Project Report

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Demand Assessment for Sharia-based Financial Products

Findings from Research in Herat, Jalalabad, Kabul, and Mazar-e Sharif

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Executive Summary

Evidence to date since the inception of Microfinance Institutions (MFIs) in Afghanistan points to a friction at a fundamental level between traditional value sets on money lending and borrowing and the business requirements that need to be adhered to by MFIs. The often absolute denunciation of paying interest on loans by many interpreters of Sharia principles in various parts of Afghanistan has sometimes led to strong opposition and open protest by some community members and condoned by religious figures.

These developments point to a need for a better understanding of the basis for the objections to microfinance, particularly microcredit, to establish whether there is a need to respond to these objections through developing new financial products in conformance with the Sharia principles.

Riba, or interest earnings from lending money, are viewed in Islam as *haram*, or sinful. While modern interpretations of riba tend to be more flexible and allow for certain forms of reward or appreciation for the lender providing the loan, to many lay Muslims all interest is riba and therefore no money should be lent or borrowed for interest. Research on Islamic banking suggests that the higher the religious commitment and the lower the level of general education, the stronger the preference for Islamic over conventional financial products. While there is a general preference by Muslim customers for Sharia-based financial products, there is insufficient awareness as to the differences between Sharia-based and conventional financial products.

Other research shows that the speed and the degree of success with which Islamic banking emerges in conventional systems will depend largely on whether potential depositors and investors are well informed about the opportunities and risks and whether Islamic banking is perceived as transparent and regulated. To establish the size of the demand for Sharia-based products, a number of conventional banks set up “an Islamic window” within their normal operations and offer select Sharia-based products. Depending on the success of this experiment, an informed decision could then be made on whether or not to move toward full Sharia-based banking.

The research found that:

1. Objection to interest payment on loans is widespread and often absolute. However, in many cases during this research the strongest objections came from borrowers who had defaulted on their repayments.
2. Use of loans appears to be a function of income levels: at lower income categories it is more likely that loans are used to pay for medical expenses and other life events.
3. The tendency among actual and potential borrowers is to ask, repeatedly, for (no interest) *Gharz-e Hasana* while religious leaders and community elders tend to suggest *Musharaka*, *Murdaraba*, and *Murahaba* (various forms of Sharia-compliant financial arrangements).
4. There appears to be willingness by a number of religious leaders about diluting interest in differential exchange rates or payment of fixed commission to banks which purchase investment goods on behalf of borrowers.

5. There is a discernible degree of self-consciousness among MFI employees about being viewed negatively by community members where they operate.
6. There are indications of intensified denunciations of borrowing on interest by religious leaders in mosques on the television and radio.
7. Many (including religious leaders) differentiate between income generating and non-income generating uses of loans.
8. MFIs are now having to apply more scrutiny to increase income generating use of microcredit and hence keep in check or reduce the number of defaults. This approach is also likely to emphasize the positive (income generating) aspect of loans and change negative perceptions of borrowing, particularly by those who view initiative and industry as positive traits regardless of strong convictions about interest bearing loans

This report recommends:

1. The question of interest, declared as sinful in the Quron and maintained as necessary for continued business activity by MFIs, is best resolved through a dialogue involving religious experts, governmental bodies, bankers, and economists committed to economic progress and modernization of the banking system in Afghanistan.
2. To facilitate such a dialogue, MISFA / MFIs should consider offering, as pilots, Sharia-based products with the intention of testing them while effectively moving the issue of soud off the agenda.
3. The matching concession from the fundamentalists / naysayers’ side should be an agreement to engage with banking experts and professionals, since many countries with similar religious reservations have managed to resolve the conflict between modern banking requirements and Islamic values.
4. Given the Islamic context for its operations, difficulties for MFIs in becoming established and institutionalized, and the apparent deterioration in the operating environment for MFIs, it may be worthwhile for MISFA / MFIs to consider covering some of the operating costs through means other than the interest charged on loans.
5. In practice, the terms and costs of Sharia-based financial products should not deviate substantially from conventional financial products because of competition. The rationale for developing Sharia-based financial products should not be because they are “better” than their conventional counterparts but because the availability of Sharia-based products expands the range of choices available to customers.
6. In addition to offering Sharia-based financial products, MFIs will need to raise the awareness of their borrowers about the differences between Sharia-based and conventional financial products. Part of this awareness raising programme should be finding the most suitable Dari equivalents for interest from riba, soud, mafad, and bahreh or other terms.
7. In the event that MFIs opt for developing full-fledged Sharia-based products, serious efforts will need to be made to set up a Sharia Advisory Board to win the trust of the Ullema and gain legitimacy among the actual and potential borrowers.
8. Coordination and consultation should be sought with the Ministry of Hajj and Religious Affairs in developing the new Sharia-based products and in initiatives to raise public awareness on Islamic values and borrowing.

1. Introduction

Evidence to date since the inception of Microfinance Institutions (MFIs) in Afghanistan points to a friction at a fundamental level between traditional value sets on money lending and borrowing and the business requirements that need to be adhered to by MFIs. The often absolute denunciation of paying interest on loans by many interpreters of Sharia principles in various parts of Afghanistan has sometimes led to strong opposition and open protest by some community members and condoned by religious figures.[1] While attempts have been made by some MFIs, such as FINCA, to address the need for Sharia-compliant financial products and services, there is insufficient knowledge about the full extent of financial products that could be designed based on Sharia principles and the demand for such products. This research was commissioned by MISFA for a study centered on Herat, Jalalabad, Kabul, and Mazar-e Sharif and adjacent rural areas to assess the demand by potential borrowers in urban and rural settings for Sharia-compliant financial products.

This report is structured as follows. The next section describes the main objective for this study. Section 3 describes the methodology used in data collection and analysis. Section 4 provides an overview and background to Sharia-based banking. Section 5 highlights some of the key contextual factors with a focus on the emergence and evolution of microfinance and Microfinance Institutions (MFIs) while Section 6 reports on the main findings from this research. Section 7 concludes with a series of recommendations to be considered by MISFA in its decision making on the development of Sharia-based products for the Afghanistan market.

2. Objective

This study assessed the demand for Sharia-compliant financial products in the four locations and some of the adjacent rural areas based on data gathered from:

1. Current borrowers (male and female) drawn from lists provided by MFIs operating in the four locations
2. MFI staff in the four locations
3. Religious leaders in the four locations
4. Community elders and other key actors in the four locations
5. Women's groups and/or associations as actual or potential borrowers in the four locations

This report is based on a review of some of the pertinent literature on Sharia-based banking, interviews with key informants including MFI staff, religious figures, community elders, and individual borrowers, and focus group discussion with borrowers and those wanting or needing to borrow but not borrowing due to actual or purported objections to interest-based borrowing. The sites of this research were Herat, Kabul, Jalalabad, and Mazar-e Sharif and the some of the outlying villages. The methodology utilized to meet this objective is described in the next section.

[1] See, for example, Parto, S. and A. Regmi (2008). "A Critical Assessment of Microfinance", available from: http://www.appro.org.af/Publications.html

3. Methodology

The assessment was based on the following activities:

- **Document review:** To establish what is known about Sharia-compliant financial products in Afghanistan and other contexts.
- **Focus group meetings:** For each location up to 10 focus group meetings were held with actual and potential borrowers, selected in consultation with the local MFIs, particularly BRAC.
- **Key informant interviews:** With individuals from the MFIs, relevant ministries, community leaders and actors, and donor organizations.

Interview questions for the individual interviews and guiding questions for the focus group discussions were drawn up based on the literature / document review and consultation with MISFA. Part way through the fieldwork and after the first presentation on May 22, 2011 of the preliminary findings from Kabul and Herat, at MISFA's request the field teams also collected socio-economic data from the borrowers and would-be borrowers prior to holding focus group discussions or individual interviews. The fieldwork, including additional data collection for socio-economic profiles in Herat and Kabul, was completed by the end of June 2011. A second presentation was made at MISFA on June 21, 2011. The analysis of the field data was completed on July 22, 2011.

APPRO's field research team consisted of two females and three males. With generous logistical assistance from BRAC, the team was able to engage current borrowers, those who refuse to borrow but would like to, bad debtors, community elders, religious leaders, and personnel from two MFIs in each of the four sites. The breakdown of the number of individuals engaged through interviews and focus group discussion is as follows: Kabul = 121, Jalalabad = 52, Mazar-e Sharif = 85, and Herat = 110. The socio-economic survey excluded MFI employees (10) and religious leaders and community elders (11). A planned interview with officials from the Ministry of Hajj and Religious Affairs did not take place.

4. Sharia-based Financial Goods and Services: An Overview

References to a market economy and a form of what later came to be known as mercantilism in Europe in during the 16th to the late 18th century in the Islamic world go back to the period between the 8th and 12th centuries. According to Labib (1969), the economies of the Islamic world were unified through the dinar, the widely circulated currency, and a host of sophisticated financial concepts including bills of exchange, various forms of loan, and various forms of partnership.[2] It has been suggested that many of the Islamic capitalist concepts were adopted and developed further by Europeans from about the 13th century onwards.[3]

[2] Labib, S.Y. (1969). "Capitalism in Medieval Islam", *Journal of Economic History* 29(1): 79-96.

[3] Banaji, J. (2007). "Islam, the Mediterranean and the rise of capitalism", *Historical Materialism* 15(1):47-74.

According to Jobst (2007), Islamic finance is based on a set of prohibitions aimed at creating an equitable system of distributive justice and the promotion of permitted activities and public goods.[4] These are:

Riba: Interest earnings or usury and money lending, or surplus value without counterpart
Haram: Sinful activity through direct or indirect involvement with alcohol, pork products, firearms, tobacco, and adult entertainment
Maisir: speculation, betting, and gambling including the speculative trade or exchange of money for debt without an underlying asset transfer
Bay' al-inab: the trading of the same object between buyer and seller
Gharar: Preventable uncertainty such as all financial derivative instruments, forward contracts, and futures agreements.

Modern interpretations of riba refer to any unjustifiable increase of capital through "usury, … charging interest and any positive, fixed, predetermined rate of return that are guaranteed regardless of the performance of an investment."[5] Put differently, "profits must not be guaranteed *ex ante*, and can only accrue if the investment itself yields income."[6] The modern term to capture these requirements is *profit-and-loss sharing*, whereby "the assets and liabilities of Islamic banks are integrated in the sense that borrowers share profits and losses with the banks, which in turn share profits and losses with the depositors."[7] Some have interpreted this requirement as a means to forbid capital-based investment gains without taking entrepreneurial risk.[8]

The current attempts to challenge interest on money lending with notions of profit (and loss) sharing date to the 1940s.[9] The interest in Islamic finance was strengthened by a number of key political events starting in the early 1950s. A number of conferences on Islamic banking were held in the 1970s in Pakistan, Egypt, Saudi Arabia, and England. A major outcome of these events was the creation of the Islamic Development Bank (Saudi Arabia) and Dubai Islamic Bank in 1975. The goal for the Islamic Development Bank was to provide development funding to member states while the Dubai Islamic Bank was the first modern commercial Islamic bank. The number of Islamic financial institutions is estimated at 300 with operations in 51 countries, holding assets in excess of US $300 billion, with an annual growth rate of 15%.[10]

Islamic banks are required to have Sharia Advisory Committees to ensure that banking operations and activities comply with the Sharia principles. Malaysia, with a significant number of Islamic banks, has a National Sharia Advisory Council to oversee and streamline the work of individual Sharia Advisory Committees.[11] At the international level, two multilateral institutions

[4] Jobst, A.A. (2007). The Economics of Islamic Finance and Securitization. Journal of Structured Finance 13(1). Page 3.
[5] Iqbal and Tsubota (2006), in Jobst (2007:3).
[6] Jobst (2007). Page 4.
[7] Chong, B.S. and M-H Liu (2007). Islamic Banking: Interest-Free or Interest-Based?. Available from: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=868567
[8] Jobst (2007). Page 4.
[9] See, for example: Qureshi (1946), Ahmad (1952), and Siddiqi (1982).
[10] Jobst (2007). Page 21.
[11] Chong and Liu (2007), page 11 and Solé, J. (2007). Introducing Islamic Banks into Conventional Banking Systems. IMF Working Paper WP/07/175.

have been created to oversee and govern the activities of the Islamic banking sector. These are the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) created in 1990 and the Islamic Financial Services Board (IFSB) created in 2002.

Box 1. Key Sharia-based Financial Terms

Bai' bithaman ajil: purchase with sale at a mark-up which is not disclosed

Bai dayn: trading in debt instruments

Qard Hassan: an interest free loan, including by a depositor to a bank

Ijara: operational leasing contract

Mudaraba: profit sharing partnership with only one of the partners providing the finance and the other having a return for risk sharing or entrepreneurial activity. Usually applies to bank deposits

Murabaha: purchase and sale for a mark-up which is disclosed

Riba: interest or usury

Salam: purchase of a commodity for future delivery with the price paid in full in advance. Usually the commodity is subsequently sold for a higher price, prior to, or at delivery, with the margin representing the profit

Shariah: Islamic law as revealed in the Holy Koran and the *hadith*, the sayings and deeds of the Prophet Mohammad

Sukuk: Islamic securities

Takaful: Islamic insurance usually provided on a mutual basis

Tawarruq: the ultimate purchaser in a *murabaha* transaction sells the commodity obtained spot for cash. It is equivalent to a cash advance or personal loan.

Wakala: trust, usually applied to a bank deposit or a trust fund

Waqf: Islamic religious endowment

Source: Wilson (2007)[12]

A study by Omer (1992) reports that the higher the religious commitment and the lower the level of general education, the stronger the preference for Islamic over conventional financial products.[13] Other studies have suggested that while there is a general preference by Muslim customers for Sharia-based financial products, there is insufficient awareness as to the differences between Sharia-based and conventional financial products. Another study from Malaysia reports that key selection criteria of Muslim bank customers are service efficiency, transaction speed, and the friendliness of bank personnel.[14] A key finding from the study by Bley and Kuehn (2004) is that the use of Arabic language in labeling Islamic finance products and

[12] Wilson, R. (2007). "Islamic Finance in Europe." RSCAS Policy Papers, RSCAS PP 2007/02.
[13] Omer, H.S.H. (1992). "The Implications of Islamic Beliefs and Practice for the Islamic Financial Institutions in the United Kingdom." PhD Dissertation. Loughborough University, cited in Bley and Kuehn (2004).
[14] Bley, J. and K. Kuehn (2004). "Conventional versus Islamic Finance: Student Knowledge and Perception in the United Arab Emirates." *International Journal of Islamic Financial Services,* 5(4).

services seems to hinder understanding for the vast number of non-Arabic language populations.[15]

According to Solé (2007) the speed and the degree of success with which Islamic banking emerges in conventional systems will depend largely on whether potential depositors and investors are well informed about the opportunities and risks and whether Islamic banking is perceived as transparent and regulated. A number of conventional banks start the process of offering Sharia-based products by setting up “an Islamic window” within their normal operations. If the window becomes firmly established and attracts a steadily increasing customer base, the bank may decide to segregate the window into a separate entity.

5. Key Findings

Microcredit provided by MFIs since 2004 has been used for a variety of purposes, which may be categorized as productive, unproductive, and destructive.[16] Loans may be taken to start up or expand and enterprise involved in value adding economic activity (productive), to buy goods for resale with a mark-up or to fix up abode (unproductive), or to participate in illegal and/or socially detrimental economic activity such as paying bribes or dealing in drugs (destructive). There are limitations to the uses of Baumol’s (1990) categories of productive and unproductive in analyzing microfinance. It would be more meaningful to replace productive and unproductive with “income generating” and “non-income generating”, respectively. Also, there is no evidence of destructive economic activity through use of MFI loans and hence this category of microfinance-assisted economic activity can be removed from the analysis of the data for this study.

There are comparable numbers of borrowers in the income generating and non-income generating categories. In many instances the borrowers state income generating purposes for taking out loans which are subsequently put to non-income generating use. There are numerous examples of borrowers taking microcredit to pay for medical treatment, weddings and funerals, fixing up abodes, and paying other loans. There are also numerous examples of borrowers who use the loans to start up or expand value adding economic activity.[17] For example,

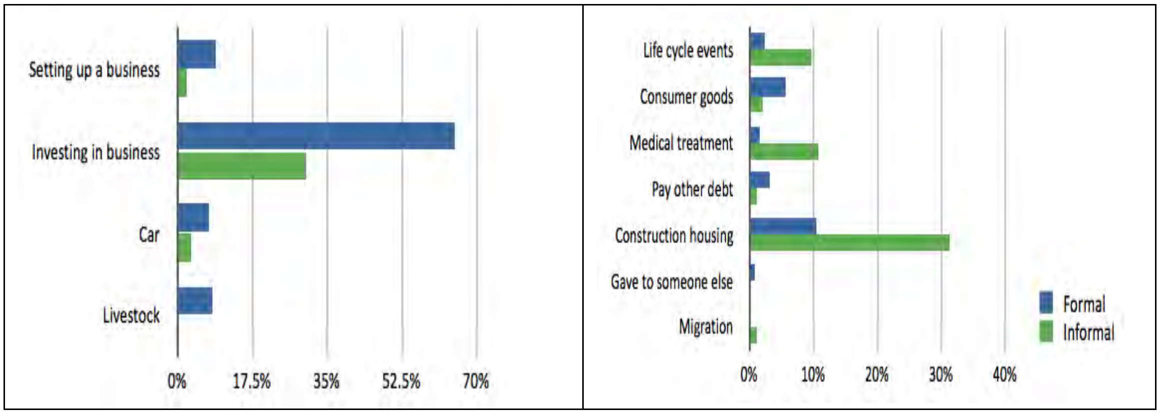
> Using the loans from MFIs helps me to improve and expand my business and increase my profits. The more I have access to loans, the better I can make my business (KI-R-K-2).

[15] Language-related difficulties are by no means specific only to Arabic. The Dari/Farsi translation of the word interest can be soud, mafad, or bahreh – each with slightly different meaning. By far, soud is the most anti-Islamic among the three meanings.

[16] This categorization is based on Baumol, W.J. (1990). “Entrepreneurship: Productive, Unproductive, and Destructive.” *The Journal of Political Economy*, 98(5)-Part 1: 893-921.

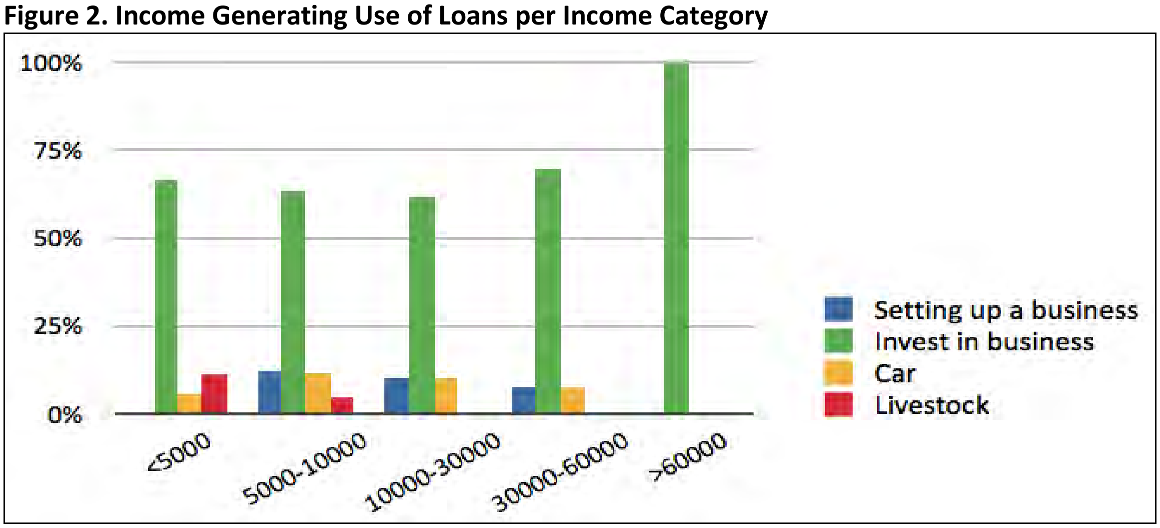
[17] The charts in this section are based on the profiling data collected from focus group participants and others who were interviewed individually because they refused to participate in group discussions. Although the charts are based on data from 347 individual cases, they are not statistically significant and used here for illustrative purposes only.

Figure 1. Income Generating versus Non-income Generating Use of Loans from Formal and Informal Sources



Objection to interest payment on loans is widespread and often absolute. However, in many cases during this research the strongest objections came from borrowers who had defaulted on their repayments. Failure to repay the debt is often followed by approaching the religious leaders for advice who "confirm" for the bad debtor that their bad fortune is due to committing a sin by taking an interest-bearing loan. Seeking comfort and advice from the community religious leaders also has the knock-on effect of Friday prayer denunciations about the sinfulness and ruinous effects of borrowing from MFIs and the immorality of those who work for MFIs or have dealings with them.

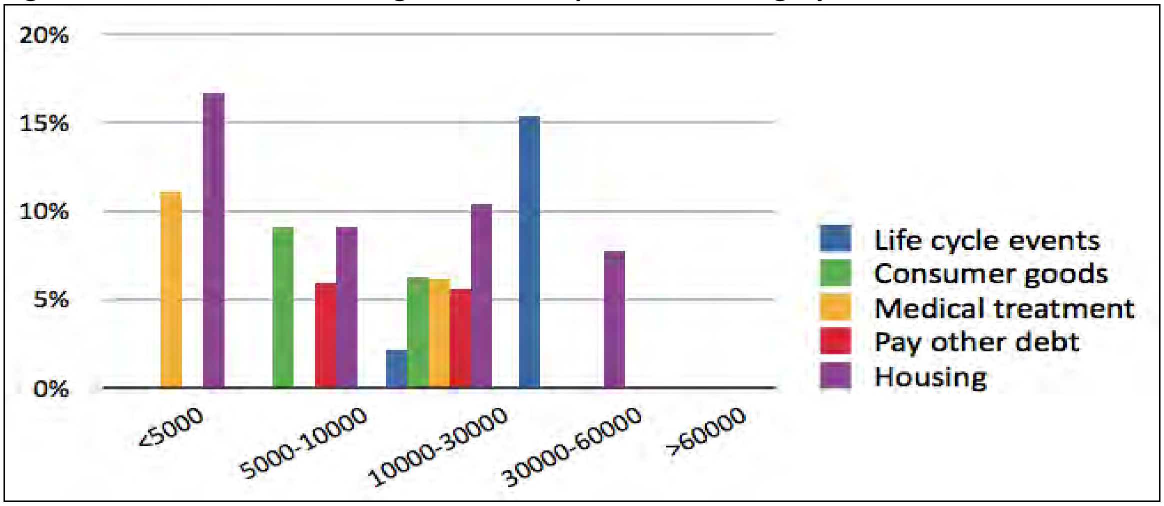
Figure 2. Income Generating Use of Loans per Income Category



There appears to be a direct relationship between higher income categories and investing in existing business (Figure 2). Use of loans also appears to be a function of income levels: at lower income categories there are more incidences of loans being used to purchase livestock or vehicles (used as income generating sources). Figure 3 also suggests that using loans to start up new businesses is more prevalent in middle income categories of greater than 5,000 and lower than 60,000 Afghanis per month.

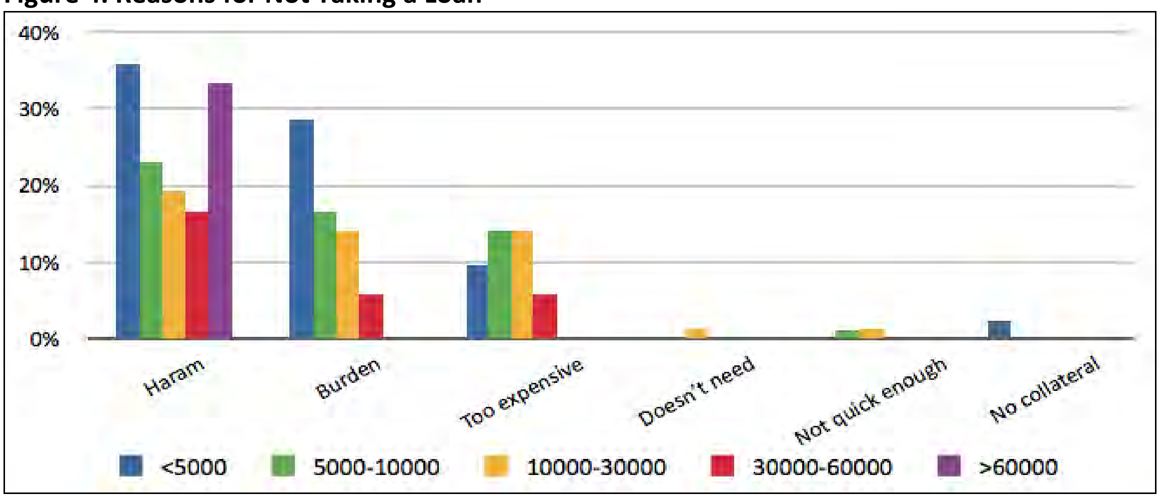
There are a higher number of instances of borrowers in the lowest income category (less than 5,000 Afghanis) to use loans to pay for medical expenses and housing / home improvements. Use of MFI loans to repay other debts appears to be prevalent in the range of household incomes from over 5,000 to 30,000 Afghanis.

Figure 3. Non-income Generating Use of Loans per Income Category



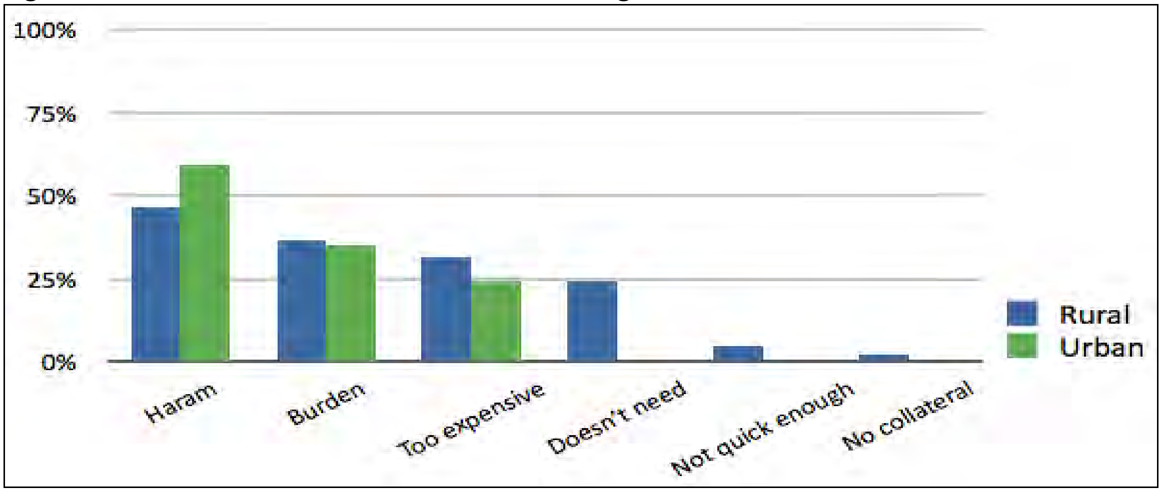
Individuals in the lowest income and highest income categories have the highest objection to borrowing on religious grounds while those in the lowest income category have concerns about the burden of debt (Figure 4).

Figure 4. Reasons for Not Taking a Loan



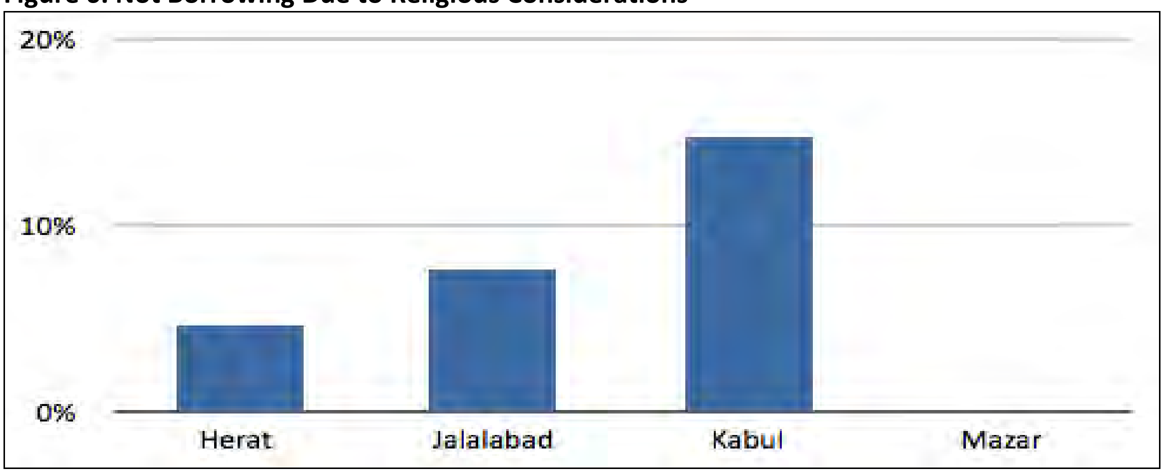
Counter-intuitively, a higher percentage of the individuals in urban settings viewed MFI loans as haram while 25% of the individuals from rural areas claimed that they had no need for loans (Figure 5). During the interviews with religious leaders the researchers asked specifically about the conditions under which borrowing from MFIs could be permitted under Sharia. Apart from repeated requests for Gharz-e Hasana, Musharaka, Murdaraba, and Murahaba suggestions were made by a number of religious leaders about diluting interest in differential exchange rates or payment of fixed commission to banks which purchased investment goods on behalf of the borrower. A religious leader from Herat even suggested that by attempting to comply with Sharia requirements, MFIs could substantially increase their customer base (FDG-H-M-RL-2).

Figure 5. Urban versus Rural Reasons for not Taking Loans



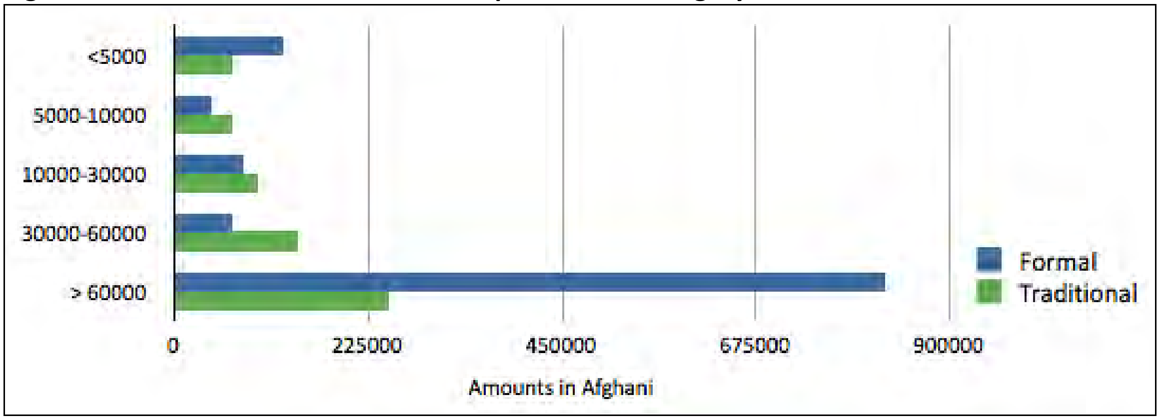
Kabul has the highest percentage of individuals who object to taking loans on religious grounds, though at around 15% this does not represent a serious concern. There were no objectors among the Mazar-e Sharif interviewees (Figure 6).

Figure 6. Not Borrowing Due to Religious Considerations



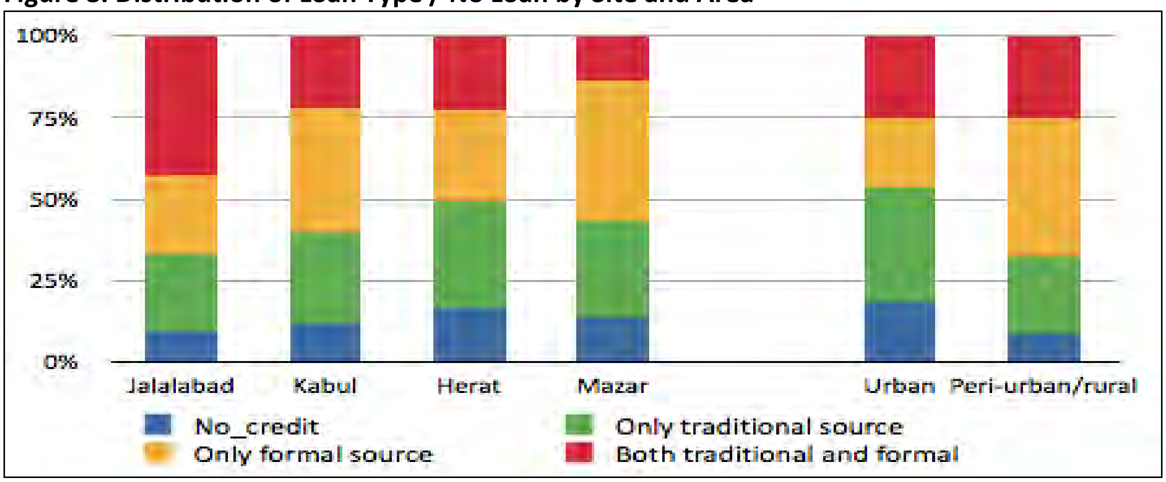
Individuals in the highest income category take the highest amounts of loan from both formal and informal sources (Figure 7).

Figure 7. Sources and Amounts of Loans per Income Category



Mazar-e Sharif and Kabul have the highest percentage of individuals with loans from MFIs. The main difference between urban and peri-urban areas appears to be a higher number of loans in peri-urban than urban areas (Figure 8).

Figure 8. Distribution of Loan Type / No Loan by Site and Area



6. Challenges for Microfinance

Throughout the focus group discussions and interviews, there were repeated comments about the immediate burden of making repayment installments shortly after receiving the loan. As one focus group participant put it,

> What could I have possibly done with the borrowed money in a week to be able to make the first installment?

Or,

> Why can't the MFIs give us something like a six-month grace period before we start making our repayment installments?

The borrowers from the same focus group objected to the obligatory saving deducted from their loan prior to the loan being released:

> When people borrow money, they want all of it and they are not interested in various excuses by MFIs to reduce the amount of loan (FGD-K-M-B-02).

Yet others expressed concern about having no cover in case of unexpected events such as a business not taking off or livestock perishing before becoming productive. Since borrowing from non-kin is taboo in the Afghan culture and borrowing on interest is viewed as sinful, many borrowers object to the manner in which MFI officials check on the credibility and credit worthiness of potential borrowers by going into the community and consulting with neighbours, wakils, or others. A sentiment expressed in one of the focus group discussion in Kabul provided another perspective on borrowing being viewed as taboo:

> The main advantage of being able to borrow [from MFIs] is that you can do it anonymously and without anyone knowing. It is such a pity that borrowing on interest is declared as haram (FGD-K-M-B-1).

An added concern by many was the high rates of interest charged by MFIs, regardless of the MFI's rationale for doing so. According to a community elder in Kabul, when the MFIs first came to his area, they charged 7% for their loans. Later this was raised to 17% and at the time of the focus group discussion it was reported as 20%:

> I have a simple question. Why is it that the interest charged by MFIs on loans has been steadily going up with more people borrowing now than before, rather than down? Also, if they say that the interest charged is for the expenses of running MFIs, why can we not see how the interest paid is spent?

There is a discernible degree of self-consciousness among MFI employees about being viewed negatively by community members where they operate. There was one case of an MFI employee in Kabul who stopped going to his local mosque after the mullah at the mosque denounced soud and announced that anyone with remotest link to lending institutions is a sinner. In Mazar and Jalalabad shopkeepers complained that because they were know to have taken MFI loans, their friends and neighbours refused to even take tea with them in the stores because the tea was haram. From the MFIs' perspective, various indications from the communities suggest that MFIs are less welcome in these communities than before. One MFI employee in Mazar reported that because they had to move office, they found a new building to rent and even agreed to the rent and other terms before the owner cancelled the deal as soon as he found out that his building was going to be used by the MFI and "contaminated by sinful activities".

There are also indications of intensified denunciations of borrowing on interest by religious leaders in mosques on the television and radio. One female borrower who had borrowed 6 times and was considering to borrow again changed her mind and did not borrow because

> Everywhere I go I hear that I must not borrow, from the religious figures, the elders, and the television (FGD-K-F-B-1).

In Herat, a key informant reported that,

> … during the Quron Week held in the sports stadium in Herat in 2010, there was a day designated as the "debt day". All day the mullahs talked about how sinful borrowing was and anyone that had anything to do with borrowing, lending, or relations with lending organizations is a kafar, his work is haram, and he is committing a serious sin. The mullahs also demanded that no wakils sign loan papers for any of their constituents because if the did, the wakils too would be committing a sin. How can you expect people to borrow in an environment like this?

Male borrowers interviewed in Herat confirmed that over the past year it has become difficult to obtain the wakil's signature in some areas.

7. Need for Sharia-based Financial Products

Despite strongly held beliefs on the sinfulness of borrowing or lending on interest there is recognition, particularly among community elders and religious authorities, that there are ways of benefiting from the availability of loans from MFIs while remaining within the Sharia provisions:

> MFIs should do something other than providing money for people. [For example] they could purchase the goods people want to buy and then charge the people the cost of the goods plus a mark-up. This is acceptable according to Sharia principles and the MFIs get their profit too because it is hidden in the mark-up. I know that this is also the opinion of the other Ullema and they are ready to discuss options like this with MFIs (FGD-H-M-RL-2).

Another religious leader suggested that whatever the agreed upon interest or commission is in lending and borrowing, attempts should be made to conceal the extra amount in money exchange. Many of those who want to borrow but have not, due to religious considerations, concur with the above view but also demand more. A current borrower from Mazar suggested,

> MFI staff should take more care in educating potential borrowers about their products and tell them about the views by many that borrowing on interest is haram but that MFI products are different.

A religious leader offered a most pragmatic approach for identifying the best and most acceptable options for borrowing money:

> It is not for the ullema alone to decree that interest is halal. The economic experts and the ullema should sit down together to reconcile the differences between Sharia values and modern economic needs (FGD-H-M-RL-2).

Some of the elders interviewed indicated that the non-Afghan MFI employees have learned from their earlier experience of working in Afghanistan and no longer insist, for example, that women lift their head cover in front of them or demand that the women's details as well as the men's be collected as pre-requisites for securing loans. This learning has not spread to other MFIs in Mazar or Jalalabad, however. Concerns regarding the provision of photographs of borrowers' wives remain a major concern for many potential borrowers.

There are the exceptional elders and religious leaders (in Kabul) who are more forgiving than others regarding interest payment, providing the money borrowed is put to income generating use and to increase the wellbeing of the beneficiaries. There is also a difference between the perceptions of males and females regarding interest payment, with a number of females (in

Kabul) insisting that as long as the loan was put to income generating use there would be nothing to be ashamed of and such use would not be haram. A similar sentiment was expressed by females in Mazar:

> Whoever works with the money she borrows, does good and in time she will get the rewards of her hard work and day by day she becomes richer while paying back her loan on time. But, if someone borrows and does not work with the money and has no intention of putting money to [income generating] use, s/he will get into trouble and get blame from MFI staff who want their loan back or from the community as a bad debtor, and everyone will know that this person is not a good person.

Similarly, a male borrower, also from Mazar, stated:

> MFIs should give loans only to people whom they know are going to put the money to [income generating] use. Otherwise the loans should not be given. Also, MFIs should be nicer to people who put the loans to positive use and repay their debts and not apply the same treatment or pressure on good debtors and they bear on bad debtors. If you don't want to have bad debtors, then only lend to people according to their ability to repay.

Females interviewed in Kabul expressed a degree of frustration with absolutist / fundamentalist statements made by some of the religious figures and mullahs against interest bearing loans:

> If the Ullema have determined that borrowing on interest is haram, then why don't they provide us with Gharaz-e Hassana?

8. Conclusion and Recommendations

The question of interest, declared as sinful in the Quron and maintained as necessary for continued business activity by MFIs, is approached by both sides from a fundamentalist standpoint. The type of pragmatism required to resolve this fundamental dispute is best captured in a comment by one of the religious elders, who proposed the coming together of religious experts, governmental bodies, bankers, and economists to come to an agreement as to what would be acceptable to both sides and for the common good. For such a gathering to take place, a positive move by MFIs would be to start offering, as pilots, Sharia-based products with the intention of testing them and as a means to move the issue of soud off the agenda as the first step toward the resolution of this conflict.

The matching concession from the fundamentalists / naysayers' side should be an agreement to participate in the dialogue with banking experts and professionals, bearing in mind that Afghanistan is not the only Islamic country in the world with issues about interest bearing loans and that there is much to be gained by Afghanistan economically and socially if it were tolerate income generating uses of interest bearing loans. Many countries with similar religious reservations have managed to resolve the conflict between modern banking requirements and Islamic values. (See Section 4, above).

Given the Islamic context for its operations, difficulties for MFIs in becoming established and institutionalized, and the apparent deterioration in the operating environment for MFIs (see previous section), it may be worthwhile for MISFA / MFIs to consider lowering the interest rates either by taking a loss or through a designated subsidy. With repeat borrowers, bad debtors, and anti-interest propaganda there has been an increase in awareness about and objections to high interest rates, particularly when the rates have been on the rise, according to some of the interviewees, and sometimes being as high as 40%. The question on the agenda for MISFA / MFIs in charting ways forward should be whether or not it is possible and acceptable to consider covering some of the operating costs through means other than the interest charged on loans.

In addition to, or regardless of, the above fundamental considerations, a number of measures could be taken to maintain and even increase the borrower base of MFIs. Having marketed microfinance aggressively since 2004 and providing loans without much attention to the uses to which loans are put, MFIs are now having to apply more scrutiny to increase income generating use of microcredit and hence keep in check or reduce defaults. This approach is also likely to emphasize the positive (income generating) aspect of loans and change negative perceptions of borrowing, particularly by those who view initiative and industry as positive traits regardless of strong convictions about interest bearing loans.

In practice, the terms and costs of Sharia-based financial products should not deviate substantially from conventional financial products because of competition. The rationale for developing Sharia-based financial products should not be because they are “better” than their conventional counterparts but because the availability of Sharia-based products expands the range of choices available to customers and removes religious objections to borrowing off the agenda.

In addition to offering Sharia-based financial products, MFIs will need to raise the awareness of their borrowers about the differences between Sharia-based and conventional financial products. Part of this awareness raising programme should be finding the most suitable Dari equivalent to interest from riba, soud, mafad, and bahreh or other terms.

In the event that MFIs opt for developing full-fledged Sharia-based products, serious efforts will need to be made to set up a Sharia Advisory Board to win the trust of the Ullema and gain legitimacy among the actual and potential borrowers.

Coordination and consultation should be sought with the Ministry of Hajj and Religious Affairs in developing the new Sharia-based products and in initiatives to raise public awareness on Islamic values and borrowing.

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