



Review Paper

## Poverty, Conventional Insurance and Takaful: A Journalistic Review

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### Abstract

*Substantial income is always an issue for poor households. Insurance is an effective mechanism for reducing the vulnerability of the poor from the effects of diseases, theft, disability, and other hazards. Unexpected losses can be protected by conventional insurance. In Muslim world, Shariah scholars prohibit the conventional insurance system because of Gharar (Uncertainty), Maisir (Gambling), and Riba (Interest). Insurance covers risks and risk can be managed by avoiding, mitigation, transfer, combination, or loss prevention activities. Takaful is one of the substitutes of insurance system, which follows the rules and regulations of Islamic Shariah. In Takaful, insurance is like collective endeavor in which a group of people, following a particular scheme, financially support the catastrophic losses that are faced by an individual, who is policy holder of that particular scheme. In the past studies little evidence is found that counter Takaful System Poverty and deprivation among the Muslim societies. Unfortunately, less services available to poor Muslim population due to affordability, lack of knowledge, and insecurities of the products. Few scholars have proposed the solution of these issues in the Micro-Takaful products and in cooperative structure scheme. So, this study is investing whether Takaful has prospectives to lessen poverty or not. More importantly, this study will also attempt to find out the impact of Micro-Takaful products on poverty reduction.*

**Keywords:** Takaful, poverty, conventional insurance.

### Introduction

Every individual in the world is vulnerable to the risk of death, disease, fire burn, accident etc. Risk is defined as: "Risk is the possibility of adverse consequences happening"<sup>1</sup>. Different religions have different concepts of risk to life, death and other adversities. Muslims believe on the concept of Qadah-o-Qadar which means the Creator of the universe has written the destiny and fate of humans for pre-eternity and without any doubts. He has the knowledge of everything in the world. But there is a provision in Islam that everyone must strive to protect himself and his family from the troubles and threats to their life. In all over the world, people are purchasing a protective shield for them that is named as insurance. Insurance is defined by number of authors.

Spencer defined Insurance in following words: "Insurance refers to a legal contract that protects the policy holder from the financial losses that cause due to unexpected events"<sup>2</sup>. Another defines the insurance in following words: "Insurance is a legal contract that transfers risk from a policyholder to an insurance provider"<sup>3</sup>. Insurance seems to be an attractive offer for the risk bearer but Islamic scholars have some apprehensions on Conventional Insurance System<sup>4-7</sup>. Shariah Scholars have prohibited Insurance due to three major issues: i. Gharar or Uncertainty: Insurance Companies indemnify the losses of policyholders that are unknown in advance. And Shariah

Scholar argues that any contract in which the outcomes are not apparent or unknown must be declared illegal because it involves great deal of uncertainty. Word Gharar refers to the contract in which one party gains benefits at the expense of others. ii. Maisir or Gambling: Insurance is considered as gambling by the Shariah Scholars because if loss occurs then policy holder may get much more amount than he has paid and if no loss occurs then policyholder might lose all the money he has paid as premium. iii. Riba or Interest: Interest is considered to be involved due to two major reasons. The first reason is that a holder of life insurance policy may get the amount on his death that is much more than he has paid as premium. Secondly Insurance companies reinvest the amount of premium received from policy holders into different investment schemes in which interest is directly involved. iv. So due to the above three reasons, Shariah Scholars prohibit the Conventional Insurance System. But if the the Muslim Ummah cannot be benefited from Insurance system then what substitute is available for them that is Gharar, Maisir and Riba free? To answer this question, Islamic Scholars presented the idea of Takaful (An Islamic Insurance System) which is rooted back from the times of Holy Prophet in which Muslims community contribute their funds in mutual cooperation scheme "Aqilah" and later on practiced by the Khulfa'ih-e-Rashideen<sup>8</sup>. Takaful is an agreement in which policyholder donates to help one another through brotherhoodness, solidarity and mutual cooperation against catastrophic losses<sup>9</sup>.

Purpose of this study is to investigate that how Takaful may help in reducing the poverty of Muslim world. Report of Human Development Index shows that there are 1.5 Billion Muslims in the world and majority of the Muslims live in poverty with the low and medium level of Human Development Index<sup>10</sup>.

So it is highly important to find out economic factors that can reduce the poverty. There are number of studies that investigated the impact of Insurance on Poverty but there are few studies, in fact rare studies investigating the impact of Takaful on Poverty. As the purpose of Insurance and Takaful is same that is to indemnify the losses of risk bearer so this study will also discuss the insurance and its impact on poverty by reviewing the literature and will draw the conclusion on the basis of the reviewed literature.

## Discussion

**Poverty in the Muslim World:** According to an estimate, there are more than 7 Billion people in the world<sup>11</sup>. Out of these 7 Billion around 1.7 Billion people are living below the poverty line and 44% of poor population resides in Muslim Countries<sup>12</sup>. On the other side, Muslim population represents the one fifth of the world population and consists of 57 countries. More than 50% of natural resources of world are owned by the Muslim World and it contributes only 5% of GDP (Gross Domestic Product) in the world's GDP<sup>13</sup>.

So all the above statistics show that Poverty in Muslim World is not under control so different economists have suggested different economic actions and strategies for poverty alleviation in Muslim world<sup>14,15</sup>. Many of the economic experts believed that poverty can be reduced through the Microfinance schemes as DrYounas of Bangladesh set a successful example in Bangladesh<sup>16,15,18,19</sup>. Different research surveys of World Bank, USAID, IFC, Frankford, CGAP verified the theories of economists that microfinance schemes are the best solution for poverty eradication<sup>12</sup>. Other writers found the solution of poverty in insurance schemes.

## Conventional Insurance and Poverty Reduction

In past researches and economists tried their best to find out how insurance can be helpful in reducing and eradicating the poverty from the developing and underdeveloped economies. Poor people in the world have low income level to afford the necessities of their life but any catastrophic or uncertain events like diseases, death or tsunamis badly affect the life cycle of poors. Floods, unemployment, diseases, droughts directly hit the poor people. But every human looks for the way through which risk can be minimized. Similarly poors also strive to minimize the risk through mutual funding among their social circles, savings, risk avoidance and income diversification. In the rich countries, it is proved that insurance is an important cushion against poverty so through effective functioning of insurance schemes, safety nets, saving schemes poor's' asset based can be

strengthened<sup>20</sup>. Similarly it is reported that in Nigeria that insurance plays very important role in reducing the vulnerability of effects of thefts, diseases, violence, fire and other hazards<sup>21</sup>. In insurance mechanism policyholders pay the average losses of group through small payments instead of paying for a single unseen event that is more difficult to afford for an individual person<sup>22</sup>. So logically and empirically it is proven that insurance really helps the poor population to manage and deal with their problems effectively.

## Different Insurance Schemes and Poverty Reduction

Two most important insurance schemes that directly influence the poor population are Unemployment Insurance Scheme and Health insurance scheme. As an empirical study on poor population of Senegal shows that health insurance improves the health of poor population, provides modest financial protection and long term negative health shocks can be reduced<sup>23</sup>. According to an estimate 93% of ill health people reside in developing economies with few options to cope with the risk of poor health. According to another estimate around 1.3 Billion people in the world cannot afford the basic health care facilities for themselves. But the risk of poor health can managed well through different insurance schemes that ultimately cause in reducing the poverty of developing economies especially<sup>24</sup>. Similarly Barofsky and Acharya, et al. confirmed that governments of different developing nations have invested heavily in the health insurance schemes to reduce poverty and improve the health of its poor population<sup>25,26</sup>. Here it is important to note that health issues are not only faced by developing economies but the rich countries like USA, UK are also suffering with same issues and Government and NGOs have found its solution in effective utilization of Health Insurance<sup>27-29</sup>.

Same like Health Insurance, there are number of reports published to highlight the need of unemployment insurance to improve the living standard of poor. A report shows that Unemployment insurance surely helps in reducing the poverty especially after the recession crisis as in 2011 recession, Unemployment Insurance affects the income level of approximately 26.0 Million people<sup>30</sup>. Similarly there is a need to expand the unemployment insurance schemes to the developing and underdeveloped nations too so the poor population could find out some substitute of income in ear of recession and crisis<sup>31</sup>. Other insurance schemes as life insurance, Pension Insurance and other different insurances may decrease the financial and mental burden of poor and middle class of developing nations as well as developed nations<sup>32</sup>.

## Takaful and Poverty Reduction

Below give figure 1 shows that in which regions of the Muslim world Takaful is actively distributed. Statistic are till the year 2010. It shows Takaful penetration is at its peak in 2010 i.e. 8,329 million US \$. In this figure GCC Countries include

Bahrain, Qatar, UAE, Kuwait and South East Asian countries include Brunei, Thailand, Indonesia and Malaysia. Growth rate is highest in Levant region that is 102%. So below given graph shows that how Takaful is growing in world.

If we draw a comparison between Takaful and Insurance penetration, we will come to know that insurance is growing more rapidly than Takaful in world. As a study shows Takaful premium in the world is US \$ 5.08 Billion in 2006 and in 2008 it was 5.3 Billion US \$, while insurance premium in only one region of the world USA is 3.7 US \$ Trillion and in 2008 it was 4.2 Trillion US \$<sup>34,35</sup>. So it is quiet difficult to estimate that how Takaful impacts the poverty as its penetration is quiet low and it is limited in few regions of the world. As statistic shows that Takaful Premium only represents the 0.2% of world's insurance premium. Therefore there are few empirical studies on Takaful and its impact on poverty. Work of Patel, (2005) is famous in this aspect<sup>36</sup>.

Here it is important to mention that purpose of insurance and takaful is same that is to mitigate the risk. As above evidences show that insurance influences the poverty and can be an effective tool for reducing poverty especially from the developing countries. So on this assumption we can expect the same results from Takaful. As Fisher, stated: "Takaful is the second most important social institution in the Islamic community to counter poverty and deprivation"<sup>37</sup>.

### Role of Micro-Takaful Products

As mentioned above, micro financial products are really useful for reducing the poverty. As Dr Younas, the Nobel award

winner has worked a lot on providing micro-financial products to poor population of Bangladesh. Through the Micro-Takaful products, the burden of premium is comparatively less on the poor population that is affordable to them. But the inconsistent support of Government would be an important element for the success of Micro-Takaful Scheme.

As Akhter, Akhtar, and Jaffri (2009) stated in their study: "Integrating Islamic microfinance with NGOs, NPOs, Zakah, Awqaf and with Takaful as well as with professional training and capacity building institutions will be helpful to achieving their aim of providing micro financial services to the poorest of the poor under one roof"<sup>38</sup>.

### Challenges to Spread Takaful among Poor Population

Patel and Bhatti listed some of the difficulties in penetration of Takaful among poor population<sup>36,39</sup>: i. Fully trained and skilled staff to promote Takaful is nearly unavailable, ii. Knowledge of Takaful Permissibility is lacking in general public, iii. In many regions of Muslim world, concept of insurance to deal with risk is not popular, iv. Efforts of Governments of Muslim countries are not so appreciable, v. Takaful industry is still in infancy stage to meet the demands of public, vi. Distribution and marketing channels are not working effectively to create awareness on benefits of Takaful program, vii. There is a lack of trust among the general public about insurance and Takaful programs.

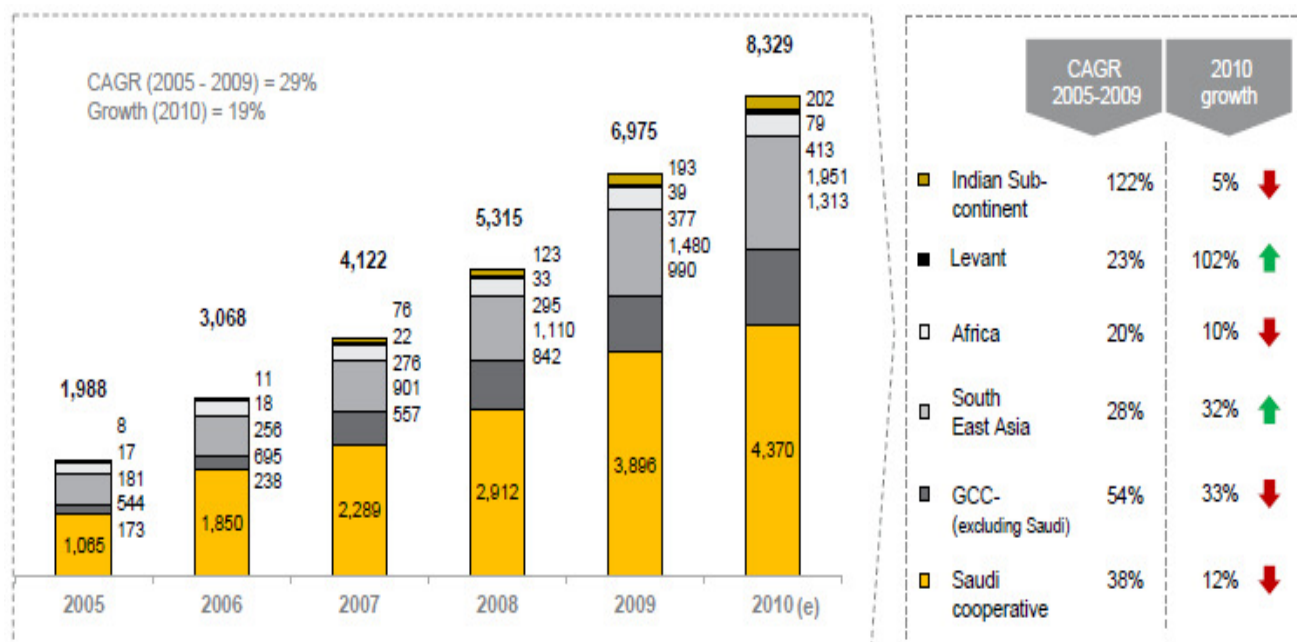


Figure 1  
 Global Gross Takaful Distribution in US \$ (Million) Adopted from: Ernst & Young<sup>33</sup>

## Conclusion

As we know risk is prevailing everywhere in the world. But poor people are more exposed to the risk of illness, catastrophic losses, unemployment, death etc. Because any huge loss badly affects the income cycle of poor families and their poverty level decreases. Therefore this issue demands attention that what strategies can be beneficial to reduce the burden of losses of poor population. There are number of empirical studies that attempted to find out how insurance affect the poverty level. Most of these studies confirmed that insurance is a helpful in reducing poverty<sup>20-22,27-29</sup>. Takaful industry is at its infancy stage and has not reached in many remote areas of Muslim world therefore to collect the empirical evidences is not possible. But the purpose of insurance and Takaful is same that is to mitigate the risk so it is expected that Takaful will also have the same results on the poverty. Here it is important to note that Takaful and Insurance both can be one of helpful tools to reduce poverty but cannot totally eliminate poverty from its roots. To reduce the burden of poor population Micro-Takaful schemes with small premium amount can be beneficial.

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