

The Potentials of Islamic Banking on Poverty Alleviation in Nigeria

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Abstract: It is a well-known fact that the global financial crisis prompted the establishment of Islamic finance to complement the traditional financial institutions, as a medium to lessen the endemic risk exposure inherent in the financial institutions. The principle goals and functions of the Islamic finance comprises the economic well-being of the populace, through full employment and maximum rate of economic growth, equal distributions of income and wealth and as a result socio-economic justice, and the generation of sufficient savings and their productive mobilization and stability in the value of money (Chapra, 2000). On the other hand, poverty, which is the absence of means to attain a “decent” standard of living, has been found to be very common in the Muslim world. It has been estimated that over 40 per cent of the Muslim population languishes in abject poverty, with nearly 350 million living on less than US\$1.25 a day (COMCEC, 2014). The objective of this study is therefore, to determine whether Islamic banking in Abuja, Nigeria has the potentials to alleviate poverty. The research is exploratory in nature, relying on secondary sources of data such as journals, periodicals, conference proceedings, textbooks, internet search and other source of published data. Findings from the analysis revealed that Islamic Banking is indeed a means of alleviating poverty. The conclusion drawn from the study indicates that the following are the poverty alleviation strategies, methods and instruments used by Islamic banks, these are; Murabaha, Mushraka, Mudaraba, Ijarah, Sukuk, Interest free service, good business ethics, Islamic microfinance and corporate social responsibility. The study further observed that Abuja, Nigeria’s Federal Capital, with its large Muslims population, shifting of attention and growing interest on Islamic banking products by its populace and the promotion of development of infrastructures in Malaysia and other countries presents a great potential for the practicability of Islamic banking products in alleviating poverty in Abuja, Nigeria. The study therefore, recommended that Islamic Banking should be highly encourage by the appropriate authorities in order to assist in the war against poverty in Abuja and Nigeria at large.

Keywords: Islamic Banking, Poverty Alleviation, Socio-Economic.

I. INTRODUCTION

Poverty has been a problem afflicting human beings right from time immemorial. Nigeria, for instance, in spite of its vast oil reserves and abundant human and material resources, poverty among the people is widely spread. Government had over the years employed various poverty alleviation policies and strategies with a view to address this problem of poverty, unemployment and income inequality.

However, in spite of all these efforts, the problem of poverty seems to have persisted. The significant role which an Islamic bank plays in its drive to lessen income inequality and improve the well-being of the populace could not be over emphasized. The Islamic banking system abolishes interest, gambling, speculation and complex derivatives, which are considered prime factors for dehumanization within the society (Abbasi, Hollman, and Murrey, 1989; F. Khan, 2010; Zaman 2009). Islamic banking system though a recent phenomenon in Nigeria, have played a vital role in economic development of some countries which includes poverty alleviation. Thus, the potentials of Islamic banking products in alleviating poverty in Abuja, Nigeria is what we intend to explore in this research. The study examined the following research questions:

1. What are the various products, instruments and methods used in alleviating poverty by the Islamic Banks?
2. What are the potentials of the Islamic Banks in alleviating poverty in Abuja, Nigeria?

The study also seeks to achieve the following objectives:

1. To examine the various products, instruments and methods used in alleviating poverty through Islamic Banks.
2. To determine the potentials of the Islamic Banks in alleviating poverty in Abuja, Nigeria.

II. LITERATURE REVIEW

2.1 Introduction

Over the past decades, Islamic system of banking has been a unique option of banking for both Muslims and Non-Muslims through the provision of easy solution in the form of capital for small and medium enterprises (SMEs). This had enabled many people to engage in some business and earn some income, thus alleviating their poverty. Islamic banking is based exclusively on the Islamic law or sharia which prohibits usury (interest). The Holy Quran states that: “O ye who believe, fear Allah, and give up what remains of your demand for usury, if ye are indeed believers. If ye do not, take notice of war from Allah and His messenger: but if ye turn back, ye shall have your capital sums; deal not unjustly, and ye shall not be dealt with unjustly” (Holy Quran, Chapter 2 verses 278-279). It should be noted that the foundation of modern Islamic banking was laid on the notion that though

commercial banks are needed but inherent challenges that are man-made had accounted for a modified banking system that is based on the concept of Mudarabha or profit and loss sharing. Uzair (1955) advocated the concept of Islamic banking as an interest free banking system.

Institutional involvement in Islamic banking however, aroused from the Conference of the Finance Ministers of the Islamic Countries held in Karachi in 1970, the Egyptian study in 1972, the First International Conference on Islamic Economics in Mecca in 1976, and the International Economic Conference in London in 1977. This involvement of institutions and governments as highlighted above, has led to the application of theory to practice and further resulted in the establishment of the first interest-free bank, which is the Myt Gamit experience in Egypt in 1963, and was followed by that of Dubai in 1975.

According to Abdullahi (2016), modern Islamic banking has its roots in the Egyptian experiment of a variant of a savings bank based on profit-sharing in the town of Mit Ghamr in 1963, which was spear headed by economist Ahmad El Naggar. Ahmad Elnaggar was said to have led the pioneering effort of Egypt, in the form of a savings bank based on profit-sharing. Chachi (2005), states that “interest free Islamic finance started with the dawn of Islam, based on a number of investment and finance contracts. Yet, despite its continued application, it did not take the form of banking until 1975”.

Islamic banking system has the potential to overcome poverty through the financing of productive sectors in rural areas. The empowerment process could be achieved through the availability of funds from Islamic banking, in which case efforts to reduce poverty could be done. According to Burhanuddin A, (2003), the principles of justice and expediency of Islamic banks will encourage the creation of synergies that are beneficial to banks, customers and communities. Many empirical studies that have been conducted show that Islamic banks contribute positively to a country's economic growth (Tabash1, 2011).

Some other studies have found that interest free banking has a much better opportunity to achieve monetary targets (Darrat, 1988). Hailu and Weeks (2011), affirmed that the monetary policy aims to prevent inflationary pressures, encourage private sector investment, and exchange rate policies which focused on achieving international competitiveness, in order to boost growth and reduce poverty. Many writers observed that Islamic banking system has done well in the last decades, which provides an alternative banking system to banking customers (e.g., Zaman, Mehmood, Aftab, Siddique, & Ameen, 2017).

Research conducted by Furqani & Mulyany (2009) found that in the long run, Islamic banking financing has a positive effect on economic growth. Islamic banking also plays an intermediary function that is far better in channeling savings from surplus units to deficit units. In addition, the development of Islamic banking also provides far greater

benefits for economic development and economic prosperity in the long term. However, many other writers pointed to the unsatisfactory performance of Islamic banks in serving the masses in Muslim countries. Ahmad (2015) maintains that Islamic banks failed to play their part in enhancing financial inclusion and development of Muslim countries, affirming further that their role has been rather unsatisfactory in the last four decades.

According to Mudrajat Kuncoro, (2010), poverty arise due to difference in access to capital. Knowles (2005) observed a strong correlation between economic growth and poverty reduction in developing countries. On the other hand, Hoeven (2004) relate the cause of poverty in many developing countries to the dichotomy (dualism) between a traditional economy (rural) and urban economy as well as the changes in the economic structure of a country. In the views of Nasution et al. (2014: 137-148) implementation of development programs to reduce poverty in rural areas is done by facilitating and improving people's access to capital. Poor households could increase access to social capital through participation in community activities (social organization or agency of the village).

2.2 Products, Instruments and Methods Used by Islamic Banks to Alleviate Poverty

It is important to note that unlike the case of conventional banking which is conservative in nature and restrict its services mainly to those who are credit worthy and those with disposable income, the Islamic banking concept tends to be liberal and humane. They have provisions for people in temporary distress/loss of business, Qard hassan for good people in temporary difficulties and they collect and pay Zakat to those who are not credit worthy, for their economic rehabilitation and socio-economic integration.

Islam encourages lending so far it is free of interest. Therefore, the motivating factor for the prohibition of interest has to do with the prevention of oppression of the poor. In this respect, Islamic banking may lessen income inequality and alleviate poverty, since Islamic banking institutions incorporate poverty alleviation in their business strategies alongside profit maximization. They would have more incentives to offer financial products and services to poor clients.

Similarly, whereas the products used in conventional banking concept are not asset-backed, on the other hand, the Islamic banking products deal with assets. That is the reason why Islamic banks all over the world were able to withstand and quickly recover from the financial crunch crises in 2008 when many banks collapsed while some were merged. The following are therefore products, instruments and methods of alleviating poverty through Islamic banking:

1. Murabaha; this is also referred to as cost-plus financing, this financing structure is such that the seller provides the cost and profit margin of an asset.

It is not an interest-bearing loan (“Qard ribawi”) but an acceptable form of credit sale under Islamic law. Islamic banks used Murabaha to finance working capital such as raw materials, semi-finished products, finished products, spare parts, stocks, letter of credit, treasury deposit (i.e. Mombasa -Treasury Deposit) to replace Treasury bill. Murabaha product could alleviate poverty because the poor are empowered through it.

2. Musharakah; this is a partnership instrument in Islam that allows two or more financiers to provide finance to a project. In this scheme, the bank will join another entity to set up a joint venture, with the two parties participating in the various aspects of the project in varying degrees. Profit and loss will be shared in a pre-arranged fashion. This is not very different from the joint venture concept. Islamic banks use Musharakah in the areas of project financing, letter of credit, home buying, real estate, etc. with a view to reducing poverty by empowering people to own their houses, businesses etc. They will be able to earn some income from rent and profits made from their business thereby raising their standards of living.
3. Mudaraba; this is a trust financing method that allows a partner to provide the investment (Rab-ul-maal) while the other partner will invest it in a commercial enterprise (mudarabah). In other words, this is a profit-sharing arrangement between the two parties, that is, the bank acting as investor and the entrepreneur. In which case, the investor (bank) contributes the finance, while the entrepreneur provides the expertise, management and labour. Profits are shared by both the partners in a pre-arranged proportion, however, in the event of a loss, the total loss is borne by the bank. Mudarabah assists a capital owner who does not have ideas of where to apply his funds in a profitable economic activity or a person with business ideas but lacks the funding. The two, if therefore combined together can boost the economy of a society, as well as reduce unemployment, generate income, eliminate criminal activities, eradicate poverty and give rise to all the good multiplier effects of such an arrangement. Both the finance provider and the finance user will share profit from the investment based on the agreed ratio, and will provide income for them, thereby improving their standards of living.
4. Ijarah; this is an exchange transaction where a known benefit arising from a specified asset is made available in return for a payment. Ijara tends to alleviate poverty in the sense that many people would be engaged on earning wages for their living. Some other people would have the opportunity of using other people's asset and property on rent to produce goods and provide services through which they also earn a living. All these would result in the creation of jobs that would empower the people and alleviate their poverty.
5. Istisna`a is a type of contract of exchange with deferred delivery, applied to specified made-to-order items. It is mainly confined to those goods that need manufacturing as against Salam that deals with any type of Shariah compliant goods. The price, kinds, quality and quantity of the good to be made must be specified. The price of the Istisna`a goods can be paid before, during or after manufacturing based on the agreement reached between the bank and the client unlike Salam”’ s price which is paid in full in advance. The method in which Istisna`a eradicate poverty is through the creation of a number of new opportunities through making funds available to manufacturers who do not have access to funds with which they can embark on productive activities.
6. One of the basic elements of Islamic Banking is the provision of interest free service to its customers. Interest payment and its withdrawal have been prohibited in all transactions, this is what distinguishes the Islamic banking system (Islam) with the conventional banking system (Algaoud & Lewis, 2001). Generally, Islamic banks development has been associated with three main interests, namely, business interests of Islamic banks, which refers to the conduct of banking business in a healthy, competitive and sustainable manner, in order to achieve earnings expectations in line with the rules of sharia. We also have the interest of central banks and financial authorities to achieve monetary stability and financial system. Finally, there is the interest of macroeconomic development in Islamic banks for society and the economy. Islamic banks potentials may therefore be linked with its wide range of facilities and the appropriate rules, in such a way that it can make a real contribution to the economy and society. This is in line with the opinion of Chapra (1996), linked to Islamic monetary policy objectives, namely achieve: (1) The economic feasibility of full employment and optimum level of broad-based economic growth; (2) socio-economic justice with equitable distribution of income and welfare 3) Stability in the value of money so as to allow a medium of exchange can be used as a unit of account, a benchmark fair in repaying the loan and the exchange rate stable and effective of all the services of the banking system. The free interest banking concept will also enable the people to have different credit choice among different types of banking structures in the country; hence, deepening and diversifying the financial system for the benefits of all. Furthermore, the free interest regime offers a

veritable incentive and attractive option for investors who are strangled by the high lending rates charged by conventional banks.

7. Sukuk is another instrument in Islamic finance which aid the alleviation of poverty within the society. It is a form of bond structured in order to generate returns to the ethical investors without infringing on the principles of Islam forbidding interest payments. Sukuk represent an ownership interest in the asset financed instead of a debt obligation. This practice of using sukuk for the transfer of financial obligations arising from trade and other commercial activities has been used during the medieval period of Islam. During that period, people like Ibn Zubayr, who was a companion of the Prophet used to give a letter to some people from whom he had collected money in Makkah to take it to Iraq.

The letter would be addressed to Mu'ab Ibn Zubayr in Iraq, asking him to pay the amount stated on the letter to those persons in Iraq. This act was confirmed lawful in Islam by Ali b. Abi Talib and Ibn Abbas. The key success of Malaysia's infrastructural developments is her use of the Islamic financial products particularly sukuk product (Uthman, 2010).

8. Similarly, with Islamic banking there is going to be a good business ethics, as the banks will only entertain such financing requests that are regarded as economically viable. Therefore, Islamic banks, instead of being lenders, will now provide financing by coming in as traders (Murabaha), lessors (Ijara) or partners (Mudaraba; musharakah) thereby providing Technical-No-How and also there will be greater transparency in their transactions with clients – depositors as well as fund-seekers-due to compliance with the avoidance of Gharar (ambiguity) resulting in clear contracts for every transaction.
9. Through Islamic microfinance, there is a tremendous potential to tap into often-scattered Islamic donor streams, such as Zakat, Sadaqat, and waqf, which would be channel towards strategic, and impact-oriented goals.
10. The corporate social responsibility concept of the Islamic banking system may propel its socio-economic contributions to the economy, particularly through the provision of free services to the indigent in the society. Through this process, Islamic banking contributes to the fostering of development in the financing of socio-economic programmes, such as, youth skills acquisition programmes, women empowerment, and micro and small-scale industrial development programmes.

11. Islamic banking concept also contributes significantly in developing micro credit schemes, which have a greater tendency to alleviate poverty by enhancing the development of income generation and reducing unemployment and hence poverty among the people.
 12. Salam - This is an exception to the rule of sale in the religion of Islam. Hadith of the Prophet, states that one should not sell what is not in his possession (Al-Hafiz, 1996: 279-280). However, this particular product in salam is a sale with advance payment for future delivery. Sharfah allows it with some conditions. Before the advent of Prophet Muhammad this type of sale was in operation in the Arabian Peninsula particularly Yathrib, later renamed as Madinatun Nabiyy. After the Prophets' migration to Madinah in 622 CE, this type of salam sale was brought to his notice. The Prophet then named it salam by putting some conditions on its operations (Tahir, 2009: 203-204). The Qur'an also confirmed its lawfulness, when Allah (SWT) states: "O you who believe! When you contract a debt for a fixed period, write it down...." (Q 2:282). Salam can thus be used indirectly to finance raw materials as well as intermediate goods. Salam sale can be used by Islamic banks to finance letter of credit, agriculture in abundance etc. In essence by employing salam concept, famine will be gone because farming is highly and heavily supported by Islamic banks through this product. This will result in the alleviation of poverty as farmers will now access funds with which to cultivate lands. This will further result in earning more income by the time the products are sold, thereby raising their standards of living.
 13. Increase consumption level - Islamic banking financing enables the poor to increase their consumption level by two way. Firstly, by giving them capital to start or expand their business. Secondly, since mudarabah should be channeled to the real sector, then SMEs will get more capital to expand their business and increase their production level, it means more workers will be involved. Thus, the welfare level of poor will increase.
 14. Encourages Investment - As the study conducted by Mallick (2018), a key component of monetary policy in overcoming the problem of poverty is through the availability of credit allocated to the business Does Islamic Banking Financing Help the Poor? 48|UII-ICABE 2019 sector.
- Therefore, low credit interest rates will encourage people to invest. This additional capital will then encourage the industry to expand its business, and is expected to absorb more workers.

15. Another method of alleviating poverty through Islamic banking concept has to do with the flow of development funds provided by Islamic Development Bank (IDB), which provides development funds for infrastructural projects to member countries from Islamic banking system of the world. It is expected that with the growth of Islamic banking system, it will provide access to the flow of such funds, which will enhance infrastructural development and poverty alleviation in the long run.

2.3 Islamic Banking in Nigeria

Nigeria has the largest Muslim population in sub-Saharan Africa. Reflecting on the size of Nigerians population which is estimated at over 200 million with Muslims consisting of over 50% population, is a clear indication that Nigeria has a great prospect of becoming the hub of Islamic finance in Africa. Nigeria has recently been opening itself to the practice of Islamic financing in order to establish a hub for non-interest banking. It is expected that with a viable Islamic Economy system in Nigeria, there is going to be far-reaching developments within the global markets, particularly, for investment managers seeking to achieve portfolio diversification. With the recent opening of some full pledged Islamic banks in Nigeria, it is expected that in few years to come, Islamic banks will be competing favorably with many of the conventional banks in Nigeria.

2.4 Potentials of Islamic Banking on Poverty Alleviation in Abuja, Nigeria

Abuja, Nigeria's Federal Capital, with its large Muslims population has a great potential for the practicability of Islamic banking products in alleviating poverty. Abuja is the capital city of Nigeria, with the country's president, ministers, members of the national assembly, top public and civil servants, businessmen and all manner of citizens residing in the area. Two Islamic banks were established in Nigeria, with their operational headquarters in Abuja, Nigeria, with the growing interest by people to deposit their funds and participates in the operations of the Islamic banks, it is just a matter of time for Islamic banks to highly excel and overshadow the conventional banking in Nigeria.

Following the economic crisis in Nigeria, attention is now shifting to Islamic banking products in Abuja, Nigeria, because of its benefits. With its rising popularity, it is expected that within the next few years, the number of Islamic banks in Abuja will considerably increase.

Islamic banking products aimed to promote the development of infrastructural facilities. This effectiveness of infrastructural development has been justified with countries like Malaysia, Qatar, Bahrain, Saudi Arabia etc. Malaysia was mentioned among the poorest nations in the late 1970s as well as early 1980s. During that time, many people were living on less than \$1 a day. However, following the development of

her infrastructures, today, Malaysia that was wallowing in abject poverty is one of the nations that are leading the world economy due to infrastructural development. The key success of Malaysia's infrastructural developments is her use of the Islamic financial products. It is, therefore, expected that with the current initial phase of the development of Islamic banking in Abuja and Nigeria at large, there is the prospect that Abuja and Nigeria will borrow a leaf from the experience of these nations in using the Islamic financial products for the development of their infrastructural facilities.

2.5 Theoretical Framework

This research theoretical framework is based on the theoretical work of Samuelson, (1958); and Friedman, (1969) on the relationship between the levels of the rate of interest with the optimality of resource allocation. Findings from the theory concluded that, a zero nominal interest rate is a necessary condition for the optimal allocation of resource. The theory further observed that in a world of paper money, an addition of extra unit of real balances costs the economy no real resources. Thus, a positive rate of interest becomes a positive cost of using money. This led traders to economize on the use of money in transactions, thereby frustrating their attempt to fully benefit from the means of exchange in minimizing their transaction costs. In order to keep the same volume of transactions, traders will have to substitute real resources for money. The said substitution withdraws real resources from the production sector to the transactions sector, which will lead to a sub-optimal level of output. In contrast, reducing the rate of interest to zero removes all incentives to substitute real resources for money. The optimal level of output can therefore be maintained.

The theory of Islamic finance is based on the simple rule of avoiding the trading of present for future money at a premium. These effectively do away with finance through debt, even though that does not exclude providing interest-free loans for charitable purposes. The provision of finance has to come through equity participation or profit and loss sharing (PLS) and the return will be in the form of equity or rights to share in pre-agreed proportions of profits. It can also come through the sale and lease of assets in return for commitment to repay their value at a later date.

III. METHODOLOGY

As stated earlier, this study is exploratory in nature based on the review of relevant literatures and write-ups on Islamic Banking carried out in the past.

IV. DISCUSSION, CONCLUSION AND RECOMMENDATIONS

4.1 Findings

The study revealed that Islamic Banking is an inevitable means of alleviating poverty, since it evidently possess the following: Better business ethics – the banks will only entertain those financing requests that are economically

viable, Instead of being lenders, Islamic banks will provide financing by coming in as traders (Murabaha), lessors (Ijara) or partners (Mudaraba; musharakah) resulting in the provision of Technical-No-How. Similarly, there will be greater transparency in Islamic banking transactions with its clients – depositors and fund-seekers-due to its compliance with the avoidance of Gharar (ambiguity) which will result in clear contracts for all transactions.

Furthermore, there is a greater prospect for Islamic banking in Abuja, Nigeria, considering the large number of Muslim populations in Abuja, Nigeria, being the Nigeria's capital city, harboring top government functionaries, politicians, ministers, national assembly members, businessmen and many other citizens. Similarly, with the economic crisis in Nigeria, attention is now shifting to Islamic banking products in Abuja, Nigeria, because of its benefits. At the same time, the key success of Malaysia's infrastructural developments is her use of the Islamic financial products, will attract Nigeria's interest in borrowing a leaf from this experience.

4.2 Limitation of the Research

The researcher encountered problem of limited data as well as the fact that the small market share of Islamic Bank, particularly in Nigeria make research on this topic still rarely done. Similarly, there is debate as to whether the small market share of the Islamic bank can truly explain the empirical phenomenon; this has also cast doubt on the topic of research. Therefore, it is necessary to conduct a more comprehensive study, so that the results obtained can better represent the actual empirical conditions. Based on the above, it is necessary to conduct a more comprehensive study on the role of Islamic banks in overcoming the problem of poverty and inequality in the area of study.

4.3 Conclusion and Recommendation

This study aims to look at the effect of Islamic banking financing in reducing poverty. The results show that Islamic banking financing has a greater effect in reducing poverty levels in Abuja, Nigeria. Islamic banking products enumerated above are able to encourage the productivity of the real sector. This is in addition to the fact that, Islamic banking has been prohibited from investing in financial markets that are full of speculative elements. In this regard, Islamic banking is expected to provide more financing products aimed at enhancing the real sector. Poverty can be said to be the most serious, pervasive and persistent problem affecting much of the world population, of which the Muslim world is a sizeable part. Therefore, all hands must be on deck to alleviate poverty in our society. There are however, a number of challenges affecting the prospects of Islamic banking in Nigeria. Some of these challenges are, poor knowledge of the principles, terminologies and operational products used in Islamic banks, lack of awareness and sensitization of Muslim public, absence of skills and technicalities required to regulate and supervise the practice of Islamic banking, use of interest based instruments by the Nigeria central bank for monetary policy operations and interbank markets and absence of

comprehensive legal framework to cater for arbitration of conflicts that are associated with Islamic financial contracts, products or individuals in Nigeria. These among other issues need urgent remedial amendments in this phase of development of Islamic banking in Nigeria. We therefore recommend that having observed the successes of Islamic banking in the development of infrastructures and hence alleviating poverty, Islamic Banking should be highly encourage by the appropriate authorities in order to assist in the war against poverty in Abuja and Nigeria at large.

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