

# Examining Islamic microfinance as a mechanism of *Takaful* in high-risk countries: case study of Palestine

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## Abstract

**Purpose** – This paper aims to identify the intersection between Islamic microfinance (MF) (IsMF) and *Takaful* in high-risk economies and propose a model for the sustainable application of IsMF. The word *Takaful*, although used to refer to Islamic insurance, means solidarity and is used as such in this paper.

**Design/methodology/approach** – The paper used a descriptive and analytical method to present findings derived from secondary data collected from the Palestinian Central Bureau of Statistics and primary data from semi-structured interviews.

**Findings** – Need in the Palestinian household is very high, and the performance of Palestinian MF institutions (MFI) was found to have deviated from the spirit of MF. A significant shortcoming by MFI lies in the Palestinian law that focuses on organizing MFI's operations as financial institutions only. With a deviated purpose and generalized laws, the paper proposed a model of IMF. The model consists of three stages covering mission and market-based financing for the economically incapable and those better off. Finally, enacting laws to protect micro-enterprises and cooperation between institutions that operate at each stage is necessary.

**Originality/value** – This research contributes to the literature on MF and IsMF, especially in high-risk countries. Furthermore, this study proposes a model for IsMF best practices based on the spirit of MF where it is most needed.

**Keywords** *Takaful*, Microfinance, Solidarity, Socio-economic development, Islamic microfinance

**Paper type** Research paper

## 1. Introduction

Microfinance (MF) is an intelligent way of doing business that focuses on the masses and the ideas that arise from the public in all corners of a country. Microfinancing novel ideas that could cause breakthroughs in certain industries or sectors is an art undertaken by business professionals and venture capitalists operating individually or through institutions. In its spirit, MF aims at socio-economic development and helping the marginalized and poor. Parallel to that, many engaged in MF aim at generating profit. The different specializations, types and size of MF implies asking about the actual level of contribution in solidarity with the poorest members of society. This is important because MF institutions usually charge interest rates or “profit rates” equal or higher than typical financial institutions. At the same time, MF is known to target marginalized groups, women and poor households (ILO, 2007; Visconti, 2016; Obaidullah, 2008; Barden, 2010) to actualize ideas and projects they wish to implement. This legitimizes the question, “who is benefiting from who?” (Kiiru, 2007).

When Islamic MF (IsMF) is at the center of this discussion, the difference will not be significant. Simply, the spirit of MF without charging interest is Islamic (Obaidullah, 2008).



Over time, the general practice of MF grew closer to typical finance; some argue that MF is not successful in making a change in the lives of the poor (Kiiru, 2007), whereas many others confirm a positive relationship between MF and poverty eradication (Visconti, 2016; Barden, 2010). So what would that mean to the relationship between MF and poverty eradication and properly serving the low-income entrepreneurs and business owners who strive to break through poverty and become productive members of their communities!

This paper aims to connect IsMF and *Takaful* [1], linguistically meaning solidarity. Precisely to identify the intersection point between IsMF and *Takaful* in high-risk economies and explain mechanisms for improvement. Furthermore, this paper presents the idea of IsMF and its connection to social solidarity and socio-economic development. The main distinction of IsMF lies in its mission-based not-for-profit mechanisms of MF. The complementary IsMF mechanisms are market-based for-profit modes of financing. This classification is explained by Obaidullah (2008) in his *Introduction to Islamic Microfinance* book. He explains that after securing a decent level of subsistence for the poorest families through mission-based mechanisms, the goal is to help those families break through the poverty thresholds of their communities and empower them to become independent, productive members of the community.

This paper focuses on high-risk economies and takes the example of Palestine, where poverty and unemployment rates are high. However, unlike other countries with similar consequences, the education level in Palestine is high, which implies a high level of entrepreneurship. In an already weak economy, “the pandemic not only creates increased financing needs to support the real sector, but also generates new”, and compounded “risks” (WBG, 2020, p. 18). In this paper, a thorough analysis of “need” in the Palestinian community and the presence and practice of MF Institutions (MFI) and IsMF Institutions (IsMFI) is achieved.

This paper uses a qualitative methodology and uses descriptive and analytical methods. Those methods are used to reach conclusions based on secondary data from the Palestinian Central Bureau of Statistics (PCBS) (2020), and primary data from semi-structured interviews with academics and professionals of MF and IsMF in Palestine. Furthermore, this paper was introduced in an interactive lecture to professionals and researchers in the ASIA-JAPAN Research Institute at Ritsumeikan University-JAPAN.

This paper constitutes three main sections, where the first introduces the notion of IsMF and its connection to *Takaful*. This section has a brief explanation of mission vs market-based IsMF models. The second section explains and analyzes the need of the Palestinian household. Finally, the Palestinian financial hierarchy is introduced with a focus on the practice of MFI and IsMFI. This section puts forth an essential module for IsMF, especially suitable for IsMFI based in high-risk countries.

## 2. Notion of Islamic microfinance and *Takaful* “solidarity”

In an Islamic economy, solidarity takes multiple forms and shapes. Economic solidarity is the focus here because poverty eradication and socio-economic development can be achieved through economic solidarity. Of the most recognized mechanisms of social solidarity is the redistributive institution of zakat (Migdad, 2019; UNHCR, 2021; Migdad, 2017). This act of charity is an obligation and not a voluntary act of kindness. The details and priorities of giving zakat were explained in the Quran (9, 60) and more explanations are found in the Hadith of the Prophet Muhammed PBUH. The essence of giving zakat lies in guaranteeing priority and achieving sustainability in the lives of deserving recipients [2]. Other forms of financial support to the needy include the Islamic institution of waqf and general voluntary charity. Those mechanisms come under the mission-based not-for-profit modes of IsMF.

Mission-based mechanisms of economic solidarity are essential for social solidarity. For instance, globally, the single-continues-largest flow of money from people in solidarity and support of other people is zakat. The estimation of an annual flow of 550–600 billion is based on a study by the World Bank and the Islamic Research and Training Institute of the Islamic Development Bank. Based on that, many international agencies such as the UN and UNICEF have created zakat funds to assist in their quest in humanitarian assistance in the Muslim world (UNICEF, 2019).

In Islam, waqf is another source of finance aimed at socio-economic development. Estimations of the value of waqf assets in the world vary, and the main reasons are size, the large number and unregistered waqfs. Voluntary charity is a global culture that provides additional support to socio-economic development globally and in Muslim countries. Because zakat expenditure is restricted to specific categories (Q, 9, 60), waqf and charity are more flexible and could support marginalized groups or in unserved areas. This ensures total and complete development [3].

This complete *Takaful* system, starting from zakat, then waqf and charity, needs to be systemized to ensure sustainable development in the lives of beneficiaries (Migdad, 2019). Making the connection between IsMF and solidarity is not a difficult task; it could be established that Islamic economics is human-centered (Ersoy and Altundere-Doğan, 2019), not profit-generation centered (Migdad, 2021), not state-protection centered; although the second is allowed, the third necessary (Askari *et al.*, 2015). This economic thought calls for cooperation among community members to achieve collaborative development. Each unit, be it an individual, a household, or a community, develops based on the level of cooperation. This minimizes class gaps and accounts for a proper return to effort based on cooperation.

### *2.1 Mission vs Market-based Islamic microfinance*

To understand the need for MF is to know that the current commercial and Islamic banking systems are based on the minimization of risk and profit maximization that is the function of a bank and investors. The ease of measuring risk leads to the possibility of quick and safe returns on bank investments. The financial and banking sector has an essential role in developing the Palestinian economy, especially for some industries (Dodeen, 2013; Migdad, 2017). This existing banking system leaves out sectors such as agriculture where risk is relatively high and outcomes unpredictable, as well as large scale and long term investments where the return is not quick, and risk is generally higher. To tackle this problem, specialized financial institutions were introduced to financially include unserved poor members of marginalized, mostly agricultural communities.

The predicament of financially unserved poor population can be explained in light of the modern commercial banking development that happened hand in hand with industrialization and urbanization. This partially explains why the poor, who generally live in rural areas are not part of this financial system. So considering rural vs urban areas, the high cost of financing, and the need for collateral, the reasons behind financially unserved populations clarify, and this brings the discussion to MFI that took the service to the poor population in rural areas. Muhammad Yunus and his Grameen Bank that were awarded the Nobel Peace Prize in 2006 is a good example. However, even MFI today are not innocent of “high cost of financing” (Kiiru, 2007) although it counts for them finding solutions to collateral, among other issues (Visconti, 2016).

Nevertheless, MF is a good solution for eradicating poverty and increasing social solidarity, primarily through mission-based modes of financing (Obaidullah, 2008; Visconti, 2016; Ghanem, 2010). As such, IsMF is important in Muslim countries where poverty rates are high and financial inclusion is low. Another reason for the importance of IsMF is the

connection between religious sensitivities and the low rates of financial inclusion in Muslim countries (Askari *et al.*, 2015, p. 332; Barden, 2010). The following sections discuss IsMF and the models used.

*2.1.1 Mission-based not-for-profit modes of microfinance.* Poverty is a significant moral challenge of the 21st century (Secretary of State for International Development, 1997). Except for some, Muslim countries suffer from poverty the most and are doing very little about it (Obaidullah, 2008, p. 1). This controversy goes against the Islamic economic thought that offers an established wealth redistribution system. Because an established system is present, attention redirects to efforts of application. Mechanisms such as zakat, waqf, *qard-hassan*, and generally *sadaqa* represent the main pillars of this approach. The *Quran* (9:60) explains in detail and order the rightful beneficiaries of zakat. That explanation may be a benchmark for dealing with the other financing mechanism listed under this mission-based approach for poverty alleviation. The primary objective of zakat is to pull its rightful recipients out of poverty by supporting them to cover their naturally recurring basic needs (Migdad, 2019). This directly refers to economic empowerment leading to sustainability, not immediate consumption-based support.

Economic empowerment programs start with satisfying the basic need and, from there, establishment of a momentum of development in beneficiaries' lives. Development in Islamic economics works in that manner, where zakat is the first support mechanism for the poor. Furthermore, the institution of waqf, charity and *qard-hassan* are complementary mechanisms in the mission-based modes of IsMF for poverty alleviation as they are more flexible. Obaidullah (2008, p. 40) explains the mission-based approach of IsMF that focuses on zakat and charity. Other research proposes mechanisms for financial inclusion (Nabi *et al.*, 2017), Hawariyuni and Kassim (2019, p. 150) propose another model of IsMF after discussing previous modules proposed by Yumna and Clarke (2011), and by Wilson (2008) as appears in Hawariyuni and Kassim (2019, pp. 149–148)

*2.1.2 Market-based for-profit modes of microfinance.* Islamic finance methods used under market-based MF are the main distinction from the previous mission-based MF as observed in models by Hawariyuni and Kassim (2019, p. 150), Obaidullah (2008, p. 54), and Abdullah and Ismail (2016, p. 52) who introduced models of cash waqf-based IsMFs. The financing tools used here are for-profit, and those include Musharaka, Mudaraba and Murabaha. However, even under this model, *qard-hassan* is used.

In typical situations, most proposed models of IsMF are applicable. However, models need to be adapted because of differences in the economic environment, legal system and the level of risk and uncertainty. As such, Abdullah and Ismail (2016) explain a model designed for Bruni Darussalam (p. 52), and Hawariyuni and Kassim (2019) propose a model for Indonesia (p. 150), Yumna and Clarke (2011) propose an integrated model of MF that combines zakat with MFIs (p. 9). More inclusive proposals include that of Obaidullah's (2008) in (p. 40) and (p. 54) and that of Ali (2014), who proposed a model (p. 8) and analyzed others (p. 15).

MF models need to account for high risks in a high-risk economy such as Palestine [4]. Additionally, the Palestinian MFIs need special supportive laws (Dodeen, 2013). Furthermore, Palestinian financial institutions require collateral and/or a guarantor for the provision of finance [5] (PALMFI, 2021); as such, most Palestinians struggle to access finance. On the other hand, many NGOs are dominated by charitable work alone (Ghanem, 2010).

From another angle, the low financial inclusion rates in Palestine (PMA, 2016) further contribute to uncertainty and weak credit history. The study on financial inclusion shows that only 22.7% of the adult population in Palestine own current accounts and 9.2% have a savings account. The study also shows that 5.1% have been granted bank loans, 4.4% have

credit cards, only 0.5% have received Murabaha or Mudaraba financing and only 0.2% of the adult population have deposits in Islamic banks (PMA, 2016, pp. 5–6). These data explain the tendency of MFIs toward adopting market-based for-profit MF. Simultaneously, this outcome stresses the need for finding solutions that deal with high-risk situations and the absence of credit history for the financially un-included adult population.

This paper proposed an IsMF model that accounts for the shortcomings of other models after analyzing and discussing the following points. First, the assistance distribution to Palestinian households, then explaining the Palestinian financial hierarchy and debating the practice versus the expectations from the Palestinian MFIs. This model is designed to account for high risk and proper establishment of credit history to reduce information asymmetry and help MFIs make the right decisions by avoiding adverse selection.

### 3. Analyzing assistance distribution to Palestinian households

The following secondary data presented in tables and figures are analyzed using the most straightforward analytical techniques offered by excel to look for trends and weights. Based on Nelson and Nelson (2016), such simplified analysis methods can present critical outcomes and trends. The data from the PCBS is rich and detailed and managed by World Bank and local professionals. This data accounts for many details that describe the background characteristics of Palestinian households, the distribution of assistance by type, the percentage of households that believe they need assistance, how many receive assistance and the main providers.

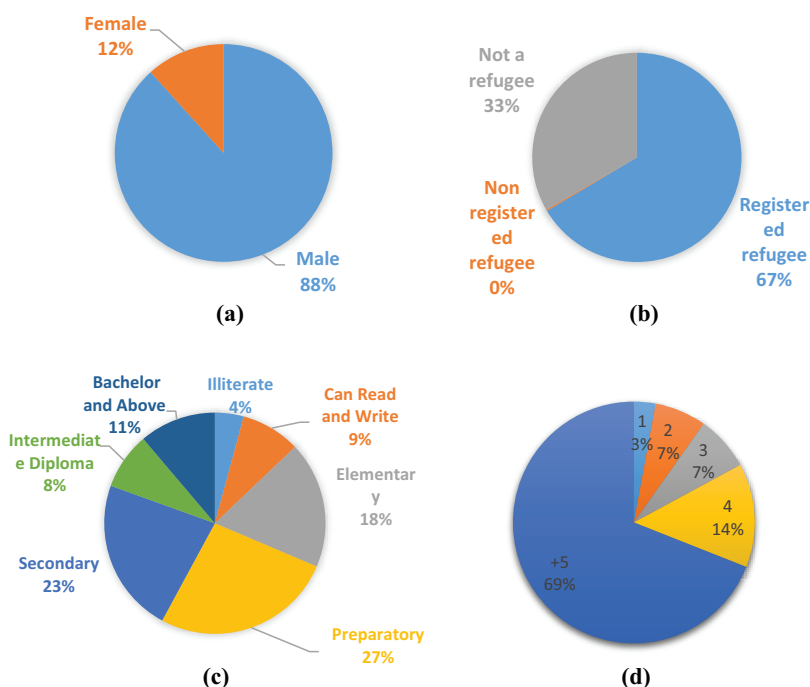
Based on the PCBS latest statistics of 2017, poverty rates among individuals according to monthly consumption patterns in Palestine reached 29.1% and 53% of that in the Gaza Strip. The unemployment rate was 25.3% based on the latest 2019 statistics. However, unlike other countries with similar circumstances of high poverty and unemployment rates, Palestine has a meager illiteracy rate of less than 4%.

Based on the PCBS (2020) socio-economic conditions survey, the percentage of households in Palestine that received assistance is 77% in the Gaza Strip and 17% in the West Bank. In total, 88% of heads of households that receive assistance are male [Figure 1(a)]. Furthermore, 69% of families consist of five or more members [Figure 1(d)]. As for the refugee status of the head of household that receives assistance, 67% are registered refugees while 33% are not refugees [Figure 1(b)]. Such data confirm the deteriorating economic conditions that can also be confirmed by the constant decline in the average household size (PCBS, 2019, p. 2).

Figure 2 shows that about 63% of assistance received was food parcels, vouchers, coupons and medicine; all used for direct consumption, and 34% cash support was also used for immediate consumption. The interview results state that most cash assistance provided to the poor in micro-credit is used for direct consumption. In the Gaza Strip, about 30% (Table 3) of households depend on assistance as the primary source of income; this implies that more than 30% live a consumption-based lifestyle that would only lead to a constant continuous level of poverty.

The statistics present in Table 1 exhibit an alarming presence of the feeling of need. About 91.8% of Palestinian households believe they need cash assistance, and 65.3% believe they need food assistance. This can be compared with only 12.7% of households that receive assistance (Table 3). The gap between the two numbers is alarming and showcases the high levels of uncertainty and low levels of living standards.

Palestinian households that did not receive assistance attribute the reason to “not requesting assistance.” Others were rejected because a family member works or does not fulfill eligibility criteria (PCBS, 2020; T14). The type of assistance varied between contingent and periodic assistance. Food, compensation for martyrs, cash, health insurance, vouchers and



**Figure 1.**  
(a, b, c, d): Percentage distribution of households in palestine that received assistance by background characteristics of households, 2020

**Notes:** (a) Gender of the head of households; (b) refugee status of the head of households; (c) educational attainment of the head of households; (d) household size (# of Persons)

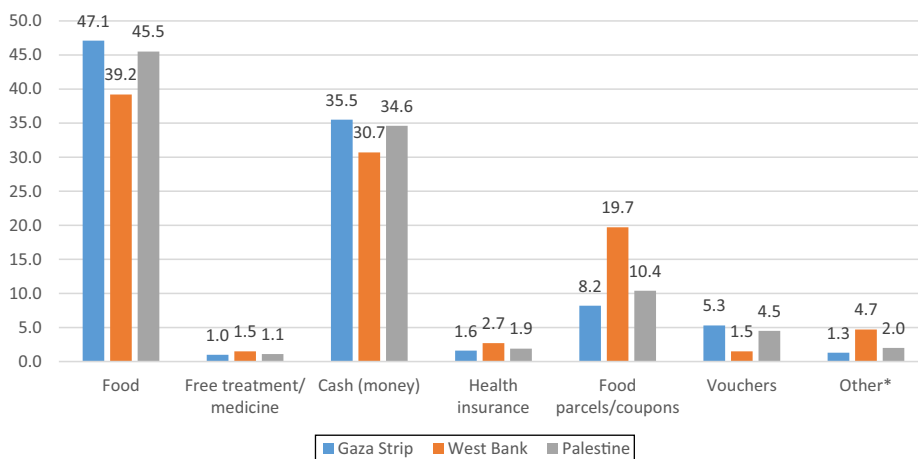
**Source:** PCBS (2020) Socio-economic conditions survey

drinking water were all periodic assistance. On the other hand, employment, medicine, housing and support paying bills were in the form of contingency assistance [6].

Elaborating on the source of assistance helps estimate the possibility of establishing a national database that shows who received assistance, in what shape and in what quantity. The government provides 36% (Table 2, Points 1 and 2), the United Nations Relief and Works Agency (UNRWA) provides 37.6%, and international development agencies offer 7.4% of assistance. The three groups provide 91% of all assistance to Palestinian households. The government and international agencies are organized entities capable of creating a database for assistance and beneficiaries. This is important because it expands the number of beneficiaries and reduces the number of opportunists. Additionally, this national database represents an additional source of information for mission-based MFI that operate in Palestine. This importance is discussed in later sections.

Based on the PCBS (2020), 73.2% of households receive assistance periodically. The majority of those (83%) are in the Gaza Strip. Based on the survey, 71% expressed their satisfaction, and 14% indicated they were very satisfied with the assistance received. The majority of those who expressed dissatisfaction complained about the quantity [7]. As for evaluating the efficiency of assistance delivery, 44.5% of surveyed Palestinians believe that

**Figure 2.**  
Percentage  
distribution of  
assistances that  
households in  
palestine received by  
type of assistance and  
region, 2020



**Source:** PCBS (2020) Socio-economic conditions survey

assistance is generally received by the needy, but non-needy households also benefit from assistance. Furthermore, 31.1% believe that assistance is generally distributed without proper consideration for need [8].

The majority of assistance by source in Table 2 is non-periodic contingency-based assistance, whereas assistance provided by the Ministry of Social Development and the UNRWA are periodic [9]. However, the concern with both lies in the nature of the assistance that is contingency-based or even periodic; it is all consumption-based assistance. The present circle of assistance spins, but in the same place, while the goal should be for the spin to generate movement. For this reason, despite the periodic provision of assistance by some sources, if it does not generate sustainable development, it only sustains the present poverty status.

**Table 1.**  
Percentage of  
households in  
Palestine believe they  
need assistance  
(whether they  
received assistance  
or not) by type of  
assistance and  
region, 2020

Type of assistance	Region		
	Gaza Strip	West Bank	Palestine
Cash assistance	92.5	90.8	91.8
Food assistance	81.5	43.1	65.3
Health/medical insurance	21.7	30.2	25.3
Disability allowance	5.4	6.7	6.0
Elders allowance	6.7	11.5	8.8
Orphans allowance	0.7	2.6	1.5
Social interventions	5.0	3.6	4.4
School/ university fees	13.4	16.6	14.8
Contingency Assistance	49.9	28.3	40.8
Employment	59.5	27.0	45.8
Training	12.8	10.4	11.8
Startup project	56.4	34.9	47.3
Customs duty exemption	1.1	2.5	1.7
Housing assistance (remonstration, maintenance, shelter, rent and caravan)	34.8	17.7	27.6
Other	2.7	5.1	3.7

**Source:** PCBS (2020): Socio-economic conditions survey

**Table 2.**  
Percentage  
distribution of  
assistances received  
by households in  
Palestine by source  
of assistance and  
region, 2020

Source of assistance	Region		
	Gaza Strip	West Bank	Palestine
Ministry of Social Development	17.8	26.6	19.5
Other Gov. institutions	14.8	23.2	16.6
Political parties/ factions	1.5	12.3	3.6
Zakat committees	2.4	3.7	2.7
International/ development agency	9.0	0.7	7.4
UNRWA	45.0	7.9	37.6
Arab or foreign states	1.0	0.4	0.9
Charitable/ religions associations	4.2	3.1	4.0
Family and relatives	2.2	5.8	2.9
Friends/ acquaintance/neighbors/doers of good deed	1.8	10.6	3.5
Labor unions	0.0	1.7	0.3
Local banks	0.1	0.0	0.1
Local reform committee	0.1	1.6	0.4
Other	0.1	2.4	0.5
Total	100	100	100

**Source:** PCBS (2020): Socio-economic conditions survey

Obaidullah (2008, p. 2) explains that the need for finance is driven by three main categories of events; lifecycle events, emergency needs and investment opportunities. The first two are push factors, and the third is a pull factor. The main reasons attributed to the need for assistance and financing by Palestinian households include the following list (PCBS, 2020; look T17). Based on the three categories, all the following are considered push factors.

- shortage of water;
- assets/project (including land) loss/damage resulting from Israeli aggression;
- assets/project (including land) loss/damage resulting from other reasons;
- inability to access the lands due to restrictions imposed by the Israeli occupation;
- inability to pay back a loan/debt;
- loss of all or total wages/salaries;
- death of the head of the household, crop damage, serious sickness;
- delay in getting paid a salary;
- loss of a source of aid/assistance;
- inability to renew work permit;
- inability to attend for health treatment because of lack of medication;
- inability to pay for medication;
- inability to leave the country for educational reasons;
- inability to leave the country for medical treatment reasons; and
- inability to leave the country for other reasons.

About 29.7% of Palestinian households indicate they can barely make it through the month, 20.1% in the west bank and 43.9% in the Gaza Strip (PCBS, 2020; T20). This also counts as a push factor for seeking finance or assistance.

As appears in [Table 3](#), the highest (28.6) source of income in the Gaza Strip being from assistance is alerting and calls for attention. Furthermore, 30.4% of households depend on the private sector for securing income. Considering the global average of the private sector's economic contribution, this is a meager percentage. For example, the private sector generates 90% of jobs in developing countries ([Department Of Foreign Affairs And Trade, 2014](#)).

#### 4. Palestinian financial hierarchy

The financial hierarchy in the Palestinian economy starts with the Palestinian Monetary Authority (PMA), which manages the operations of the financial institutions in Palestine. Under this authority, there are six registered local banks with over 200 branches and another six foreign banks with 120 branches. Additionally, the PALMFI has eight members who specialize in MF in the Palestinian community, aiming to achieve economic development in the lives of their targeted groups and in the Palestinian economy. Furthermore, over 240 currency exchange organizations operating under the PMA also engage in micro money transfers ([PIPA, 2022](#)).

The Palestinian MF sector was created by business professionals who recognized the potential in particular community groups. Therefore, it is safe to say that MFI are for-profit business models, and the Palestinian laws were created for MFI being financial entities ([Dodeen, 2013](#)). Despite that, MFI's serve marginalized and agricultural communities in Palestine ([Ghanem, 2010](#)), and the region's MF sector continues to achieve positive financial performance ([Tabbaa, 2019](#)). The results of a study by [AbuKarsh and Anan \(2019\)](#) "show that the small level microfinancing is the best resource for the economic stability as well development."

Furthermore, "Institutions such as Reef have a considerable advantage in the provision of financial services in line with the traditional religious sensitivities of Palestinians" ([Barden, 2010](#), p. 102). Based on another research, small IsMFI operating in the Gaza Strip, such as the individual initiative institution, *Al-Asdiqa* for community and economic development and *Al-Mujamma Alislami* society, do not comply with MF best practices to ensure the survival of their institutions. However, those small institutions adhere to the

Main source of income	Region					
	Gaza Strip	South of the West Bank	Middle of the West Bank	North of the West Bank	West Bank	West Palestine
Agriculture, animal breeding, fishing	0.8	3.6	3.6	3.2	3.4	2.4
Family business (other than agriculture)	3.8	8.4	7.7	10.9	9.2	7.0
Government wage and salary	27.7	18.4	10.8	18.6	16.4	20.9
Private sector wage and salary	24.5	27.0	40.5	36.3	34.5	30.4
Wages from Israeli labor sectors	0.1	30.5	15.4	17.7	21.4	12.8
Transfers from inside Palestine (including pension)	9.6	5.1	4.1	5.8	5.1	6.9
Transfers from abroad	0.4	0.0	2.3	0.8	0.9	0.7
Assistance	28.6	2.7	1.5	1.4	1.8	12.7
Salary from international organizations	2.3	0.4	0.0	0.3	0.2	1.1
Property income	0.8	1.3	2.7	1.2	1.6	1.3
Other	1.4	2.6	11.4	3.8	5.5	3.8
Total	100	100	100	100	100	100

**Table 3.** Percentage distribution of households in Palestine by main source of income and region, 2020

Source: [PCBS \(2020\)](#) Socio-economic conditions survey

#	MFI	Status	Description
1	FATEN	Non-profit private shareholding company	Founded in 2014, works in GAZA and WB, gives normal and Islamic loans
2	ASALA – Credit and Dev. Company	For-profit private shareholding company	Founded in 2014, works in GAZA and WB, focus on women, and gives normal loans
3	ACAD – Finance and Dev. Company	For-profit finance company	Founded in 2014, works in GAZA and WB, gives normal and Islamic loans
4	VITAS Pal. (formerly CHF Reyada)	For-profit company	Founded in 2015, works in GAZA and WB, gives normal consumption loans
5	Reef Finance Company	Limited liability not- for-profit company	Founded in 2007, works in GAZA and WB, gives normal and Islamic loans. (group and individual)
6	Al-Ibdaa	For-profit company	Founded in 2014, works in the WB, gives normal consumption loans
7	UNRWA – MMP64	UN Agency	works in Gaza and the WB, gives normal consumption loans
8	Palestinian Dev. Fund (PDF)	Private joint stock company	works in Gaza and the WB, gives normal consumption loan
9	Islamic Relief – IRPAL	NGO	Established in 1998, Works in Gaza, offers loans at zero interest
10	PARC – Pal. Agri. Relief Committee	Cooperative reporting to the department of labor	Established in 1983 focusing on rural development in Gaza and WB, offers normal loans
11	Al Ameen	For- profit company	Established by a group of individuals and operates in Gaza
12	Individual Initiatives Inst	Not-for profit institute	Established 2007 and operates in The Gaza Strip

**Table 4.**  
Microfinance  
institutions in  
Palestine

Source: IFC (2017, pp. 40–42); PALMFI (2021), Ghanem (2010)

spirit of MF. Charitable work alone dominates those institutions' operations (Ghanem, 2010). This is a situation where IsMFIs that comply with the spirit of MF are very weak and vulnerable to failure, and business-based MFIs can survive. The survival of market-based MFI's is good, but the survival of mission-based MFI's is even better.

### 5. Discussion on practice vs expectation of Islamic microfinance in Palestine

Palestinian specialists in economics and MF have confirmed the status of dire need in the Palestinian community. This information was collected through semi-structured interviews. First, the need in the Gaza Strip is higher than that in the West Bank [10]; as such, ground-up solutions to the deteriorated economic condition is of high importance in the Gaza Strip. There is a general agreement that MF, especially IsMF, could play an important role in poverty eradication and employment. However, MF institutions need to reflect on the spirit of MF, and more importantly, to cooperate with NGOs that provide in-kind MF and government agencies that support those in need. The following part discusses the status of

MF provision, the entrepreneur's desire and demand for finance, the interaction between MF and *Takaful* and whether MFI and IsMFI's general goals align with the original microfinancing philosophy. The discussion continues to cover opinions on the role of IsMFI's in poverty alleviation, whether they provide *qard-hassan* to those in need and if any IsMFI does not require collateral or a guarantor as a condition for financing.

MFIs in Palestine provide financing to those in need and cover the demand for MF, but with strict conditions. Those strict conditions that usually cannot be fulfilled [11] reduce the demand for MF, making it possible for MFI's to cover the demand associated with the ability to accept the conditions of financing. One of the main reasons for entrepreneurs' reluctance to seek funding is the high-risk situation. Because this is the case for economically able entrepreneurs, economically unable entrepreneurs will be more reluctant, especially with the absence of law to protect startups and new businesses. As such, the nature of the relationship between MFI's and *Takaful* within the community is fragile.

The MF industry has its philosophy and limitations considering the size of the finance and the target group as well as the effect of financing on supporting production and relinquishing poverty and unemployment through building the capacity and including the marginalized in the economy. It is not possible to enact laws concerning MF with no consideration to the original philosophy of MF. Dodeen (2013, p. 125) explains how Palestinian MF laws were not enacted to uplift the groups that MFI should initially target; instead, the focus was to organize MFI's operations as financial institutions [12]. The interviews conducted for this paper confirm results in previous literature. Despite this:

Initiatives to support bank intermediation and financial diversification and broadening could be implemented, including the recently adopted financial inclusion strategy and priorities highlighted below to strengthen SME, housing, and long-term finance (WBG, 2020, p. 18).

Up until now, the practice of IsMFI in Palestine requires people to provide guarantors when seeking financial services, even a *qard-hassan*. There is no judgment on right and wrong practice, but the spirit of a module such as *qard-hassan* and MF in general is to help people who have no resources and to remove stumbling block.

The outcome of a discussion on IsMFIs best practices in Palestine suggested the following:

- Given the existence of the occupation and the continuation of the local political division, the presence of cash and food assistance programs is very important.
- Especially for marginalized groups that do not have the capabilities or skills that enable them to manage a small project.

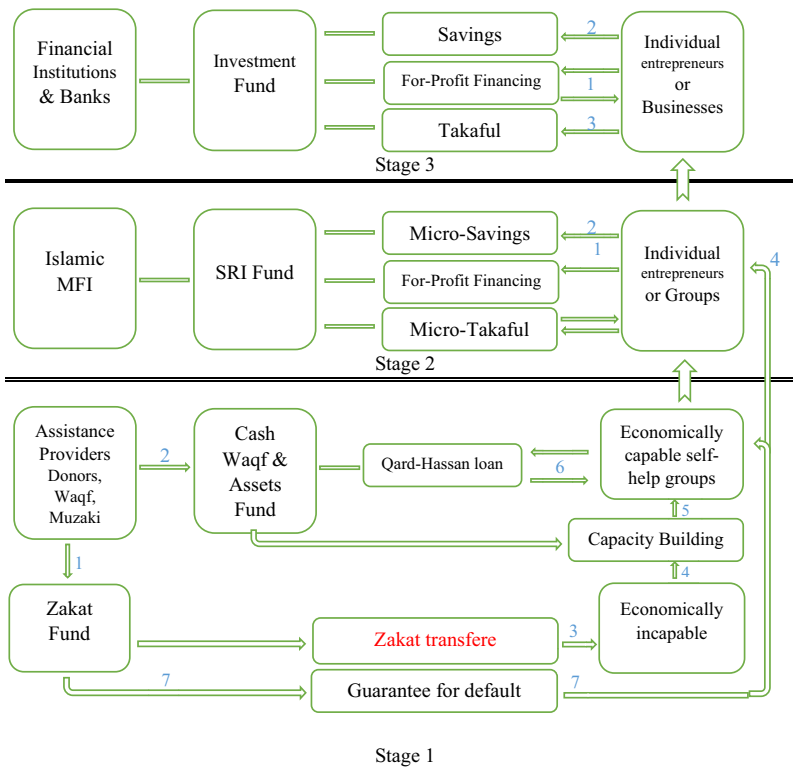
At the same time, programs for economic empowerment of families that have the capabilities and skills is necessary to manage small projects. Meaning that social protection must be in two parallel tracks: relief and development. First track, relief assistance programs must focus on health and educational. The second track focuses on economic empowerment projects for the poor; those must be protected and supported to be able to survive. Finally, the focus should be on relief programs in the Gaza Strip more than in the West Bank, given the depth of the economic crisis and social suffering of the residents of the Gaza Strip.

In conclusion, the intersection between both MF and *Takaful* lies at the stage of mission-based not-for-profit modes of MF. Such modes of financing are the heart of solidarity in an Islamic economy. However, the way forward implies cooperation and focus to ensure a positive outcome for the scattered uncoordinated efforts of relief (mission-based) and development (market-based). The following is a proposed module that built on previously suggested models of MF. This model considers the factor of high-risk, and relies on cooperation.

**6. Practical module for Islamic microfinance in Palestine (high-risk countries)**

The key to this module is cooperation among specialized assistance (relief) institutions and specialized IsMFI's. Otherwise, it becomes necessary for each institution to guarantee a private sustainable mechanism [13] to be able to survive. Obaidullah (2008, p. 40 and 54) presents two separate modules he called mission-based and market-based IsMF. Those modules may be functional in some countries, however, in the case of Palestine, both modules need to be merged and modified to function. Another module for Palestinian IsMF presented in a conference focused on market-based Islamic financial instruments in the Palestinian MF sector (Rana *et al.*, 2015), which is a reflection of the present system that needs modification.

The essential characteristic of the following model stresses cooperation between institutions in each stage or the collaboration between the different departments in a single large institution, each serving the purpose of one of the stages in the model. For example, the Islamic relief worldwide combines aid provisions and has a unit for MF through *qard-hassan*. This is an example of an institution that operates at Stages 1 and 2. The cooperation between the two departments leads to higher possibilities of graduating beneficiaries from poverty. The government has an important role to play, based on the suggestions of previous literature and the outcomes of the interviews. Law that protects new businesses must be enacted. This further incentivizes the economically able entrepreneurs to seek financing with



Source: Author's own illustration

**Figure 3.**  
Islamic microfinance  
model in high-risk  
economies

reduced concerns connected to the present high-risk situation. This governmental role is crucial for Stage 2 participants to become active in Stage 3.

This model presents solutions to some of the stumbling blocks facing entrepreneurs, especially the poor. It serves as a mechanism for establishing a credit history, provides solutions to the pre-request of a guarantor or collateral and strengthens solidarity and presents a platform for equal opportunity finance. The foundation of the IsMF model is established on zakat and waqf but maintains the connection to market-based financing mechanisms through the proposed stages. An additional fundamental factor for the success of this model is establishing a national-based database where clients' information who benefit from MF may be exchanged in a manner that generates credit history.

- (1) Stage 1:
  - Accepting zakat money into the zakat fund;
  - Accepting waqf and cash waqf into the waqf fund;
  - Zakat transfer to eligible recipients who are economically incapable;
  - Through the waqf fund, the economically incapable receive necessary capacity building;
  - With training, zakat recipients become economically capable and form self-help groups;
  - Self-help groups receive *qard-hassan* loans and payback as a group; and
  - In the case of default, the zakat fund acts as a guarantor.
- (2) Stage 2: is market-based financing with social considerations. The IsMFI creates a SRI fund that provides micro-financial services.
  - Individual entrepreneurs or groups receive financing based on different IsMF contracts.
  - Entrepreneurs are encouraged to engage in micro-savings schemes managed by the SRI fund.
  - Entrepreneurs are encouraged to engage in micro-*Takaful* schemes managed by the socially responsible investment (SRI) fund.
  - In the case of default, the zakat fund acts as a guarantor after investigating the eligibility of the defaulting party.
- (3) Stage 3: Entrepreneurs need to fulfill normal finance conditions that include providing collateral or a guarantor.
  - Individual entrepreneurs or businesses receive financing based on different IsMF contracts by financial institutions and Islamic banks.
  - Entrepreneurs and businesses are encouraged to open savings accounts.
  - Entrepreneurs and businesses are encouraged to engage in *Takaful* schemes.

## 7. Steps forward

After analyzing Palestinian households needs through the PCBS survey and semi-structured interviews, a few matters can be addressed. First, assistance providers and MF institutions that operate in Palestine cannot be heavily criticized. The country's high percentage of poverty and unemployment implies immediate assistance to cover basic needs, leaving very little room for sustainable development in recipients' lives. As for MFI

and IsMFI, all that exists are cautious market-based for-profit enterprises that refuse to engage in high-risk investments. As such, MF services in Palestine are not available to the poor because most poor households cannot recognize the conditions for receiving financial support. The second matter refers to cooperation as necessary to assume progress to alleviate poverty. This cooperation must be between all assistance providers and MF providers in Palestine. However, it appears that each of the two is working separately, resulting in great scattered efforts with minimal progress.

One crucial fact is the positive relationship between investments and high returns. If high returns are promised, investment increases. Attempts to attract investors to engage in SRI have not been very successful because the returns are quite low (Rahman *et al.*, 2020). The culture of SRI needs to be internalized, especially in high-risk economies such as Palestine. If a margin of investment is made socially responsibly, that would have an increased positive effect on socio-economic solidarity.

The idea that some organizations are too big or too important to fail should be implemented on MF institutions as a collective. The services provided by MF institutions to micro and small enterprises and individual entrepreneurs or families are, in fact, a service too big and too noble to fail. Mohammed Croseen (2020) [14] explains the importance of MF institutions being treated as “too big to fail” and emphasizes constant support whenever needed. When the government supports MF institutions, they indirectly support poor people who took loans from MFI but could not pay because of the COVID-19 crisis. This government support backs the solutions provided by the proposed model to account for default.

Finally, MFIs are specialized financial institutions created to tackle the problem of the poor having no access to finance. Analyzing original examples such as Garmin bank in Bangladesh and present MFI's studied by this paper show a deviation in the performance and spirit of the current MFI. As for examining IsMFI's as a mechanism of *Takaful* in high-risk countries, such examination shows theoretical possibilities that may be implemented with proper government attention and institutional cooperation.

## Notes

1. The word (Takafuk) refers to insurance when used in research related to Islamic economics and finance. However, the word also used in the Arabic literature in different topics mean solidarity and that is the linguistic meaning.
2. A poor man, with a certain set of skills, or a craftsman, are given their share of zakat for a year. The idea is to achieve sustainability in the lives of poor capable individuals. This is the spirit of microfinance. On the contrary, zakat is given to deserving individuals on monthly bases if they are incapable of production. Those include the old, handicapped, children, etc.
3. Look (Figure 3) in this paper.
4. (PCBS, 2020; look T17).
5. This information is clear in the website of the Palestinian Union for Small and MFIs (PALMFI) and was also confirmed by more than one interview conducted for the purpose of this research.
6. Look Table 9 of the Palestinian socio-economic conditions survey, 2020.
7. Look Tables 6–8 of the Palestinian socio-economic conditions survey, 2020.
8. Look Table 15 of the Palestinian socio-economic conditions survey, 2020.
9. For more details look through Table 11 of the Palestinian socio-economic conditions survey, 2020.

10. This is based on the statistics by PCBS (2020) and the observation of both the interviewees and the researcher.
11. Based on an interview (1, 2), no MFI in Palestine provides financing with no condition, except through occasional funded developmental projects of microscale financing for the very poor.
12. (A) Regulation No. (132) of 2011 for the Licensing and Supervising of Specialized Credit Institutions \ (B) Instructions No. (2) of 2012 for Managing Specialized Credit Institutions \ (C) Instructions No. (2) of 2014 for the Loan Classification and Provisioning Requirements
13. A private sustainable mechanism will mean depending on traditional mechanisms of security, collateral and guarantee.
14. Head of the microfinance unit at the Islamic Relief.

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