Exploring New Initiatives for Financial Inclusion

Dr. Zohra Jabeen

Assistant Professor, Institute of Management Sciences, Peshawar

Abstract

One wonders, why the economic prosperity and extreme poverty are co-existing in the world while there is neither shortage of resources nor dearth of commitment to eliminate at least starvation and extreme poverty. However, market economy cannot be expected to develop institutional setup for promoting social inclusion. The right question is what institutions and products can possibly compliment the market in taking care of those excluded by the market. This paper is addressing the financial inclusion for the poor and unbanked segments of the society by discussing formation of institutions and products, with different models than the conventional banking industry, based on cost plus profit margin modes financing and the market forces of competition. It discusses the potential sources of finance for forming better models for financial inclusion of unbanked segments of the society. The study is a synthesis for new initiatives depicting financial practices, based on deductions from review of literature providing insight into past and current financing practices other than banking. It vouches for institutional framework for better management of potential funds available in the form of Zakah, sadaqat and waqf for further action to promote financial inclusion. Such sources and business models also need enactment of proper laws and establishment of commensurate regulatory authorities for guiding, supervising and controlling their activities. The paper raised the question, what institutions can possibly compliment the market in taking care of those excluded by the market.

Keywords: New initiatives, financial inclusion

Introduction

Ownership or availability of shared resources, in the form of money and assets is an essential element of one's life for life's sustenance and business development. While the conventional banking and the Islamic Banking models are business models for profitability of the institutions there is a large segment of the society, for which this business model is not suitable and requires a sharing of resources. While one of its offshoots is a sharing of risk and return for pure business motives, there is another yet very important wing of it. This is in the form of temporary or permanent philanthropy and giving away permanent ownership to others. Hence, these variations of sharing enables inclusion of a large segment of the society in availing financial and economic wealth and resources, for their individual livelihood, start-up businesses and business ventures, as well as general public welfare. This is the essence of financial inclusion which was practiced in the Islamic civilizations at their peak time. However, it is wrong to expect the banking sector (capitalistic model or Islamic model) to provide these resources, as their business models are different and cannot cater to these requirements, for being high risk for the capital of their owners and depositors. Financial Inclusion highlights the need to give financial support to those people who need financial support but cannot access and avail them due to a number of reasons. These include:

a) The poor who needs financial support for their subsistence and welfare. They cannot guarantee pay back of any principal finance amount or additions to it.
b) Entrepreneurs with great capabilities but no or little funds; and start-up business entrepreneurs who need risk sharing capital for launching or promoting their but are not sufficiently "creditworthy" for commercial banking loans and Islamic banking financings

The World Bank estimates 38% of the world population and 73% of the poor population to be in the financially excluded section. It stresses on financial inclusion by bringing maximum number of unbanked people to the banking networks and other channels of formal finance networks to imply minimizing poverty and hunger from the society. The Organization for Economic Cooperation and Development (OECD) of the European Union, stresses on the growing inequality among the rich and the poor as the culprit in increasing poverty. However, access to financial aid, even if through cash and kind from households, without the use of formal banking channels is also a good thing, since the objective is to help the poor and reduce poverty.

Conventional Financial Industry

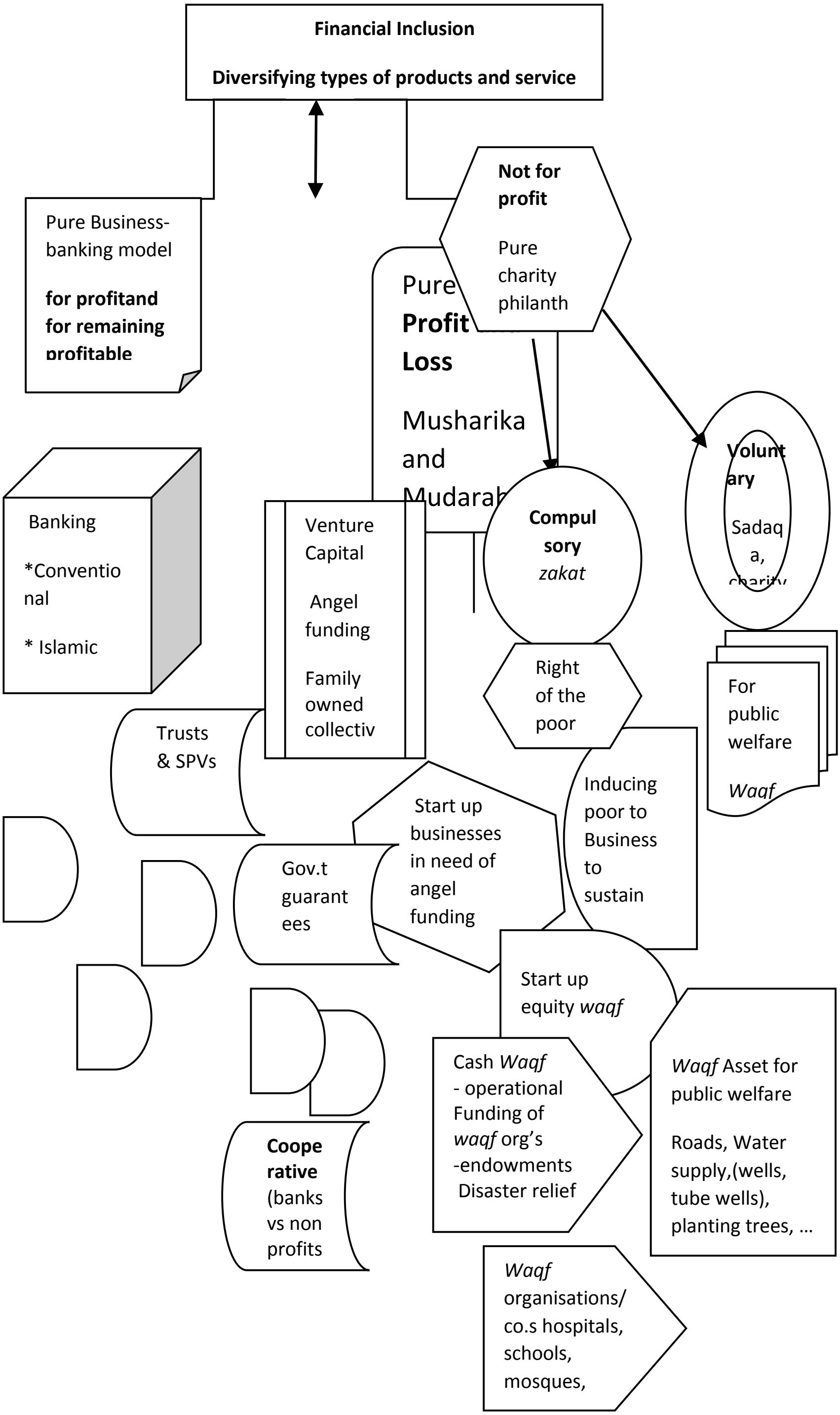
The conventional Micro financing, SME financing or banking industry's financings are predominantly fixed return /interest- on- debt –based models, whether lending to individuals , corporate clients or groups of borrowers. For being capable of borrowing, the borrowers have to be able to pay back the principal amount as well as the interest and guarantee it with collaterals. As explained earlier, micro lending too proved far too expensive to the poor people and exerted unbearable pressure on women for repayment. Therefore, a large section of the population remains unbanked because their financial status is below lending standards set by the lending agencies. The for-profit financial services cannot take the risk of the unbanked sectors through peoples' (depositors') wealth.

In this rapidly expanding world, the institutional development and capacity building for conducting social business (such as eliminating starvation) is not taking place at the same pace at which the institutional development and capacity building is taking place for promoting commercial interests. The information cost, transaction cost and uncertainty/risk elements are rising exponentially with the expansion of the world. The institutional arrangements to overcome these costs for commercial motives develop and innovate to meet the needs of time. The Banking sector has rapidly expanded to minimize information and transaction cost for financial services, and the insurance concept innovated tools to share and distribute risks. Financial markets (including stock markets) invented instruments to mobilize resources, from micro investors and medium and large-scale investors alike, to promote the commercial motives. The puzzling question in the contemporary world is why the economic prosperity and extreme poverty are co-existing side by side in the world while there is neither the shortage of resources nor the dearth of commitment to eliminate at least starvation and extreme poverty. The incidence of starvation and sufferings of the extreme poor continues to exist (and in, many ways, growing) despite all the efforts, resources, programs and safety nets of World Bank, United Nations, NGOs and national governments. However, the market economy works on the principle of exclusion. Social exclusion is therefore logical outcome. Market economy cannot be expected to develop institutional setup for promoting social inclusion. The concept of increasing the GDP to reach a level that poverty is eliminated, is such that the poorest countries of the world may not be able to reach that level of GDP growth even in fifty more years. IMF studies have already declared trickle-down theory was a joke (Pacific Standard, 2015). Those theories of 1970s neglected poverty and inequality theorizing “trickle down” basis of beneficial effects of development to reach the poor. Further studies asserted that unequal income distribution has social and political consequences which slows down economic growth (Alesina and Rodrick, 1994). It is now being asserted that economic growth slows down when the high income groups earn more, and when the poorer peoples' earnings increase, the whole society benefits from it (CNN, 2015). According to the OECD 2015 report (OECD, 2015):

"*Making the rich richer, while incomes of the bottom 40% remain flat, could be seen as sensible from an economic perspective – after all, some are better off, and none are worse off. However, policies which lead to this outcome may not be even economically sensible if wider inequality reduces the capacity of the bottom 40% to improve their position and that of their children in the future. But just because inequality is bad for growth does not mean that all policies that reduce inequality are good for growth.............. structural policies are needed now more than ever to put our economies back on a path of strong and sustainable growth, but have to be carefully designed and complemented by measures that promote a better distribution of the growth dividends. The challenge, therefore, is to find appropriate policy packages that are both growth-friendly and that reduce inequality*"

This report asserts that the gap between the rich and the poor is widening. If there is any growth at all, it is benefitting the higher income groups but not the lower income groups. In the long run, this increase in income inequality causes more social and political problems as well as economic problems too. This drags down GDP growth, as the lower 40% of the income groups get farther away from the standings of the rest of the society and the lower income people cannot realize their human capital potential, and this is a bad thing for the economy as a whole. The report asserts that structural policies are needed for re-directing the economies on the path of sustainable growth.

There are different types of business and financial services. For example the banking industry and other interest based lending institutions, including the NGO's , which lend to those who can afford to pay back and sustain themselves profitably. Given below is the model depiction of the types of financial flows in order to expand the nature of services for enabling financial inclusion and the forms they take. Its explanation follows after the diagram.


Financial Inclusion
Diversifying types of products and service
Pure Business-banking model
for profitand for remaining profitable
Not for profit
Pure charity philanth
Pure Profit and Loss
Musharika and Mudarab
Banking
*Conventio nal
* Islamic
Venture Capital
Angel funding
Family owned collectiv
Compul sory zakat
Volunt ary
Sadaq a,
Right of the poor
For public welfare
Waqf
Trusts & SPVs
Start up businesses in need of angel funding
Inducing poor to Business to sustain
Gov.t guarant ees
Start up equity waqf
Cash Waqf
- operational Funding of waqf org's
-endowments
Disaster relief
Waqf Asset for public welfare
Roads, Water supply,(wells, tube wells), planting trees, …
Coope rative (banks vs non profits
Waqf organisations/ co.s hospitals, schools, mosques,

The model above depicts different types of business and social models along with the tools appropriate to make them possible. The left-most branch is a part of the business model but through the banking system, in which the funds of the depositors are utilized in such a manner that the businesses can sustain themselves, and keep giving a rather safe form of returns to depositors. This is done either through the conventional interest based lending and borrowing model or through the cost plus profit margin and the *mudarabah* deposits model of the Islamic banks. The depositors' funds' safety is a primary concern here while promoting and maintaining the profitability of business activities. The Islamic commercial banking model is the pure business model, or private business model in which the shareholders of the Islamic banks ultimately get the residual profit or bear the business loss, even if the depositors were given a profit on their investments.

In the center, the pure business model for profit -making is given, being used in a capitalistic system as well as Islamic business system. Any private business venture from sole proprietorship, to partnership, private company to public limited companies and multi-nationals fall in this category. This private business sector is common in a capitalistic system as well as Islamic economies. The business owners are sole proprietors or shareholders, and their contracts types are called *musharaka* and *mudarabah* in the Islamic contracts system.

The right side shows the social business model/s. Their existence side by side with the business models is necessary for addressing poverty and social wellbeing of the have-nots in the society. In the western developed countries, along with the pure commercial business models & the banking system, the state undertakes basic welfare activities, like some free or subsidized education, unemployment benefits for subsistence, and some health care facilities, subsidized food and housing. Wealthy Muslim countries too, have plenty of similar state sponsored facilities and some of them do not charge tax from the public. However, countries with scarce resources (whether Muslim, secular or non-Muslim), except for socialist countries, governmental welfare is generally missing. In such countries in particular, private donations and charity is instrumental in helping the poor. However, these personal and private philanthropic efforts need to be streamlined in order to be more effective in addressing poverty and eliminating hunger and starvation throughout the world. The point being made is that the potentially available funds for social finance are much more than being currently made available (Shirazi, 2006) through informal channels as well as scanty governmental funding in such countries. This requires an inclusive approach towards societal development.

The conventional and Islamic approaches to inclusive socio-economic development or the newly coined term "financial inclusion", have some basic differences too. The World Bank's initiative of Financial Inclusion, means reaching the unbanked people and it gives data of 38% of the world population, and 73% of the poor people and more than half of adults in the poorest 40% of households in developing countries as without access to formal bank accounts and without access to financial services worldwide (The World Bank, 2015). Some of the reasons cited are difficulty of access, costs, and lack of affordability, [being poor and therefore being denied financial services], and the behaviour of the poor, by not planning to save, or planning their expenses, among others. (*Global Financial Development Report 2015/2016).* This behavioural aspect has been cited in the conventional approach in the previous economics literature on poverty too. With a slogan, "Working for a world free of poverty", the World Bank's Financial Inclusion initiative states that: "access to financial services through formal accounts can enable individuals and firms to smooth consumption, manage risk, and invest in education, health and enterprises" (Ibid,2015).

The Islamic Approach to addressing poverty is to give to the hungry on immediate, and emergency basis instead of progressive help over a period of time and to help the poor whether or not they are productive, or enterprising enough. After their basic needs are fulfilled, they must be helped to earn for their own and sustain themselves economically. Islam does not address the behavior of the poor but addresses the neighbours, the community, the institutions and whole system and it make it their duty to take care of the deprived. For the first step, *Zakat* is given by the rich to the poor. *Zakat* is the right of the poor in the wealth of the rich. It belongs to the poor for meeting their needs. This act of giving *zakat* also leads to increase in consumption in the economy, because the *zakat* money is used on the imminent needs of the poor, like buying flour, rice, food, footwear, clothes, and basic medicines. This also increases the consumption of basic goods. The traders and the manufacturers of the basic goods also benefit as a result of this basic consumption.

Secondly, by setting aside money voluntarily for the uplift of the poor for their economic sustainability, the necessary funds can be made available for the poor and the new entrepreneurs to help them stand on their own feet economically, while not being burdened by the interest payments. On the contrary, in the conventional lending based micro-lending, there are examples of many poor women, when unable to pay debts, committing suicides due to helplessness, and under pressure from the community to pay. This was the downside of the micro lending at exorbitant rates and community based lending to the poor and to the women.

If we review the Islamic history, the example of *waqf* dates back from the early Islamic civilization of Madinah, during the times of the Holy Prophet (PBUH) where upon his instructions, the well of Bayruha was bought by Muslims and designated as public property for drinking water (Kahf, 1999 and 2003). Later, when the Islamic civilization had spread to a large part of the world during the 18th century Ottoman Empire, *waqf* based revenues constituted one-third to half of total state revenues (Cizakca, 2000). Taking lessons from the Islamic history, it can be asserted that an initiative of institutional setup in Muslim economies is needed to help the people take up the responsibility and eliminate poverty and social exclusion from the society. Rough approximation, supported by some statistical calculations (Shirazi 2006), indicates that this means an amount of 7 to 10 percent of GDP is potentially available for this sector in Muslim economies.

The right question is what institutions can possibly compliment the market in taking care of those excluded by the market. If social business of caring for the needy was as developed as commercial self-interest based business, such economic evils like starvation, hunger and extreme poverty would not have existed. However, this is not the case, and social business is lagging behind and is not being developed on institutional footings. The institutions did not emerge to allow the caring instinct to compete the commercial institutions in allocating resources between self-interest and the instinct of caring for the downtrodden. Islamic system of life requires that hunger and *maskanah* do not exist and if they do then those who sleep full stomach are responsible for it. However, many Muslim countries also do not follow this principle in letter and spirit, and thus there is a widening gap between the rich and poor, and the worsening situation of the poor.

Islam, on the other hand, gives the principles for human behavior that aim at eliminating social exclusion. Following key principles need to be highlighted in this respect are:

1. A minimum amount has to be given away to the poor every year. “And in their wealth, is the right of needy who asked and needy who for (some reason or in some way) is deprived from asking (help)[1]. Anyone who owns gold, silver, cash, savings, investments, rental income, business merchandise and profits, shares, securities, and bonds above a certain value (currently $3500 in USA) is liable to pay a certain percentage (minimum 2.5 percent and on some assets 10 percent) to the poor.
2. Social exclusion (depriving the *Masakeen* from sharing the fruits of prosperity) is a divinely punishable crime[2].
3. It is in the benefit of the haves to take care of have-nots[3]

The two key questions are:

a) how to distribute *zakat* effectively

b) how to provide financial assistance to needy section of the society in a manner that they get out of hunger and poverty and

[1]The Quran 51:19 and 70:24-25

[2]See the parable described in the Quran (68:19-33)

[3] “The parable of those who spend their substance in the way of Allah is that of a grain of corn: it grows seven ears, and each ear Hath a hundred grains. Allah gives manifold increase to whom He pleases: And Allah cares for all and He knows all things”. The Quran (2: 261) and also “The Evil one threatens you with poverty and bids you to conduct unseemly. Allah promises you His forgiveness and bounties. And Allah cares for all and He knows all things. The Quran 2: 268 and also “Whatever of good ye give benefits your own souls, and ye shall only do so seeking the "Face" of Allah. Whatever good ye give, shall be rendered back to you, and ye shall not be dealt with unjustly”. The Quran (2: 272). Using the terminology of modern economic thought (Coase theorem), poor have property rights in the wealth of rich. If rich make it convenient and less costly to give the poor what is due to them, this will increase the value of all property rights.

then become able to pursue their economic activities for sustaining and developing their economic wellbeing further?

c) how to provide business finance to new entrepreneurs profitably or at breakeven over a period of time to help the needy while making it feasible for the financial institution as well.

For No. a) above, streamlining *zakat* and charity and regulation and institutional development for its effective management is needed. The funds collected through *zakat* cannot be used for motives other than giving to the poor quickly. The statistics of Pakistan shows a poor performance of the official national level *zakat* funds and the news about their mismanagement. Studies also depict the abundant *zakat* and charity paid in Pakistan by the general public (Shahab Nafees, 2014). Muslim world gives abundantly in charity (Shirazi, 2006).

We are discussing *zakat* and the poor because *zakat* is given by the haves (wealthy) and to the have-nots (poor). In political economy's terminology, Money or wealth or "affluence" makes one powerful, and hunger makes one weak and almost a "slave" of the worldly powerful. "*Faqr* leads to *Kufr*", i.e. extreme poverty leads one to disbelief in Allah (SWT). Allah (SWT) clearly says that in your wealth there is the right of the poor (The Quran, 51:19) and the family members (The Quran, 59:7)[4]. It means that wealth must circulate from the haves to the have-nots. It is for benefiting the poor and needy. This is a source of satisfaction for giving and doing good and also hereafter's benefit to the wealthy too.

Although the Muslims and all kind hearted philanthropists give to charity and help those in need, there are three main problems:

a) the mismanagement of *zakat* and charity given, at personal and national levels
b) slow allocation and misallocation of *zakat* due to lack of accountability and transparency for political gains, for ulterior motives
c) lack of networking and lack of unified *ijtehaad*: on an international and Muslim *Ummah* level, about the

utilization of the available surplus *zakat* funds in wealthy countries~~.~~

There is mismanagement of *Zakat* funds and charity funds due to personal disposition of monetary *zakat* and charity and in kind (food & allied items)[5]. For instance, there is over abundant charity of food items during ramazan, in which many food items eventually get wasted.

In some countries, *zakat* collected at national levels, is poorly and slowly allocated, and even misappropriated since those who get used to usurping government's money and resources, cannot understand the sanctity of other people's rights and wealth, and hence the sanctity and urgency of correct *zakat* allocation is forgotten.

In addition, there are countries which have pools of abundant *zakat* funds but the understanding of *zakat* and the sense of nationalism above *ummah* and humanitarianism is also causing the funds to be lying in different accounts but not being utilized for the needy. Hence there is slow allocation and misallocation of *zakat*. Lack of worldly accountability and transparency and political gains are some of the reasons for it too.

Lack of unified *ijtehaad* on *zakat* issues: very little of *Zakat* goes for sustainable development, due to lack of ijtihad on spending zakat collections for sustainable development of the poor. The consensus of the Sharia scholars is to give away zakat to the poor and needy immediately as it falls due and not to take a portion of it, to be spent on them or used by them in another form. There are individual statements of *shariah* scholars that *zakat* can be given "*fi sabeelillah"*, and what it entails and which organisations it includes.

According to the Quran (09:60) *zakat* should be given to the following types of people:

"They are; the poor and the needy, those in bondage and in debt, those who are in the way (cause) of Allah, the wayfarer, those employed to administer the (funds) and those whose hearts have been (recently) reconciled (to Truth)."

One website (qtafsir.com, n.d.)has aptly stated regarding *zakat* that "There is no religious drawback to giving *zakat* and *fitrah* to societies, institutions, solidarity funds that are known to collect them in a fund and give them to the people mentioned in the 60th verse of Chapter at-*Tawbah* and directed by reliable

[5] (Analysis: A faith-based aid revolution in the Muslim world?, 2012)

people" This is good, provided such institutions commit that the collected amount will exclusively be given to the poor. There should be transfer of ownership of the *zakat* funds and resources to the poor. It will not be acceptable if a society mixes *zakah* with other funds and uses them to provide benefits to people that includes poor and non-poor.

Despite giving *zakat* as an obligatory duty, according to the World Giving Index (Charitable Aid Foundation, 2010) , in the list of % of population giving money to charities, none of the Muslim countries rank among the top seven countries. This may also be due to their question stating charities and not asking about informal *zakat* and charities instead of their contributions to formal charities.

Regarding business help and uplift for the entrepreneurs who have ideas and talent but do not have the necessary resources, there are the choices of angel funding, profit and loss sharing, and *Waqf* based giving that can be utilized (Ahmed, 2007). These choices need to be promoted through institutional setup and regulatory requirements with transparent practices governed by good management practices under the control of regulatory authorities. Their regulators will not be lenders of last resort or guarantors of their losses, but can enforce good governance and financial management practices.

Taking part in Venture capital and startup businesses through financial contribution requires a different set of capital contributors. They will not be the typical depositors of banks that are "saved "from losses and are provided a portion of the gross profit even when the bank / or Islamic bank incurs losses. As partners in business, they have to be ready for losses too. However, they'll be free to choose the businesses or ideas they want to invest in and take part in their management or entrust the management to their agents who shall run the business for them.

The concept of *Waqf* is to set aside a portion of your property or money for some beneficial cause or benevolent activity. Usually the money collected through *Waqf* or property given as *Waqf*, is used for creating an asset that provides beneficial services forever, as long as its maintenance and proper management is provided for (Cizakca, 2000). *Waqf* is institutionalization of charity. It has played a very important role in the earlier Muslim societies, such that Waqf based institutions were independently providing welfare activities and help to the poor. There were individual *Waqf* contributions as well as by the rulers of the countries. The relevant factor about the institution of *Waqf* is that it is "*sadaqa e jaariya*" (Ibid, 2000), which means that it is a perpetual charity. Unless it is misappropriated or gets destroyed through a calamity, for as long as it exists, it gives benefits and is available for the needy recipients in general.

Waqf entails things or money that is set aside, away from personal use and benefit and invested in productive assets that provide revenue. It can be in the form of Land and building, Corporate *Waqf* and as Cash *Waqf*. This is something that is done for public welfare. Allah (SWT) advises the people to give to the poor and needy and for the welfare of the public, which is considered as giving in the way of Allah (SWT). The institution of trust is being used in private equity management and in Sukuk. It is adopted by the English common law and the financial law for financial products throughout the world. However, it is a modified version of *Waqf* (Norman, 2009). Other types of financial and business activities work through cooperative societies and trusts. Although they became infamous in Pakistan, due to lack of regulatory control, transparency and corruption by the people in charge of the affairs, this model has a potential for working for the benefit of the society for their financial inclusion. Venture capital and angel funds providers which have been very successful in the USA and other countries of the developed world, is yet to be adopted by the developing countries, although on family business levels, venture capital and collective family business funding and activities are very common throughout the country. These business and financial models have their benefits and drawbacks of failures and complete loss too.

Conclusion

Apart from the money in banks, there is a lot of charity-based giving away of wealth, passing through informal channels, that needs to tapped and organized in a systematic manner through formal channels of the financial system. This has to be done without mixing the *zakat* with *Waqf* and the business venture capital of profit and loss. *Zakat* means giving ownership of *zakat* money and assets to the poor immediately. There is a need to pull up the people from the brink of starvation and "*Faqr*", and enable them to have sustainable livelihood. *Waqf* institutionalization and specific Islamic banking products for poverty alleviation, based on people's and institutions' *Waqf* endowments, can be instrumental in bringing informal charity funds that are currently outside banking channels into the banking channels for the societal usage and hence making them a part of the financial system and expanding the system, albeit on a different set of values, other than commercial business and interest based lending to the poor. Continued product and business model innovation is required so that more people can access a broader range of business financing facilities at lower costs and at shared costs and benefits. Innovation in providing a system that serves the new entrepreneurs profitably or at breakeven is required too. These systems need to be supported by regulations and management practices that encourage *Waqf* based institutions and philanthropy.

Since the market works on the principle of financial exclusion, on the basis of who can pay for what is available in the market, the market institutions alone cannot be expected to achieve inclusion. In other words, commercial banks alone cannot be expected to enhance financial inclusion. They have to be complimented by appropriate non market institutions in enhancing financial inclusion. Financial development that can mobilize and encourage social finance to pass through formal channels can play an important role in enhancing financial inclusion. Public policy aiming at financial inclusion will need to promote such institutions as *Waqf*, *Zakah* and *Infaq* (Charities) that have religious significance. Islamic banks need to be integrated with such institutions to bring social finance to pass through formal channels. Islamic banks need to re-orient their business model as to attract social finance.

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