

# Microfinance from the Perspective of Islamic Economics and its Importance for Afghanistan

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## ABSTRACT

In Afghanistan, Islamic microfinance stands as a pivotal solution in combating poverty and fostering socio-economic development. This integral financial mechanism extends essential financial services and modest loans to economically vulnerable segments and small enterprises. Its multifaceted approach incorporates diverse strategies including profit-sharing partnerships like *Musharakah*, *Mudaraba*, *Muzarah*, and *Musaqah*, as well as sale and debt-based contracts such as *Murabaha*, *Salam*, *Ijarah*, deferred and installment payment contracts, *Istisna'a*, and *Tawarruq*. Moreover, it integrates righteousness and charity-based models such as *Qard-al-hassan*, Zakat, Waqf, Hiba, Takaful, and *Wasyyah*. Setting itself apart from traditional microfinance, Islamic microfinance staunchly opposes usurious practices and deceit, prioritizing Islamic principles that emphasize moral virtues like honesty and sincerity in individuals. These ethical benchmarks, deeply rooted in Islamic jurisprudence, are considered fundamental across various domains, spanning from economic affairs to matters of governance.

**Keywords-** Microfinance, Islamic economics, perspective, importance, Afghanistan.

## I. INTRODUCTION

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ، الْحَمْدُ لِلَّهِ رَبِّ الْعَالَمِينَ وَالصَّلَاةُ وَالسَّلَامُ عَلَى  
رَسُولِهِ الْكَرِيمِ مُحَمَّدٍ وَعَلَى آلِهِ وَاصْحَابِهِ أَجْمَعِينَ.

Financial and monetary concerns are fundamental within the economy, wielding considerable influence on the achievement of economic and social progress. Islamic economics aims to tackle the financial and economic hurdles encountered by individuals by offering specialized financing methods suited for ventures of varying scales. These methods play a vital part in extending financial aid to individuals with restricted incomes aspiring to launch small ventures, grow their current businesses, or meet their day-to-day financial needs. This financing model serves as an alternative to the customary practices observed in banks and conventional financial establishments. This research focuses on Islamic microfinance and its pivotal contribution to reducing poverty and unemployment.

### 1.1 Research Objectives:

This study aims to achieve the following objectives:

1. To clarify what Islamic microfinance is and explaining its basic principles.
2. To study how important Islamic microfinance is and how it helps reduce poverty and unemployment in Afghanistan.
3. Describing the different ways where Islamic microfinance works.

### 1.2 Rational for the Study

1. The need for Islamic banks to explain Islamic microfinance modes in Afghanistan.
2. The importance of this issue in Afghanistan.
3. Contributing to delivering goodness to our dear people by clarifying the provisions of Sharia in the field of finance.

### 1.3 Research Questions:

This study answers the following questions:

1. What is the concept of finance and Islamic microfinance?
2. What is the importance of Islamic microfinance in Afghanistan?
3. What are the methods of Islamic microfinance?
4. What are the origins of Islamic microfinance?
5. What is the role of Islamic microfinance in reduction of poverty and unemployment?

## II. EMPIRICAL REVIEW

The Islamic microfinance industry: between the drivers of growth and the challenges of practice" by Abdelkader Zitouni (2012) is an article published in Algeria. It explores Islamic microfinance as a model for microfinance institutions grounded in *Zakat* and donations. The study originates from Farhat Abbas University in Setif, Algeria. Another pertinent work is "The Concept of Islamic Finance" by Dr. Munther Al-Qahf (1999). This research investigates the general concept of finance. What sets our study apart is our in-depth exploration of Islamic microfinance and its applicable modes within the context of Afghanistan.

### 2.1 Research Methodology:

Aligned with the nature of research topic, the study adopts a descriptive and analytical approach. This methodology entails presenting a comprehensive description of the key Islamic microfinance modes tailored for small projects, coupled with a thorough examination and analysis.

## III. THE CONCEPT OF ISLAMIC FINANCE

Financing denotes the act of providing someone with the necessary wealth, which can comprise commercial items, real estate, livestock, or money (Ebrahim, 2014). Various contemporary scholars have put forward definitions of Islamic finance, with some key interpretations outlined below:

1. Dr. Munther Qahf defines Islamic finance as the transfer of wealth, whether in goods or cash, with the aim of generating permissible profit. This transfer occurs from the wealth owner to a manager who operates it in accordance with Sharia principles (Qahf, 2002).
2. Dr. Shawqi Donia's perspective views finance as a multifaceted process that involves provisioning resources and energies. It requires the availability of both cash and consumer goods, which are then mobilized and channeled into investments (Donia, 1999).
3. Dr. Al-Sartawi's definition involves an individual offering their wealth to another party, either as a charitable donation or for investment purposes. This collaborative effort entails both parties investing the wealth, with profits distributed based on the predetermined contract terms. Contributions to the capital determine the proportional share of profits, and

contributors partake in administrative and investment decision-making (Sartawi, 1999).

These definitions collectively emphasize that Islamic finance entails an individual, the financier, contributing their assets in the form of goods or cash. These funds are then allocated to another party, either for charity or profit, in accordance with Islamic legal principles.

## IV. THE CONCEPT OF ISLAMIC MICROFINANCE

Islamic microfinance refers to the provision of financial services in adherence to Islamic Sharia principles (Alzeitoni, 2012). This comprehensive definition encompasses various types of financing for both large and small-scale projects, extending beyond the scope of Islamic microfinance alone.

However, other definitions specifically outline Islamic microfinance as the provision of financing in the form of goods or cash to individuals facing financial constraints, particularly the poor, or delivering essential financial services like insurance and savings to those in need (Fartas, 2013). Nevertheless, this definition primarily focuses on general microfinance practices and lacks the incorporation of specific Sharia-compliant restrictions and principles essential in Islamic microfinance.

To specifically define Islamic microfinance, it involves delivering micro-financial services tailored for individuals with limited income or those seeking assistance to initiate or expand small businesses. These services are provided in accordance with Islamic principles and regulations, ensuring compliance with Sharia guidelines.

## V. DIRECTIONS OF PROPHET (PBUH) REGARDING MICROFINANCE

Islamic law alleviate poverty and begging and urges the Islamic community and Islamic state to finance the poor and oppressed according to their ability, because Islam is a comprehensive religion that cares about all aspects of social, economic and spiritual life, and because poverty and begging create many problems in Islamic society and lead to multiple sins and crimes in the society. There are many *hadiths* that indicate the fight against poverty and begging and encourage people to finance the poor and needy in various ways, including free financing such as giving *zakat* and various charities, and financing based on compensation such as partnerships, *Mudarabah*, and *Salam*, *Ijara*, *Murabahah*.

Islam prohibits individuals from begging and encourages them to work and trade in order to preserve people's dignity and strengthen the economy, because begging leads to laziness, poverty, and dependence on others, and these things cause the collapse of the economy

in society, and Islam goes to great lengths in prohibiting people from begging. Allah Almighty said:

لِلْفُقَرَاءِ الَّذِينَ أُحْصِرُوا فِي سَبِيلِ اللَّهِ لَا يَسْتَطِيعُونَ ضَرْبًا فِي الْأَرْضِ ، يَحْسَبُهُمُ الْجَاهِلُ أَغْنِيَاءَ مِنَ التَّعَفُّفِ تَعْرِفُهُمْ بِسِيمَاهُمْ لَا يَسْأَلُونَ النَّاسَ إِلْحَافًا ، وَمَا تُنْفِقُوا مِنْ خَيْرٍ فَإِنَّ اللَّهَ بِهِ عَلِيمٌ .

On the poor who are straitened in the cause of Allah (SWT), unable to make a way in the earth, the ignorant considers them free from need due to their reticence. Thou wilt know them by their mark they do not ask of men importunately, and what you spend of good, Allah (SWT), knows it (Surah Al- Baqarah: 273).

This verse indicates that charity is for the poor who cannot obtain a livelihood due to their weakness and lack of strength to trade and work. Likewise, the Prophet “peace be upon him” (PBUH) forbade giving charity to someone who is able to work. He (PBUH) said:

“لا تحل الصدقة لغني، ولا لذي مِرَّةٍ سَوِيٍّ”

It is not permissible to give charity to a rich person, nor to a person who is able to work (Tirmidhi,1998). “مِرَّةٍ سَوِيٍّ” is a man who is able to work, is physically abled. The prohibition of begging was also mentioned in many *hadiths*, including what was narrated by Ibn Umar that the Messenger of Allah (SWT), PBUH said:

“ما يزال الرجل يسأل الناس حتى يأتي يوم القيامة وليس في وجهه مُرعة لحم”

A man will continue begging people until the Day of Resurrection comes without a trace of flesh on his face (Muslim, N103) and it was narrated by Abdul Rahman bin Awf that the Messenger PBUH said:

“لا يفتح عبدٌ بابَ مسألةٍ إلا فتح اللهُ عليه بابَ فقرٍ”

No servant opens the door of begging except that Allah (SWT) opens for him the door of poverty\_ (Ahmad, 1995).

Another *hadith* which is narrated by A'id bin Amr, that a man came to the Prophet, and begged him and he gave him something. When he left, the Prophet PBUH said:

لو يعلمون ما في المسألة ما مشى أحدٌ إلى أحدٍ يسأله شيئاً

If they knew what was in begging, no one would have gone to anyone to beg him for anything (Al-Nasa'I, 1986).

Islam urges people to use all means to reduce poverty and to establish and finance small and medium economic projects to provide and create job opportunities for the poor. Islam considers appropriate projects as means of earning *Halal* income and achieving self-sufficiency and improving the economic condition of individuals and society. Thus, the Islamic state must finance the poor and create job opportunities for workers who can work and have the physical ability to establish small and medium enterprises for those who do not have financial means. A *hadith* was narrated from the Prophet PBUH, indicating the introduction of Islamic micro finance. It was narrated by Anas bin Malik (may God be pleased with him) that “a man from the Ansaar came to the Prophet and begged from him. He (the Prophet) asked, ‘Do you not have anything in your house?’ He

replied, ‘Yes, a piece of cloth, a part of which we wear and a part of which we spread (on the ground), and a wooden bowl from which we drink water.’ He said, ‘Bring them to me.’ He then brought these articles to him, and he (the Prophet) took them in his hands and asked, ‘Who will buy these?’ A man said, ‘I shall buy them for one dirham.’ He said, ‘Who will offer more than one dirham?’ (He said it twice or thrice.) A man said, ‘I shall buy them for two dirhams.’ He gave the articles to the buyer and took the two dirhams and, giving them to the Ansari, he said, ‘Buy food with one dirham and hand it to your family, and buy an axe with the second dirham and bring it to me.’ He then brought it to him. The Messenger of Allah fixed a handle on it with his own hands and said, ‘Go, gather firewood and sell it, and do not let me see you for a fortnight.’ The man went away and gathered firewood and sold it. When he had earned ten dirhams, he came to him and bought a garment with some of them and food with the others. The Messenger of Allah then said to him, ‘This is better for you than that begging coming as a spot on your face on the Day of Judgment. Begging is suitable only for three people: one who is in severe poverty, one who is seriously in debt, or one who is responsible for paying blood money and finds it difficult to pay.’” (Abu Dawood:1641).

This *hadith* explains the approach and strategy for alleviating poverty by using Islamic microfinance services and this strategy summarizes the following: Identifying the resources available to the poor person, encouraging self-employment and enhancing the economic independence of the poor by encouraging them to self-work and developing their skills and abilities to create sustainable sources of income, providing training and education opportunities for the poor to enhance their capabilities and increase job and income opportunities, promoting entrepreneurship among the poor by providing financial and technical support and advice to establish small and medium enterprises, providing Islamic loans with *halal* interest to the poor to help them establish and expand their businesses, encouraging social solidarity and cooperation between individuals, society to help the poor and achieve social justice, applying social justice at all levels through distribution of wealth and dispense fairly and equitably.

This *hadith* also indicates essential matters for the success of the microfinance program, and these matters are: providing microfinance to all the poor and even to the poorest of the poor, accurately assessing the financial health of the poor, converting the beneficiary’s non-productive assets into income generating assets through careful assessment, meeting basic needs on a priority basis; investing the surplus in productive assets, direct participation of the program in capacity building in the period preceding income generation and technical assistance to the beneficiary, technical assistance in the form of providing the necessary training to the beneficiary in implementing the income-generating business plan project, transparent accounting of the results, operational and the freedom to use part of the income to meet higher

needs, strong encouragement not to resort to charitable assistance. These matters mentioned in the *hadith* make the microfinance program successful without any problem (Obaidullah, 2008).

## VI. CHARACTERISTICS OF ISLAMIC MICROFINANCE

Islamic microfinance is a type of financing that is provided in accordance with the principles of Islamic Sharia. Islamic microfinance has different characteristics from that of the conventional microfinance. The following are the main differences between the two:

First, Islamic microfinance is interest-free microfinance: Islamic microfinance is free from all types of interest. Islamic microfinance are either based sale (*baia*), or partnership in profit and loss between the financier and the beneficiary of finance, or cooperation and donation. On other hand, conventional microfinance is based on usury, and that is it provide interest based loans. Usury is forbidden in Islamic law in all its forms. There are numerus verses of Quran and *Hadith* that prohibits usury. Apart from that the prohibition of Usury is also verified by the *Ijma*. Allah Almighty says,

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ “ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

Those who consume usury will not stand save as stands he whom the Satan buffets with his touch; for it is that they say: "Commerce is but the same as usury," when Allah (SWT) has made commerce lawful and forbidden usury! And he to whom came the admonition from his Lord, and desisted: he has what is past, and his case is with Allah (SWT). But whoso returns: those are the companions of the Fire; therein they abide eternally. (surah al Baqarah,276)

In a *hadith* narrated by Jabir, may Allah (SWT) almighty be pleased with him, says:

لعن رسول الله صلى الله عليه وسلم أكل الربا، ومؤكله، وكاتبه، وشاهديه، وقال: «هم سواء»

The Messenger of Allah (SWT) PBUH cursed the one who consumes usury, the one who pays it, the one who writes it, and the witnesses, and he said: "They are all the same" (Muslim, N: 1598).

Furthermore, many Islamic scholars conveyed the *Ijma* on the prohibition of usury in Islam, and in all other religions. Al- Mawardi said: It is not permissible in the *sharia* (Al-Sarakhsi, 1993 KL; Al-Sharbini, 1994; Ibn qudhama, 1998; Al-Sharbini, 2009).

Second, the presence of guarantees: Islamic microfinance contracts can include legitimate guarantees that protect the rights of all parties. These are *Kafalah*, mortgage, certificate, and *shahadah*. The intent of these guarantees is to compensate the financier and in the event of failure these guarantees will compensate the financiers. (AAOIFI, 2017).

Third, transparency and avoiding deception: Islamic microfinance contracts must be clear and transparent, as these contracts include clear details about

the rights and duties of the two parties and the conditions for sharing in profits and losses in order to avoid deception, because deception is forbidden in Islamic law. Abu Hurairah said:

” نهى رسول الله صلى الله عليه وسلم عن بيع الحصاة، وعن بيع الغرر”

The Messenger of Allah (SWT) may God bless him and grant him peace, forbade the sale of pebbles, and the sale of deception (Muslim, 1513).

Fourth, fostering ethical principles in providing microfinance: One of the most important characteristics of Islamic microfinance is raising the individual's soul on good morals and the good qualities of honesty, sincerity, and mastery in matters. These morals have great importance in Islamic law and must be nurtured in all aspects of life. From economics, politics...and there is much evidence that encourages merchants to have good morals in economic and financial transactions (Muhammad Sharif, 2018).

Fifth, directing of wealth towards real investment: Islamic microfinance directs wealth towards real investment, which aims to mix the factors of production with each other, and therefore any profit resulting from this investment is real profit (Muhammad Farhan, 2003).

Sixth, directing of wealth towards legitimate spending. One of the characteristics that distinguishes Islamic financing for small projects is that this financing is for projects that are permissible from the point of view of Sharia, so it is not spent on projects that contradict the purposes of the Sharia (Muhammad Farhan, 2003).

Seventh, sustainability: Islamic microfinance is a tool for achieving sustainable economic development and promoting social justice. Funding must be directed towards sectors that strengthen the local economy and provide job opportunities for the neediest groups.

## VII. IMPACT OF ISLAMIC MICROFINANCE

The issue of poverty and unemployment in Afghanistan has reached critical levels, particularly exacerbated by the COVID-19 pandemic. Statistics reveal a staggering rise in poverty rates, reaching around 70%, with a significant portion of the population living below the national poverty line. These analysis shows that 85% of Afghans had a monthly income of 2,668 Afghanis. Moreover, over 30% of Afghans lack access to essential resources like real estate, land, or reliable income sources. With a population of approximately 40 million, Afghanistan faces severe economic challenges, evident in its low per capita income and a sharp increase in the number of impoverished individuals, which rose to 34 million in 2022 according to UNDP reports (UNDP, 2023).

Agriculture stands as a cornerstone of Afghanistan's economy, contributing 52% to the gross domestic income and employing over 80% of the population. However, despite its significance, poverty

remains pervasive, necessitating targeted interventions for poverty alleviation and job creation (Hassan Zai, 2009).

In this context, Islamic microfinance emerges as a pivotal solution at the individual and familial levels. It offers tools that uplift the income of impoverished families in Afghanistan. Islamic financing mechanisms facilitate diverse income sources and provide crucial financial services, enabling access to land, strengthening agricultural initiatives, housing improvements, purchasing livestock, consumer goods, and investing in self-enhancement such as healthcare and education.

The implementation of Islamic microfinance not only aids in income elevation but also fortifies projects, reducing vulnerability to external shocks. Specifically tailored for the marginalized and economically disadvantaged individuals excluded from formal financial systems, microfinance facilitates their participation in economic activities, thereby augmenting income, building assets, and fostering investments.

The significance of Islamic microfinance is summarized as follows:

1. Alleviating poverty by offering financial support to individuals and families, ensuring a decent standard of living.
2. Catalyzing private projects that bolster economic development and spur production and industry.
3. Stimulating demand for goods and services through financing small projects, thereby boosting income and consumption.
4. Creating a wide array of job opportunities by diversifying projects and subsequently reducing unemployment rates.
5. Diversifying family income sources, guaranteeing food security, and supporting childcare.
6. Empowering women by fostering financial independence through their engagement with microfinance institutions.
7. Reducing unemployment rates by relying on accessible technology and workforce-based operations.
8. Contributing to exports, diminishing imports, and aiming for a trade surplus.
9. Establishing a link between the economic and social aspects, promoting familial savings mobilization and connectivity.
10. Facilitating regional development by disseminating small projects across diverse geographical areas, thus combatting regional disparities and unlocking untapped resources in remote regions.

This comprehensive view underscores the instrumental role of Islamic microfinance as a multifaceted tool for poverty alleviation, economic empowerment, and regional development in Afghanistan.

## VIII. THE MODES OF ISLAMIC MICROFINANCE IN THE ISLAMIC ECONOMY AND ITS IMPORTANCE TO AFGHANISTAN

Afghanistan, as an Islamic country, seeks legitimate financial means aligned with Sharia principles to uplift its population from poverty, rejecting conventional banking practices involving usury forbidden in Islamic Sharia. The nation's urgent need for Islamic microfinance institutions becomes evident as they can catalyze economic and social development, combat poverty, and address unemployment challenges to some extent. Various modes and tools of Islamic microfinance are segregated into several sections, detailed below:

**8.1 Swap-based Islamic Microfinance:** Swap-based Islamic microfinance involves financing through sale and purchase contracts or leasing, where a financier acquires a good or product from a customer at a set price and then sells it back at a higher price incorporating a reasonable profit. In this module, the ownership of the item is initially transferred to the financier, who then resells it to the customer at an increased price, incorporating a profit. The pricing and profit margins are pre-determined, transparent, and established according to the mutual agreement between the involved parties. Examples include:

*Murabaha:* The *Murabaha* sale represents a type of trust-based transaction where the seller discloses the initial price of the commodity to the buyer. It can be either a simple *Murabahah*, where the item is sold at the original price plus a profit margin, or a compound *Murabaha* involving a designated purchase order. This method is suitable in Afghanistan for funding raw materials essential for small-scale production projects. However, in other instances, financing small projects through the *Murabaha* contract might not be feasible due to higher financing costs, which may not align with the income generated by these small projects (Qal'a Ji, 2002).

*Ijarah:* The *Ijarah* contract involves acquiring a known benefit or service gradually over a specified period from a particular asset or work, ensuring compliance with permissible terms (Al-Buhuti, 1993). This lease arrangement can take two forms:

**Financial Lease:** In this type, the bank purchases a capital asset intended for leasing, typically for the asset's lifespan. The lessee assumes responsibility for maintenance and repairs, with no right to terminate the contract prematurely. The contract specifies potential outcomes, which may include selling the asset at a nominal price or transferring ownership for free.

**Operational Lease:** Here, the Islamic bank leases assets to the lessee for a specific task and subsequently reclaims the asset to lease it to another party. The lease period is shorter than the asset's lifespan, making the rental amount insufficient to cover the asset's cost. The lessor shoulders

all maintenance and repair responsibilities, and the lessee can terminate the contract before its completion (Walid Abdul Hadi, 2011; Hassan Zaid, 1996).

Financial leasing stands out as a suitable financing method in banks due to its compatibility with the characteristics of small projects. It offers advantages such as tailored leasing payments to suit project needs, potentially lower overall leasing costs compared to usurious bank financing, and improved financial and liquidity positions for small projects. Furthermore, the asset's value does not appear on the balance sheet, with only rental expenses reflected in the profit and loss account. This method is viewed as a legitimate and superior alternative for small projects seeking equipment and assets necessary for growth and replacement without resorting to usurious lending (Hassan Zaid, 1996).

*Al-Salam*: *Al-Salam* represents a contractual agreement where a commodity is described, payment is deferred, and the transaction is completed at a price agreed upon during the contract's execution (Al-Babarti, 1998; Al-Shalbi, 1985; Abdul Rahman bin Muhammad, 2014). This deferred and accelerated sale mechanism is particularly beneficial for financing small-scale projects. The essence of the *Al-Salam* contract involves an immediate cash payment for a specified quantity of goods to be delivered in the future, making it well-suited for financing agricultural, productive, and artisanal projects. Consequently, it stands as a potential instrument for microfinance within Afghan banks (Muhammad Farhan, 2003).

*The Istisna' and Parallel Istisna'*: It represent contracts facilitating a unique form of outstanding sale that incorporates work conditions. Within Islamic finance, the *Istisna'* model holds significant importance for Islamic banks in fulfilling client demands for specific goods and services. This financing model stands out as a crucial tool for economic development, particularly for Islamic banks. *Istisna'* plays a pivotal role in nurturing the small enterprise sector by financing construction contracts and meeting the requirements of merchants or consumers seeking particular commodities.

Islamic banks facilitate this process by providing the required commodities with precise specifications through manufacturing, catering to the needs of small projects. This approach aids in supporting the small project's objectives by offering essential financing, while also benefiting the bank by potentially acquiring the commodity at a reduced price (Muhammad Farhan, 2003). This versatile financing mode is well-suited for various applications in Afghanistan, including but not limited to constructing houses, acquiring machinery, and fulfilling the requirements of low-income individuals in the country.

*Tawarruq*: It refers to a contract where a commodity is purchased for a set period intending to sell it and obtain its price (Ibni Taymiyyah, 1987). The essence of this contract lies in acquiring funds rather than the commodity itself. In this transaction, an individual in need of money

approaches a merchant and buys a commodity from them, paying in installments over a specific duration. Subsequently, the buyer takes possession of the commodity and sells it in the market at a price lower than the purchase cost, securing immediate cash to fulfill their financial requirements.

*Tawarruq* serves as a crucial mechanism for meeting demands, especially for merchants and individuals facing financial constraints, enabling them to access necessary financing. This contract facilitates obtaining immediate cash by selling the acquired commodity at a reduced price, addressing the urgent monetary needs of individuals in need.

Installment sales: It is when a person buys the commodity at a deferred price and pays it in regular payments at specified times (qallajji,2002). This sale is one of the most important types of microfinance mods because the man gets the commodity, he needs even though he does not have money pay the price because he is poor and unable to pay for it immediately.

### 8.2 *Musharaka based Islamic Microfinance*

Islamic financial models differ based on their principles, functions, and underlying procedures used for microproject financing. Among these modes are those rooted in the concept of partnerships, as detailed below.

1. *Musharaka*: *Musharaka* is a contractual agreement between parties involved in capital and profit-sharing, or solely profit-sharing (Al-Khayya, 1995). Under this contract, two or more individuals share funds for commercial, agricultural, industrial, or service-related activities. Profits are distributed among them based on predetermined percentages, and it stands as a financing mode applicable for direct funding in Islamic banks. It provides a legitimate alternative to conventional bank loans and is centered on profit and loss sharing.

*Musharaka* in Islamic banks can either involve permanent participation, where the bank contributes capital for a new or existing project, becoming a permanent stakeholder entitled to a share of profits or losses according to the partnership agreement (Khaldi, 2009). Alternatively, it can be diminishing *Musharakah* or ending with ownership, enabling the bank to transfer ownership rights gradually or in one go based on agreed conditions. Although it shares similarities with permanent partnerships in terms of rights and obligations, it differs concerning permanence aspects (Basharat, 2008).

*Musharakah* represents a significant form of small-scale Islamic financing that aligns well with the principles of Islamic banks. It can effectively finance diverse economic activities for small and micro-enterprises. This financing model involves the Islamic bank providing funding for a specific project without fixed interest rates typical of loans from conventional banks. Instead, the bank shares the expected project outcomes, be it profit or loss, based on mutually agreed-upon rules and principles of distribution between the bank and the client in adherence to legitimate principles (Muhammad Sharif, 2018).

2. **Modaraba:** Modaraba signifies a contractual arrangement between two parties, where one provides the capital, and the other utilizes it for trading, thereby sharing the resulting profits (Al-Babarti, 998; Muhammad Alyash, 1988; al-Nawawi, 1991). The significance of the Modaraba contract lies in its ability to finance small-scale institutions and aid impoverished individuals by providing necessary funding that they might typically lack to establish or sustain their operations. Furthermore, Modaraba helps in reducing project investment costs, consequently leading to decreased prices of produced goods. By employing Modaraba, risks are shared between the Islamic bank and small or medium-sized institutions, thereby mitigating potential risks that these institutions might face in the future and offering support to minimize these risks (Muhammad Sharif, 2018).

3. **Muzara Contract:** The Muzara contract operates as an agreement between the landowner and the worker, focusing on cultivating lands and sharing the resulting crops between them (Committee of Scholars, 2003). This contract represents a prominent and widely employed agricultural financing mechanism, where an Islamic bank provides land and seeds. The low-income client contributes labor in cultivating the land, and the yield is distributed based on a pre-agreed arrangement between both parties. Additionally, the Islamic bank might supply agricultural machinery, equipment, seeds, and fertilizers, while the labor and land are provided by the client. Contributions from each party are determined before the contract, specifying their respective shares in the farm's output. After the harvest and marketing phase, costs incurred by both partners are deducted, and the remaining proceeds are distributed accordingly. Agricultural financing through Islamic banks contributes to revitalizing agricultural lands, boosting national income, curbing rural-to-urban migration, and elevating agricultural production until achieving self-sufficiency. This approach helps utilize unemployed workers, alleviate poverty, particularly in rural areas reliant on the agricultural sector.

4. **The Al-Musaqah contract** involves compensating someone who tends to trees with a share of their fruit (Ibn Al-Humam, 2003). It represents an ideal solution for landowners lacking the effort to manage their land and workers who lack land ownership or the means to practice agriculture. This arrangement relies on the worker's labor in nurturing productive trees, with the resulting harvest divided between them as agreed. Islamic banks employ this contract to fund land reclamation endeavors and implement modern agricultural techniques. They provide financial support and essential irrigation tools, potentially engaging a worker to manage the work and share the outcome with the landowner. Additionally, Islamic banks support impoverished individuals or small institutions by providing irrigation machinery and related accessories for installation on their farms with proper authorization. Alternatively, the bank may supply orchards or trees to these institutions, which must oversee the tree-watering

process in return for a share represented by a percentage of the fruit yield. By financing institutions and aiding the less privileged through this method, Islamic banks significantly contribute to boosting the gross domestic product and reducing rising unemployment rates amidst the ongoing global financial crisis. This support creates new employment opportunities, aims to enhance agricultural output, and cultivates high-quality dates, various vegetables, and fruits for export, consequently reducing reliance on imports and fostering a surplus in the trade balance (Muhammad Sharif, 2018).

### **8.3 cooperation and charity based Islamic Microfinance**

Islam, as a merciful religion, places great emphasis on cooperative financing, as evident in various Qur'anic verses and Prophetic hadiths that encourage believers toward social solidarity. Among the significant types of Islamic cooperative financing are the following:

**Al-Qard Al-Hassan**, as per the Hanafi school, refers to a loan where something similar, not identical, is returned in exchange (Ibn Abidin, 1991). This distinction arises because a loan involves ownership contracts, where the borrower consumes the amount lent with the obligation to repay something equivalent. This definition excludes gift (Hiba) contracts and charity, as they entail ownership without any compensation. Similarly, it also excludes the Ariyeh contract, which pertains to usufruct or usage rights for a specific period but not ownership of the property itself (Al-dabyan, 2010).

**Al-Qard Al-Hassan** stands out as one of the primary cooperative financing methods for small projects. It grants the borrower the liberty to utilize the loaned amount, with the condition that they repay the lender the borrowed sum or an equivalent. This form of financing is particularly suitable for industrial and production projects that require short-term capital, such as procuring raw materials or covering employee wages. It offers flexibility to project owners who may prefer not to share a portion of their profits within a partnership arrangement (Muhammad Farhan, 2003).

**Gift (Hiba) Contract:** The Hanafi school of thought defines the Gift (Hiba) Contract as an immediate transfer of ownership of property without any compensation (Al-zailaye, 1895). This definition underscores that the gift contract involves the transfer of ownership rights, encompassing financial and other assets.

This contract offers a means of financing for small projects due to its flexibility, allowing the recipient to have full authority over the gifted subject, whether it's in the form of goods or cash. Concurrently, Grant financing and loan financing are considered the most fitting financial options for small projects (Muhammad Farhan, 2003).

3. **Al- Wasiyyah:** Al-Wasiyyah refers to an ownership addition made after death through donation, comprising items or benefits (Ibn Najim, 1998). Al-Wasiyyah is regarded as a model of social financing within Islam. The majority of scholars allow Wasiyyah in anything permissible for benefit, whether it involves wealth or

other advantages. Scholars have granted permission for Al-Wasiyyah to be designated for relatives, both individuals, and groups, as well as for non-relatives. Additionally, they have sanctioned its use in financing projects that could benefit the wider public (Muhammad Farhan, 2003).

4. Waqf refers to the confinement of assets to generate benefit, as defined by Ibni Qudhama (1968). This practice takes various forms, including endowments dedicated to mosques, land, educational institutions, schools, and hospitals.

Islamic endowments have received particular attention due to their distinctive characteristics that set them apart from other cooperative financing sources. Notably, their continuity and diversified sources are key features. The varied purposes of Islamic endowments and their manifold and sustained benefits significantly influence economic life and financial aspects. While their primary aim is not solely social, endowments extend their impact to economic aspects, contributing to infrastructure development and funding projects beneficial to society. Consequently, endowments play a substantial and effective role in fostering economic development and could actively support small-scale projects (Muhammad Farhan, 2003).

Zakat and charity also hold considerable importance in funding small projects and supporting individuals with limited income. These charitable funds serve as essential forms of donations, actively contributing to community development and advancing social justice. The diverse mechanisms of microfinance in the Islamic economy encompass various aspects that cannot all be covered within this research. Numerous aspects related to Islamic microfinance remain to be explored, considering its rapid emergence as a crucial tool in poverty reduction, particularly in Afghanistan.

## IX. CONCLUSION

Islamic microfinance, adhering to Sharia principles in its financial services provision rather than traditional interest-based methods, plays a pivotal and beneficial role in Afghanistan's economy and societal fabric.

Aligned with the core Islamic values prevalent in Afghanistan, Islamic microfinance stands as a Sharia-compliant solution meeting financial needs while fostering community involvement and sustainable growth. Its introduction significantly aids in boosting financial inclusivity by extending services to the most underprivileged and marginalized sectors. Empowering both individuals and small to medium-sized enterprises, it serves as a catalyst for entrepreneurship and local development. By funding local enterprises and elevating economic activities at grassroots levels, it not only generates employment opportunities but also elevates the living standards of residents.

Crucially, Islamic microfinance diminishes reliance on conventional usurious loans, thereby mitigating the associated risks and costs while fortifying financial stability for individuals and society at large. Beyond its economic impact, its emphasis on financial justice and adherence to Islamic financial ethics fosters trust between local communities and financial institutions. Moreover, it underscores transparency in financial dealings, reinforcing ethical practices within the financial ecosystem.

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