the potential Paretian improvement) criterion is adopted. The Kaldor–Hicks criterion is that an economic activity or change is socially desirable if gainers from this activity or change could compensate any losers and remain better off than before the change. This criterion favours economic growth (Tisdell, 2009). Posner (1981) argues that its application is morally justified but his point of view is questionable (Rawls, 1971). The sorting problem is one involving transaction costs whereas the second involves the objective of obtaining the highest return on the aggregate amount of microfinance distributed.

Sorting inefficiencies that arise owing to transaction costs may (in principle) be overcome, to some extent, through the presence of moral values, as Adam Smith pointed out in *The Theory of Moral Sentiments* (Smith, 1971). Smith was of the view that abiding by the virtuous rules of "One Creator" would lead to fairness and justice. This is also a tenet of Islamic financing systems (Mirakhor and Askari, 2010). One of the distinguishing features of Islamic finance is that it emphasises compliance with contractual obligations by promoting the trust element. Trust-building not only promotes social harmony but also reduces the monitoring cost of contracts. Moreover, some Islamic financial rules provide a basis for redistributing income and wealth in a society and are important in achieving social justice. The different forms of Islamic

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financing are discussed later. However, moral values often fail to prevail in the provision of finance, both in Muslim and non-Muslim countries. In practice, microfinance markets are far from perfectly competitive. It is, therefore, unlikely that funds will be distributed so as to maximise the return on their aggregate amount. Moreover, the rate of interest on micro-loans may not be ideally adjusted to allow for variations in the risk of such loans. Ignorance about the real risk and social prejudice may influence the disbursement of such loans. Therefore, market-based systems can fail to achieve economic efficiency.

Note that the Kaldor–Hicks concept of economic efficiency does not take into account the desirability or otherwise of the income distribution effects associated with its attainment. When this factor is taken into account, there can be a case for providing micro-loans to the poorest members of a community on more favorable terms to those who are less poor, but still poor. This is particularly so when the poverty of the poor is not of their own making. This is suggested, for example, by Rawls (1971).

In any case, most NGOs providing micro-loans seem to adopt a mixed approach: some of their loans are virtually on commercial terms, some are at reduced rates of interest and some of their support is purely charitable or philanthropic. For example, this is so in the case of the Sindh Rural Support Organisation. Posner suggests that a mixed strategy of this type is adopted by the Grameen Bank. The possible reasons for this mixed strategy will be discussed in the next section.

The main message of Becker and Posner is that providing charity to the poor is likely to be at the expense of economic efficiency, in the two senses stated above. Their position is not surprising. Posner, for example, has strongly advocated the application of the Kaldor–Hicks criterion as a desirable (just) approach to economic policy (Posner, 1981, 1985). The main reason he favours it is his belief that its application will result in maximum economic growth and eventually will provide an economic benefit to all. In effect, he supports the "trickle-down" thesis, that is, the poor will eventually be lifted out of poverty by macroeconomic growth. However, this view is deceptive because there is no guarantee that losers from such an approach will be eventually compensated as a result of the stimulation of economic growth, and many of those adversely affected by an economic change may be dead before the trickle down occurs.

While Becker's view that preference should be given to the poor who are prepared to help themselves, this disregards the fact that most of those in severe poverty are unable to help themselves because of their lack of resource endowments. They are so strongly trapped in poverty, it is almost impossible for them to escape because of their economic circumstances. Most have inadequate resource endowments and entitlements as has been pointed out by Sen (1992), and this restricts their economic capabilities.

Some individuals may be poor owing to circumstances beyond their control, but others may be poor because of their own decision-making. Sometimes, the former are regarded as the "deserving poor", and the latter not so. Rawls' principle of justice (Rawls, 1971) suggests that extending assistance to the former group, for example, the handicapped, would be justified as being in their poor situation is a chance event. Similarly, it can be argued that doing likewise for those who owe their poverty to social constraints is justified. Thus, one would expect both Rawls and Sen to reject the ethical approach to economic policy adopted by Becker and Posner.

Considering the opposing views, an intermediate position is probably the most tenable. Compensating the poor entirely for their disadvantage by gift-giving may severely restrict the prospects for economic growth, but some compensation seems justified on ethical grounds. If, as a result of this compensation, the poor are able to

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significantly increase their productivity and their incomes, then the case for assisting them by means of some charity is strengthened.

5. To what extent are high interest rates and short-term loans for microfinance justified and why do they occur?

Most NGOs providing micro-loans seem to charge high interest rates on most of their loans, and these loans are usually for short periods. This may partly reflect the risk of default of repayment and the transaction costs involved in making and managing such loans. In addition, this may be done, as was discussed above, because of the type of allocation (rationing) and sorting role played by interest rates in selecting borrowers.

It should, however, be noted that NGOs that provide financial assistance engage in a broad range of policies to deliver that assistance. On one end of the spectrum are those that are purely philanthropic, and at the other end of the spectrum are those that expect to receive a positive economic return for their assistance. Many NGOs providing micro-loans have a mixed portfolio of assistance. For example, some loans are made at commercial and near-commercial interest rates, others at concessional rates and a portion of their portfolio may also consist of gifts or donations to the needy. This seems to be so of the Sindh Rural Support Organisation (Tisdell *et al.*, 2017). Some NGOs even provide microfinance completely free of charge (e.g. interest-free) or equity sharing (of profit and loss). The proportion of high-interest loans in the portfolio of NGOs varies. Becker and Posner (2009) suggest that even in the case of the Grameen Bank, it could be quite high.

What factors (other than those mentioned above) might motivate microfinancing NGOs to charge high interest rates on their loans? Their prime aim might be to survive as an organisation (remain solvent) and in many cases, to grow in size. Provided the rate of default on high interest loans is not too high, charging high interest rates would help them to achieve these objectives.

This strategy would also help them to sustain or increase the size of their pool of funds for lending to the poor. Thus, over time, this policy would contribute to sustaining or increasing their level of financial support to the poor; even though the poorest families are likely to miss out on funding because they are unable to service loans, as a result of their inability to pay high rates of interest. Nevertheless, most microfinancing NGOs are not completely self-funded – they rely for varying portions of their funds on donations and sometimes government transfers. One would expect this to be taken into account in their strategies for assisting the poor.

While some of those donors to microfinancing NGOs may feel that the ethical views expressed by Becker and Posner are desirable, others may subscribe to a more philanthropic or charitable ethics. To increase the likely level of their receipt of donations, some microfinancing NGOs include philanthropic assistance in their portfolios. In certain cases, this portion of their portfolio may be given priority in advertising to attract donations from philanthropic donors. In practice, the financing and the financial strategies of NGOs providing development assistance cover a wide spectrum.

Two other aspects of micro-loans are worth considering. These are the length of time for which they are given and the schedule of repayments. Many such loans seem to be for a period of one or two years and repayments are often required very soon after the loan is given (Tisdell *et al.*, 2017). The latter can cause cash flow problems for loan recipients because many investments take some time before they yield a significant return. Consequently, investments that yield a quick return tend to be favoured and/or loans to borrowers who are able to cover initial cash flow shortages by drawing on other sources, for

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example, by selling some other assets. The repayment conditions for many micro-loans can be expected to deter individuals from the poorest households from seeking such loans.

Because interest rates on many micro-loans are high, 30-40 per cent, per annum, is typically charged by microcredit institutions. According to the Global Islamic Finance Report 2016, returns on any investment of these funds must be higher than this to provide a positive yield. Such returns are frequently hard to achieve, and consequently taking such loans can add to the financial difficulties and the poverty of poor borrowers. The risks of this happening are particularly large when borrowers lack the ability to forecast the return on their investment. When financial difficulties of this nature arise, some micro-borrowers seek continuing loans and their cycle of indebtedness continues.

There is also the additional complication that some micro-loans are taken for the purchase of consumption goods and yield no return. This can make it extremely difficult to repay micro-loans supplied to poor borrowers. Moral hazard exists. Lenders may obtain a loan on the understanding that they will use it for an investment project but instead use it for consumption purposes.

Furthermore, principal-and-agent problems can arise. Agents of bodies making micro-loans may out of self-interest entice potential borrowers to take loans even though they know that borrowers can be expected to face financial difficulties as a result. This raises the question of the moral responsibility of the agent. There is also the additional problem that the agent may have little idea of the expected return on the investment to be financed and consequently can finance unprofitable projects.

6. Alternative forms of financing to institutional microfinancing

Becker and Posner (2009) briefly consider alternative sources of financing to microfinancing as means for poverty alleviation. Posner discusses:

- commercial lending;
- family or clan loans; and
- equity financing.

He claims that the ability of and the willingness of commercial institutions, such as commercial banks, to engage in microfinancing, is very limited – virtually non-existent. This is because of the high transaction costs involved in the making of such loans. These costs arise partly from the formality of their procedures. Prudential requirements and obligations to their shareholders also limit the willingness of these institutions to provide micro-loans. Thus, they do not service the same "markets" as microfinancing NGOs. Nevertheless, there can be some overlap in competition between banks, NGOs and other institutions for the supply of micro-loans to borrowers.

The second possible source of micro-loans for the poor mentioned by Becker and Posner (2009) are family or clan loans. These involve little transaction costs. The extent to which such loans are likely to be substitutes for microfinancing by NGOs is probably quite limited because many poor families and clans have no surplus funds. Nevertheless, they can be important in some societies. There is evidence of this among the Kirghiz minority located in Western Xinjiang, China (Hong *et al.*, 2017). Furthermore, in some societies, family or clan loans may be less available to women because of local social customs. These types of loans are unable to completely substitute for the missing "market" niche filled by the microfinancing of NGOs. This is so even though microfinance markets themselves are not perfect (Honohan, 2008). Despite this, the growth in charity-based microfinancing has been

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tremendous in recent years and continues to increase in many Muslim dominated countries in Asia, the Middle East and Africa.

Posner expresses a preference for equity financing or joint venture financing but considers that this is likely to be uneconomic for micro-loans intended to assist the poor. This is so because the transaction costs experienced by the provider are likely to be high. Also, the client may have an incentive to "hide" the real return on the investment from the financier. However, some microfinancing NGOs may include some equity financing in their assistance portfolios. See, for example, the importance of *musharaka* and *mudaraba* financing shown in Table II in the next section.

While Posner's classification of possible sources for microfinancing is a useful introduction to the subject, it does not provide in-depth analysis. For example, only limited attention is given to the evolution of hybrid microfinancing institutions. In Pakistan, for example, some microfinancing NGOs have spun-off microfinance banks (such as Tameer Bank) as separate entities (Zulfiqar, 2017). These banks specialise in small loans, attach conditions to loans that reduce the bank's risk of loss if there is default, and these banks are, in general, profit-oriented. Posner might no doubt welcome such a development on economic efficiency grounds.

Whether this development reduces the amount of micro-funds available to women is unclear. Zulfiqar (2017) argues that it does. The extent to which a gender substitution effect occurs, or does not, needs more investigation.

The general picture emerges that loans made by microfinancing NGOs and other bodies provide a supply of funding to the poor, which, otherwise, would be missing owing to market and social failures. This extra supply can (but need not) be economically beneficial.

7. Islamic microfinance: a significant addition to microfinancing

The foundations of Islamic finance are based on *Sharia'h* objectives (*maqasid*), and ethics are embedded in its core principles. The main objective of Islamic finance is not only to avoid "*riba*" (interest) and "*gharar*" (uncertainty and risk) elements, but also to achieve social justice and welfare- also called *maqasid al-Sharia'h* (Ayub, 2007; Siddiqi, 2006; Iqbal and Mirakhor, 2017). The prohibition of "*riba*" is manifested to avoid social exploitation and preserving the property rights, whereas the prohibition of "*gharar*" is aimed at avoiding risk and uncertainty that could exploit the parties involved in the sale/purchase transactions or contracts. Both features of Islamic finance adhere to justice and fairness and encourage the risk bearing by all parties involved in transactions rather transferring it on one party (i.e. the borrower; see for details, Choudhury, 2016; Chapra, 2000; Iqbal and Mirakhor, 2013).

Type[a]	Amount of portfolio US$ millions	(%)
Murabaha	413	66.29
Qard hassan	156	25.04
Musharaka and Mudarabah	40	6.42
Salam	2	0.32
Other	12	1.93
TOTAL	623	100.00[b]

Notes: [a]Only includes finance requiring at least repayment of the capital or similar. Excludes purely philanthropic financing; [b]May not exactly add to 100 because of rounding
Source: *Based on Figure 6 in Global Islamic Finance Report* 2016

Table II. Estimates of Islamic microfinancing by type in 2016: value and percentages of the total

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The foundations of Islamic financing are built upon the theory of oneness of God (*Tawhid*), which emphasises unified social actions to safeguard justice and fairness. Given the complex nature of financing products and its mechanism, the embeddedness of ethical considerations (e.g. morality) is imperative to ensure justice, fairness and trust in financial transactions, which is at the core of Islamic financing (Choudhury, 2016; Iqbal and Mirakhor, 2017).

While conventional microfinancing mainly relies on debt-based transactions, Islamic microfinancing rests on asset-based financial transactions. Other instruments of Islamic microfinancing (such as *qard hassan, waqf* and *Zakat*) support the financial inclusion. According to Islamic codes of business (i.e. *Sharia'h*-compliant), returns on financial capital are prohibited because Islam only allows transactions that are based on tangible assets (goods or objects). Any transaction on financial capital bearing the element of interest (*riba*) [1]is not permissible in Islam. In addition, Islam does not sanction any financial transactions that involve financial speculation and uncertainty to ensure that all activities (transactions) are socially productive and that they do not result in the exploitation of, or harm to, parties involved in those financial transactions (Khan and Phillips, 2010). Another feature of Islamic finance is that it emphasises risk-sharing between financial institutions and their clients. It is desirable that all transactions in Islamic financing should be either asset- or equity-based. However, practices and principles can easily diverge.

Different forms of Islamic commercial microfinancing exist, as well as additional forms of providing charitable finance. A comprehensive list would include *murabaha* (cost-plus sale)[2], *mudaraba* (trustee-partnership)[3], *musharaka* (joint-venture)[4], *qard hassan* (benevolent or interest-free loan)[5], *bai-salam* (advance payment)[6], *bai-muajjal* (deferred payment)[7], *Istisna* (sale contract of manufacturing related materials)[8] and *ijara* (leasing) [9]. Other charity- and endowment-based (i.e. philanthropy) financing schemes are also in place in many Muslim countries, which include *sadaqa* (charity)[10], *zakat* (mandatory deductions from income)[11] and *waqf* (Islamic endowment)[12]. For instance, the provision of financial services through charity funds (e.g. zakat and waqf) is being practiced in some countries as a mean of poverty alleviation (Obaidullah and Manap, 2017; Hashim, 2007). Similarly, some other contract-based financial products are being used in agricultural financing to combat food insecurity and poverty issues. A detailed discussion about the various Islamic modes of finance can be found in Obaidullah (2015), (Ahmed, 2002), Kustin (2015), Siddiqi (2006) and Ayub (2007).

Islamic microfinance is expanding rapidly by introducing innovative financial products to foster poverty alleviation. The social justice system of Islam offers various partnership-based and other financial products (including profit- and loss-sharing and donor-driven strategies) to help eradicate poverty. Equity-based financing contracts are considered important instruments in Islamic finance (Shaikh, 2017; Iqbal and Mirakhor, 2017). Nevertheless, only a minority of Islamic micro-loans are made on this basis according to the Global Islamic Finance Report (2016, p. 240).

Although microfinancing initiatives in Islamic banking date back to the 1970s, the potential of Islamic microfinancing has been overlooked until recently. Despite the fact that there has been significant growth in microfinance products during the last two decades, the amount of Islamic microfinancing is still quite small compared to the global total. A survey by the Consultative Group to Assist the Poor (CGAP) indicated that in 2013, this form of financing amounted to US$623 million (see Table II), whereas the total global portfolio for microfinancing for 2013 was valued at US$95.1 billion (see Table I). However, as pointed out in GIFR (2016), the CGAP estimate is subject to significant uncertainty. Therefore, it should be treated purely as indicative.

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Table II provides an indication of the relative importance of different forms of Islamic microfinancing. In 2013, most Islamic micro-loans were based on *murabaha* contracts. It was estimated by CGAP that 672,000 clients relied on murabaha contracts and that the total amount of *murabaha* loans was US$413 million, about one-third of the value of types of microfinance listed in Table I. *Murabaha* loans are based on the repayment of a fixed sum comprising the principal of the loan, plus the cost of servicing the loan and an addition for profit. It is a relatively transparent form of contract, but it does not ensure the absence of "excessive" charges. The second most important mode of microfinancing involved *qard hassan* arrangements.

Qard hassan is a type of benevolent loan for which the borrower is only obliged to repay the principal plus the administrative costs associated with the loan. Funds for such loans are, to a considerable extent, obtained from charitable donations. As a rule, such loans are only made to the needy. The sum involved amounted to about a quarter of the value of the portfolio listed in Table II and assisted 192,000 clients, according to CGAP estimates. The terms and conditions of *murabaha* loans are largely market-determined, whereas qard hassan loans are based on compassion and contain a charitable element. Despite the phenomenal growth in Islamic microfinance in recent years, Islamic microfinance industry still accounts for just 1 per cent of the total Islamic financial industry (Islamic Financial Services Board, 2016, p. 23).

Both *musharakah* and *mudaraba* are forms of equity-based financing, and as such would presumably have the approval of Becker and Posner, as discussed above. Under *mudaraba* contracts, the lender is expected to share profits with the borrower in a predetermined ratio. Financial losses are entirely borne by the lender. This is a type of joint venture arrangement and is susceptible to moral hazard (Siddiqi, 2006). *Musharaka* arrangements are less subject to moral hazard and differ from *mudaraba* because both the capital provider and the service provider (e.g. farmer) share financial losses. Because of the risks involved and the need for the lender to vigilantly monitor use of the finance, these types of arrangements are a less common form of Islamic microfinancing than *murabaha* and *qard hassan*.

Salam is a specialised form of financing restricted to agriculture. Lenders offer farmers a cash advance in return for the purchase of the output of their crop at a predetermined purchase price. It accounts for a relatively small amount of Islamic microfinancing (see Table II). Questions can arise about how fair the predetermined purchase price is.

Though there has been a significant growth in Islamic financing, little of it has been focused on Islamic microfinancing; following the principles of Islamic finance is imperative to achieve one of the Islamic objectives of poverty alleviation. The foremost motive of Islamic banking theory is the provision of alternative modes of financing (e.g. profit-sharing), which should not only be interest free but also take into consideration ethics in financial contracts. However, the existing modes of Islamic financing (e.g. *Mudarabah*) are not much different from conventional financing, inherent problems of adverse selection and incentives mechanism (i.e. principal–agent problem), which need to be addressed (Siddiqi, 2006). In addition, most of the existing Islamic financing practices have been around credit-based instruments (e.g. *Murabha*), and little has been focused on the consideration of *Sharia'h* objective. Empirical evidence shows that currently Islamic financing modes are not functioning based risk-sharing (e.g. *Mudaraba*), rather price benchmarking of Islamic modes of finance is pegged with the conventional financing modes (Beck *et al.*, 2013; Chong and Liu, 2009; Khan, 2010; Trad *et al.*, 2017). Drastic regulatory reforms to build the institutional framework are needed

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to implement true Islamic financial system that adheres to ethical financing based on *Sharia'h* principles.

8. Preference for female rather than male borrowers in microfinancing

Posner in Becker and Posner (2009) points out that the majority of micro-loans are made to women rather than men. Reasons for this could include the following:

- females are more disadvantaged in obtaining loans than males;
- they are able to implement projects that will give a higher return than those of males, as claimed by Naudé (2011);
- they are likely to be more diligent in their repayments than are males, according to Becker and Posner (2009); and
- the "bias" in favor of females may be appealing to some of those donating to microfinancing NGOs.

Overall, in the absence of NGO microfinancing, the lack of availability of funds for female-initiated projects is likely greater than that for males. In other words, "market" failure is more prominent in relation to the demand of women for finance compared to that of men. Nevertheless, some poverty-stricken males may experience similar problems to females in obtaining finance. Becker and Posner (2009) suggest that the financial needs of impoverished males should be given greater consideration in microfinancing.

In Pakistan, while females account for the largest proportion of borrowers from NGO micro-financiers, males predominate in the case of loans from microfinance banks (Zulfiqar, 2017). Zulfiqar is concerned that the development of microfinancing banks in Pakistan might reduce the availability of micro-loans to women because microfinancing banks primarily have commercial goals. This substitution does not appear to have happened yet and may not occur. However, micro-loan banks will be more focused on profits in making micro-loans than NGOs and, therefore, less likely to take into account the impact of such loans on reducing poverty and are likely to have a higher proportion of the non-poor among their customers than NGO micro-financiers. While the development of micro-financing banks seems to favor males, this possibly does little to supply finance to the poorest males.

9. To what extent can social networking contribute to the efficient provision and allocation of microfinance?

Tisdell *et al.* (2017) have observed that a group of poor rural women in Pakistan who have been engaged in a significant amount of social networking (and were politically active) secured more micro-loans and other means of support for agricultural development than groups of women who were uninvolved or relatively inactive in this regard. It could be said that this poorer group amassed more social capital than the rest. That raises the question of whether it is economically desirable for other female groups which engage in little or no accumulation of this type of social capital to do so.

Apart from the fact that many of those who fail to engage in social networking to obtain development assistance do so because this is uneconomic for them (Tisdell *et al.*, 2017), the larger the number engaged in social networking for the purpose of obtaining limited available microfinance, the higher will be the economic transaction costs incurred by potential borrowers. This is because establishing and maintaining social networks incurs a cost, for example, the opportunity cost of time expended on this activity. If the pool of funds available for micro-loans is limited, increased network competition can add to the overall costs experienced by potential borrowers in trying to obtain loans.

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However, it might be argued that this increased networking would provide extra information to financiers, reduce their transaction costs and consequently improve their allocation of micro-loans. This may, nevertheless, not happen. Those demanding micro-loans are likely to vary in the persuasiveness, and therefore, lenders would still have to sort out demands. Furthermore, the social connections of potential borrowers may bias the allocation of loans.

In assessing the value of social networks, it is necessary to keep in mind the fallacy of composition. Just because it is found in a sample that superior social networking has enabled some groups to obtain more microfinancing and economic development benefits than others, it does not follow that increased social networking by all will enable all to obtain an increased amount of microfinance or greater economic support for development. This appears to be frequently overlooked in studies of the value of social networking.

10. What are the prospects of poor agricultural families escaping from poverty as a result of microfinancing?

The capacity of microfinancing to relieve poverty needs to be assessed in an economy-wide context. Although it can provide some relief from poverty, it is probably not a long-term solution to poverty reduction in situations where households own small amounts of land. Given the existence of positive economies of scale as a function of farm size in modern agriculture, those owning small amounts of land cannot take advantage of these economies. If they depend mainly on market sales to earn their income, they may find that in the long-term, their market supplies become increasingly uncompetitive with supplies from larger farms, thereby reducing their levels of income. In such circumstances, they can be expected to seek alternative employment, most likely off-farm. However, in developing countries, such as Pakistan, the opportunities for this are liable to very limited, unless the whole economy exhibits significant economic growth, as has happened in China. How the poor will cope with this situation is unclear. They may, for instance, revert to greater reliance on subsistence (non-market) strategies to survive. This possibility requires empirical investigation.

It is observed in some countries, for example, Pakistan, that land inheritance procedures are leading to increasing subdivision of land owned by families. This has reduced their livelihood opportunities and has made it more difficult for agricultural landholders to escape poverty.

11. Further discussion

The purpose of this further discussion of microfinance is to add additional emphasis to the connection between neoclassical economics and the ethical assessment of microfinance by mainstream economists and to highlight some additional shortcomings in the contemporary literature evaluating the supply and use of microfinance. The latter includes the lack of attention to the role of microfinance in cooperative contexts, especially the failure of this literature to pay adequate attention to the family as a cooperative economic partnership. Apart from discussing the family (in this section) as a cooperative unit, other forms of joint venturing and cooperative partnerships are also given more attention, and the ethical obligations of lenders in making loans are considered.

11.1 Mainstream economic assessment of microfinance is dominated by the neoclassical economic paradigm

The mainstream ethical evaluation of the provision of microfinance has been dominated by reliance on the neoclassical economic paradigm, as has been illustrated above by the

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discussion of the views of Becker and Posner (2009). Their assessment of microfinance is based on the theoretical view that a perfectly competitive market system is ideal because it minimises scarcity according to the criterion of Pareto. That is, under ideal conditions, it results in it being impossible to make any individual better off without making another worse off. However, we know that the assumed ideal conditions do not hold in practice. Furthermore, even if they could be achieved, the technological conditions required for the sustainable operation of a competitive economic system (such as the elimination of significant economies of scale in production) would not result in a Paretian optimal outcome (Young, 1928). Consequently, the neoclassical paradigm involves "internal" contradictions and does not pay enough attention to market failures, which cannot be eliminated or which cannot be eliminated economically. Nevertheless, supporters of the paradigm argue that it is (or is able to be) sufficiently approximated in reality to be a good guide to policy.

The neoclassical preconception can result in distorted assessments of the market supply of finance. Among other things, it results in insufficient attention to the influences on financial markets of risk and uncertainty, especially the role of entrepreneurship in this context and the ability of entrepreneurship to reduce economic scarcity. Frank Knight (1921) was the first economist to emphasise this point and to stress the limitations of the neoclassical economic model in this entrepreneurial regard. The systematic analysis of the role of finance (including microfinance) in the economic system requires entrepreneurship to be taken into account in the system. Nevertheless, not all finance (supplied for productive economic activity) is intended to support entrepreneurship and innovatory decisions; a wider spectrum exists. The economic assessment of the supply of finance needs to take account of the whole of this spectrum.

It is also relevant to note that Choudhury (2016, pp. 23-24) rejects mainstream and neoclassical economic postulates on a different basis to the above-mentioned ones. He concludes that they are inconsistent with the application of *Tawhidi* Islamic methodology because their development is not based on the unity of knowledge (Hossain and Choudhury, 2016).

The neoclassical vision of the ideal economic system was bolstered by the adoption of the Paretian potential improvement criterion, also known as the Kaldor–Hicks criterion, that is, an economic change is desirable if the gainers could compensate the losers and be better off than before the change. Most adherents to this view, including Posner (1981), argue that such a change is desirable even if compensation is not paid.

Posner's adoption of this view explains his attitude towards microfinancing as has been pointed out above (Tisdell, 2009, Ch. 4; Tisdell, 2011). In this type of approach to economic justice, the question of the ideal distribution of income or wealth is side-stepped. This is most evident if only the Paretian criterion is adopted because improvements in social welfare are solely considered in relation to the existing distribution of wealth and income. This approach (a hallmark of the so-called New Welfare Economists) tends to preserve the existing social status quo without questioning its desirability. Adoption of the Kaldor–Hicks criterion can alter the distribution of income and, from an ethical point of view, its application requires a judgement about the desirability of the change in distribution of income or wealth generated by it. However, many economists, including Becker and Posner, avoid this judgement and this colours their evaluation of microfinance. Incidentally, this is also the approach adopted in most social cost–benefit analysis.

Posner (1981) argues that in the long-run, all will benefit by the application of the Kaldor–Hicks principle. If some individuals lose from some projects, they will gain from others, and so on balance, all will gain. Furthermore, application of this principle is believed by its adherents to promote economic growth and result in all gaining as a result of a "trickle

down" effect. However, it should not be supposed that these claimed favourable effects will follow. At least, the extent to which they occur needs to be supported by evidence. The view of Becker and Posner (2009) that the provision of microfinance is unlikely to promote economic growth and is not very desirable from this point of view is understandable given the above perspective.

A major problem for the applicability of the neoclassical economic model is its relative lack of attention to risk and uncertainty. The application of the Kaldor–Hicks criterion also suffers from this problem. In many cases, it is uncertain (or there is only some probability) that gainers can compensate losers from an economic change and remain better-off than before this change. The type of issues involved have been discussed by Tisdell (1983, 1993, Ch. 5). Neoclassical economics is silent about desirable choices in these circumstances. This is relevant because it impinges on decisions about the social desirability of financing projects that create significant environmental and other hazards for other than the borrowers. This problem, however, is less likely to occur with microfinancing than with the financing of major new projects, especially new projects for which the consequences of adverse spill-overs are poorly known.

11.2 Insufficient attention to the family as a co-operative unit in the literature on microfinance

One of the central pillars of Islam is its support of actions that increase the welfare of families (Choudhury, 2016, p. 72). Much of the contemporary feminist economic literature, particularly that discussing microfinancing, does not give sufficient attention to the family as a cooperative partnership. Gender confrontation or conflict seems to dominate the debate, at least implicitly. As with most social units, decision-making within families (for example, between husbands and wives) involves varying degrees of mutualism and conflict. It can be argued that ethically, it makes little difference whether a micro-loan is given to a wife or to a husband provided it promotes the common good of the family. If, however, the supply of finance to one family partner rather than another is more beneficial to the family, giving it to the former partner would be preferable, even if in both instances the family would benefit from the loan. Choudhury and Abbas (2017, p. 429) have argued that a test of desirable agricultural development ought to be whether it promotes the common good. While determining what is the common good is difficult (and opinions differ about its determination), this test provides an important focus for assessing microfinance for agriculture, and certainly the common good of the family should be considered in relation to the provision of finance for it.

There is a further ethical issue: if a loan is taken by one family member (for example, a wife) and used by another (for instance, by her husband), this is ethically defensible if it promotes the common good of the family most advantageously. Nevertheless, to promote social harmony in a family, there ought to be consultation by the person or persons seeking the loan with all other members of the family who are likely to be affected by it, especially if the loan could become a financial burden on them all. To what extent do inequalities exist in doing this type of consultation? This could be investigated further. What economic or other effects does the lack of such consultation have?

11.3 Further consideration of finance for cooperative ventures

Discussions of Islamic finance pay a considerable amount of attention to the supply of finance as an element of joint business ventures and to the ethical dimensions involved, and recognises several different types of arrangements and their possible ethical consequences

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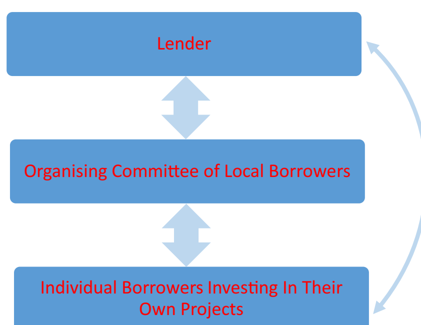
(see Section 7 of this article). A very useful overview of the available types of Islamic finance and of their ethics is also provided by Siddiqi (2006).

A feature of some micro-loans is that they are made to a group of individuals and the group as a whole is responsible for their repayment. The group may, for example, consist of women who cooperate to obtain the loan that is distributed between members of the group to finance their individual projects. Usually, a small committee from among the recipients supervises the repayments and is primarily responsible to see that repayments are met in a timely manner. The type of structure shown in Figure 1 seems to be common in this case.

The type of cooperative loan arrangements illustrated in Figure 1 reduces the level of transaction costs that the lender would have in dealing only with individual borrowers and lowers the level of moral hazard that the lender could experience, for example, delinquency in repaying loans. On the other hand, it increases the burden and workload of local committee members in ensuring compliance with loan conditions and can create social disharmony, for instance, as a result of social pressure being placed by local committee members on individual borrowers to satisfy the conditions of their loans. These consequences can be a deterrent to involvement in such financial arrangements. Furthermore, these arrangements may result in unwelcome intrusion into the financial affairs of some borrowers by other borrowers.

Focus discussions with a group of women from a village (Gagri) in South Pakistan revealed that some of them had been instigators in securing the type of cooperative fund arrangement illustrated in Figure 1 and had been members of its organising committee (Tisdell *et al.*, 2017). However, they said that they did not want to enter into such arrangements again because of the extra burden it imposed on them. However, it is also pertinent to note that subsequently, they were able to obtain micro-finance without entering into such arrangements. Possibly, their earlier experiences (obtained as a result of the type of cooperative microfinancing illustrated on Figure 1) reduced their barriers of entry to the micro-finance market, for example, helped to establish their credit worthiness and made them more aware of their opportunities for obtaining micro-loans.



Notes: Borrowers cooperate to obtain funds, which are then allocated to individual borrowers for their own projects via their organising committee, which assumes prime responsibility for loan repayments

Figure 1.
An illustration of lines of responsibility in some cooperative micro-loan arrangements

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The ethical consequences of these types of loan arrangements are mixed. They can add to the psychological stress experienced by borrowers but can also provide them with economic benefits, which otherwise would be unavailable to them. However, there is the risk of economic losses owing to environmental hazards (especially in agriculture), also as a consequence of unexpected changes in market conditions, and as a result of limited knowledge of borrowers about how to use their loans to obtain a satisfactory level of economic returns. Incidentally, the taking of loans by semi-subsistence agriculturalists forces them to become more dependent on the market economy for their livelihood because repayment of loans must be in cash or in the form of money that is the accepted currency. This can expose borrowers to extra economic risks.

11.4 The moral obligation on lenders to exercise due diligence and care in providing loans
In some circumstances, lenders or their agents can fail to exercise due diligence and care in providing loans to borrowers. This is most likely to occur when the agents of lenders earn a commission or other economic benefits that increase with the amount of loans they manage to secure, and/or they are not audited for the consequences of these loans. The question, however, remains open morally of the relative extent to which borrowers as well as lenders should exercise due diligence. This is a matter requiring more attention. It might, however, be noted in that regard that the balance of responsibility legally has tended to alter with economic development. With economic development, increased legal responsibility has been placed on suppliers of goods and services relative to the responsibilities of those purchasing commodities (Tisdell, 1983, 1993, Ch. 5). There is some indication that this process is also occurring in relation to financial services, at least in Australia, where some legislation has been passed to punish financial bodies that take advantage of unwary borrowers or those lenders who do not take adequate care in providing financial advice to clients. Pakistan has also passed legislation to help safeguard borrowers seeking micro-loans (State Bank of Pakistan, 2014a, 2014b). Note, that it is immoral, according to the precepts of Islam for lenders to take advantage of the ignorance of borrowers (Siddiqi, 2006; Iqbal and Mirakhor, 2017); and in general, it is regarded as abhorrent in most societies to do so.

12. Concluding remarks

The availability of microfinance enables some of the "deserving" poor to alleviate their poverty, but it seems to do little to reduce the poverty of the very poorest agriculturalists because of their lack of assets, such as having very little land to complement their investment, and because of their inability to service such loans and/or to bear the high degree of risk they experience by taking such loans (see, for example, Tisdell *et al.*, 2017). In the absence of the greater availability of economy-wide employment opportunities, this group can probably only be helped by charity.

Despite significant efforts to introduce true Islamic financing products, aiming at the embeddedness of ethical considerations to avoid any exploitation that could occur owing to risk transfer (*riba*) or excessive risk taking (*gharar*), many Sharia'h scholars argue that these financial instruments are exploitative and do not achieve the Islamic objectives.

Even though existing systems of microfinancing are not perfect from some economic and social points of view, microfinancing does help to fill gaps in the financial system, which otherwise would be vacant. Overall it, therefore, may confer a net economic benefit by reducing the presence of missing financial "markets". The availability of Islamic microfinancing also helps to fill a gap in the financial demands of some Muslims. The faithful are likely to be more agreeable to such loans rather than their alternatives and more likely to accept them.

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Despite the inability of microfinancing to provide a long-term solution to reducing poverty among poor agriculturalists in developing countries, it is able to assist some, and for those, it may buy time until the economy grows and creates new opportunities for their employment. This is not to say that all countries will be able to achieve sufficient economic growth to alleviate the existence of poverty. Some, for example, are being held back in this regard by a lack of law and order, as well as by the presence of terrorism and by their social customs. Becker and Posner (2009) are correct in arguing that the ability of microfinancing to stimulate economic growth is quite limited. Furthermore, its scope for reducing poverty is restricted. Nevertheless, this does not mean that it is not beneficial nor does it mean that it cannot make a modest contribution to economic growth.

Although most writers have presented a positive picture of the availability of microfinance, it is not without moral risks, as has been pointed out in this article. There are a couple of additional moral considerations that are worthy of attention. Agents for lending bodies may be anxious to make some loans to potential borrowers even though they know that the borrowers will be worse off as a result of a loan. Alternatively, some lenders may fail to exercise due diligence in advising customers about taking a loan. This raises the general question of what ought to be the relative responsibility of lenders and borrowers in assessing the value of loans and the ability of borrowers to repay them.

Another issue (not mentioned above) is that some NGOs that have microfinancing as their major mission may use an excessive amount of donated funds for satisfying the demands of their staff or may be inefficient in their administration. The former is definitely a moral transgression, and the second aspect could also be one because of lack of care shown in using donated funds.

It is also worthwhile noting that most of the literature on microfinancing pays no attention to microfinancing in more developed counties. However, it does exist and is often accessed by the poorest members of the community, but its use in agriculture is probably quite limited given the size of most agricultural enterprises these days.

Notes

1. *Riba* is an Arabic term implying that usury occurs or excess interest is charged. It is considered immoral in Islam.
2. *Murabaha* is sale kind of deferred payment, whereby a bank adds its fee/profit to the purchase price of a good or asset. This mode of finance is prevalent in the existing Islamic financial transactions.
3. *Mudaraba* is based on equity investment between the financier (mudarib) and the entrepreneur (e.g. farmer), and both parties share the profits according to an agreed ratio.
4. *Musharaka* is an equity-based investment (similar to mudaraba) but differs in responsibilities of shareholders as well as sharing profit and loss on initial capital.
5. *Qard hassan* is an interest-free loan. It is meant for charitable purposes to improve the welfare of poor and deprived persons. This is considered one of the most morally acceptable forms of loan in the Qur'an (57:11). For further details, see Obaidullah (2015) and Kustin (2015).
6. *Bai-salam* refers to a contract, whereby payment is made in advance (at the spot price of a good), but delivery of the good/object is made in the future. This kind of contract is prevalent in agriculture for financing the needs of farmers in purchasing inputs to grow crops.
7. *Bai-muajjal* refers to a contract whereby the good or object is delivered at the time of the contract, but the price is paid later (either in a lump sum or in installments). It is also called deferred payment.
8. *Istisna* is a sales contract for input materials (e.g. for construction) or assets, whereby a financing party agrees to deliver the goods at pre-determined prices in the future.

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9. *Ijara* is a leasing contract in which the financier purchases equipment/assets on behalf of the client (farmer or firm) and leases it to the client on the basis of regular payments (installments). This type of financing is used in agriculture equipment financing in Pakistan and other countries (see Kustin, 2015).
10. *Sadaqa* is another form of charity and philanthropy. It involves voluntary giving of donations to help the poor and needy.
11. *Zakat* is also a form of charity but is compulsory for every eligible Muslim (who possesses a certain amount of income/wealth during the one year, which is called "*nisab*"). It is deducted from income/wealth at 2.5 per cent of the value of assets at the end of the year. However, in practice, there is considerable variation in paying zakat.
12. *Waqf* is an endowment (in the form of an asset/building/cash) supplied by a donor (individual/organization) often for charitable purposes to generate sustainable funds through investment. These funds can be used to help the needy and the poor.

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About the authors

Em Prof Clement Tisdell is an Emeritus Professor in the School of Economics at The University of Queensland, Brisbane, Australia, and a Fellow of the Academy of Social Sciences in Australia. He is a prolific author with many publications in leading academic journals. ResearchGate has recorded over 9,000 citations of his work, and he has an h-index of 39 (including self-citations). Agricultural economics is one of his specialties. A significant proportion of this research examines the human value of agricultural development, both in ancient societies and in modern times. Currently, he is assisting with a research project on the consequences of microfinancing in Pakistani agriculture for the economic welfare of small-scale agriculturalists, with an emphasis on finance for women in agriculture. Clement Tisdell is the corresponding author and can be contacted at: c.tisdell@uq.edu.au

Dr Shabbir Ahmad is a Postdoctoral Research Fellow at UQ Business School, The University of Queensland, Brisbane, Australia. His major research themes focus on development agriculture and resource economic policy analysis, which include efficiency and productivity analysis; environment and sustainability; applied econometric analysis; and financial sector performance assessment. He has wide-ranging experience of survey design and conducting field work on different projects as well as handling large secondary data sets to perform rigorous econometric analyses of various economic issues. Currently, he is involved in several agriculture and resource policy projects in Asian developing economies. Dr Ahmad completed his PhD in econometrics at the UQ School of Economics in 2014.

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