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The Role of Islamic Micro Financial Cooperatives (*Baitul Maal Wat Tamwil*) in Local Economic Development: Case Study of Three Provinces in Indonesia

R D Putra SOFANA 

Sharia Economic Forum

Jl. Tamansari No.KM 2,5, Mulyasari, Kec. Tamansari

Kab. Tasikmalaya, Jawa Barat 46196, INDONESIA

✉ rsofama@gmail.com

ABSTRACT. Indonesia as one of the largest Moslem countries in the world, is still facing chronic poverty problems. Despite the fact that GDP per capita has shown a positive trend since the financial crisis that hit

Indonesia in mid 1997, it is not difficult to see that poverty and inequality still prevail in reality. There is widening gap between those who control main business and the poor. According to the Indonesia Central Bureau of Statistics, around 17.75 percent of total population (around 220 million) are still living under poverty line. The poor themselves have underutilized entrepreneurship potential due to the structural barriers in economic activities. Microfinance is an alternative for micro entrepreneurs and the poor, who are normally not eligible or bankable to receive loans from commercial banks. The study is intended to analyze the role of BMT (*Baitul Maal wat Tamwil*) on strengthening the local economic development in Indonesia.

KEYWORDS. *Baitul Maal wat Tamwil, BMT, Local Economic Development, Economic Policy, Poverty Reduction*

I. INTRODUCTION

Until the Asian financial crisis, Indonesia was a success story in economic development in Southeast Asia region. With convincing sustained economic growth of not less than seven percent annually, Indonesia was acclaimed as one of the prospective Asian Tigers. However, in mid-1997, the Asian financial crisis interrupted this improvement and Indonesia plunged to a situation in which the social and economic complexities of became apparent along with growing demand for the democratization (Gulzar, Mujtaba Kayani, Xiaofen, Ayub & Rafique, 2019; Seo, Kim, & Ryu, 2019).

In the past three decades, economic prosperity has been enjoyed by very few business moguls called conglomerates while most Indonesians, particularly the poor, only enjoy a small part of economic development pie. Approximately 99% of the Indonesian economy is backed up by small-medium enterprises (SMEs). This huge entity of SMEs actually has a strategic role in economic development through job creation, which in turn may alleviate poverty. As the 2006 Nobel Peace Prize Laureate, Muhammad Yunus convinced that the poor essentially has entrepreneurship potentials. The poor are under-utilized, given that structural barriers inhibit them from reaping benefits from formal economic activities. Essentially, the poor have some potential to engage in economic activities (Yunus, 2003; Yunus 2007).

Past economic development in Indonesia seems experienced what Kasri & Ahmed pointed out as the failure of experimenting in top-down (trickle down) development policies for a few decades to alleviate poverty (Kasri & Ahmed, 2015). Although in the Soeharto regime, the poverty figure had declined from about 40 percent in the transition era from the Old Order to nearly 16 percent before Asian financial crisis, the inequality between those controlling the most part of economic business and the majority of Indonesians is still widening (Zulkarnain, 2016; Sihotang, 2016; Melina, 2020). The rate of poverty as measured by Indonesian Central Bureau of Statistics criteria demonstrated that around 17.75 percent of Indonesian population is living under poverty line. However, if we measure the poverty rate by using World Bank 2 USD/ day standard, approximately around half of 220 million Indonesian population living under poverty line. Indonesia known as agriculture-based country. According to Central Bureau of Statistics, nearly 40 percent of 111.48

million Indonesian working forces are farmers and the remains mostly work in informal sectors.

Indonesia also known as the largest Muslim country in the world since approximately 80 percent of its population is Moslem. Six years prior to Asian financial crisis in 1991 Islamic finance has evolved comprising Islamic commercial banks, commercial banking units, rural banks, and financial cooperatives. Indonesia also has one of the most differentiated micro- and rural finance sectors among developing countries, comprising both formal and non-formal financial institutions. Currently there are three Islamic banks and 226 small Islamic banks, and 3,100 Islamic Microfinance Institutions (IMFIs). All of Islamic Financial Institution constituted around 2.6 percent of total financial system in Indonesia. It is expected that in 2008 the proportion of Islamic financial institutions would reach 5%. Given the promising and strategic role of IMFIs in fostering economic development and poverty alleviation, this paper extracts research on the prospects of microfinance from an Islamic perspective with the special case of *Baitul Maal wat Tamwil* in Indonesia and its role in fostering local economic development in three provinces ([Mulia, 2019](#); [Sudjana & Rizkison, 2020](#); [Dewi & Astari, 2018](#); [Muctharom, 2019](#)).

This paper is organized in six sections. The first section is introduction. Then, the second section discuss about the micro finance and micro enterprise overview. Then the third section talks about Islamic Micro Finances Institutions (IMFIs) with the special regard to *Baitul Maal wat Tamwil (BMT)*. The next section provides empirical field survey of BMTs in three observed provinces. The section V and VI offer conclusion and policy recommendations.

II. OVERVIEW OF MICROFINANCE AND MICRO ENTERPRISES

Microfinance grew out of experiments in Latin America and South Asia, but the best-known start was in Bangladesh in 1976, following the widespread famine in 1974. Advocates argue that the microfinance movement has helped to reduce poverty, improved schooling levels, and generated or expanded millions of small businesses. The idea of microfinance has now spread globally, with replications in Africa, Latin America, Asia, and Eastern Europe, as well as richer economies like Norway, the United States, and England ([Rahman, 2007](#); [Hidayat, 2018](#); [Dawami, Razak, & Hamdan, 2021](#)).

Most of the microfinance institutions (MFIs), however, have non-Islamic characteristics. Their financing is interest-based. Furthermore, apart from the delivery of finance to the poor, many MFIs have social development programs that are mostly secular in nature. Given that, microfinance can facilitate poverty alleviation. Concerning on this issue, a study by Dhumale and Sapcanin ([1999](#)) in Segrado ([2005](#)) had drafted a technical note in which they tried to analyze how to combine Islamic banking with microfinance. They took into consideration the two main instruments of Islamic finance (*mudaraba*, and *murabaha*) trying to use them as tools to design a successful microfinance program ([Mursid, 2018](#); [Ascarya, Rahmawati, & Tanjung, 2018](#); [Arafat, 2020](#)).

1. A Mudaraba Model

The microfinance program and the micro enterprise are partners, with the program investing money and the micro entrepreneurs investing in labor. The micro entrepreneurs are rewarded for his/her work and share the profit while the program only shares the profit. Of course, the model presents a series of difficulties, given most of all by the fact that micro entrepreneurs usually do not keep accurate accountability, which makes it more difficult to establish the exact share of profit. As stated before, these models are complicated to understand, manage and handle which implies that those who are involved need specific training on the issues ([Sihotang, 2021](#); [Melina, 2020](#)).

For this reason, and for an easier management of the profit sharing scheme, the mudaraba model might be more straightforward for businesses with a longer profit cycle.

2. A Murabaha Model

Under such contract, the microfinance program buys goods and resells them to the micro enterprises for the cost of the goods plus a markup for administrative costs.

The borrower often pays for the goods in equal installments, and the microfinance program owns the goods until the last installment is paid. On the other hand, micro enterprise is defined as those having fixed capital or the number of workers under certain threshold levels. Ahmed (2002) pointed out that there are three broad categories of economic activities that can be identified namely, production, trading, and providing transport services. In production, the poor may be involved in agricultural or non-

agricultural activities. Agricultural activities include farming, cattle rearing, poultry rearing and fisheries. Non-agricultural production can cover a wide variety of activities ranging from food processing to producing different handicrafts and household items like pots, mats, cloth, etc. Trading includes shop keeping, small business, and selling specific items like vegetables, fish, etc. Providing transport services can be through rickshaws, boats, or motor vehicles used as taxis ([Ahmed, 2002](#); [Sihotang, 2021](#); [Melina, 2020](#)). These descriptions are also common found in Indonesia.

III. ISLAMIC MICROFINANCE INSTITUTIONS IN INDONESIA

Indonesia as developing country has rather similar problems like other third world countries. Perplexing problems, such poverty and inequality are prevailing. Most of Indonesian people apart from income generating living like farmers, they depend on informal sector for income generating sources. In urban areas and in each big cities in Indonesia, we can easily find people working by opening street vendor, becoming manufacturing labors, and doing small services provider, for instance. Whereas in rural areas, besides farming, they have side jobs or main jobs as handicraft makers, agricultural laborers, and trading ([Mukhibad & Nurkhin, 2020](#); [Riwajanti, Muwindha, Handayani & Miharso, 2020](#)). These kind economic activities only have small and limited impact for their living standard and welfare improvement. Although they have the willingness to expand their small business, this thing cannot make out easily since their businesses considered as informal sector and has no sufficient legal foundation and

physical collaterals. In attaining their business expansion, often, micro entrepreneurs borrow money from either families or illegal moneylenders.

Frequently, the micro entrepreneurs borrow money from the illegal moneylenders charging high interest rate. Those are not difficult to find where the micro entrepreneurs trapped in huge debt leading to their business bankruptcy (Amri, 2018; Susilowati, 2018).

Since the early 1980s, there is growing tendency to apply what Islamic Sharia compels to Moslem adherents. In 1991, the rise of Islamic Economic came to the scene. During the last 15 years, there is growing awareness of sharia banking practice in Indonesia. This development also goes further to widespread establishment of Islamic Micro Finance Institutions (IMFIs).

Conventional microfinance itself not necessarily complies with the rule of interest (usury) prohibition. Realization of Islamic economic application in the realm of Indonesian economic entity is relatively new. The first milestone of Islamic economics application was the establishment of Bank Muammalat Indonesia in 1 November 1991 and it effectively operates in September 2002. This bank is the first bank applying sharia rules in its operation. One of conspicuous aspects of this bank is prohibition of *riba* (interest or usury) for all banking transaction and its related business. The very recent development of Islamic Financial development is the enactment of The Bill of Sharia Banking in 2008. As above-mentioned earlier in this paper, one of the underlying reasons of the mushrooming (IMFIs) is that the awareness given the fact that the conventional banking and micro finance institution does not reach those marginalized group. This situation happened because not only classical collaterals and physical assets prerequisites but also the reason for the application of sharia ruled by Moslem adherents.

One of burgeoning Islamic financial institution Indonesia is *Baitul Maal Wat Tamwil* (Islamic Financial Cooperative). The first *Baitul Maal wat Tamwil* (BMT) was established in early 1980s but BMTs were not growth significantly until 1992. BMTs themselves can be classified as a non-governmental organization (NGO) with the legal foundation as a cooperative. One of BMT activities is to finance micro enterprise by soft loan called *Qard Hasan* (loan without interest charge). Basically, *Baitul Maal Wat Tamwil*'s role are not only in financing micro-enterprise but it has social role in helping the disadvantaged people. In *Baitul Maal wat Tamwil*, *Baitul Maal* refers to its function of collecting Zakat, Infaq, and Shadaqah and these for non-profit activity. This function is in accordance with one of five pillars of Islam that is Zakah for the prosperous Moslem. On the other hand, *Baitut Tamwil* has role for profit motive from fund it collected. In this function, *Baitul Tamwil* deals with economic activities of micro enterprise and informal sector run mainly by people who traditionally has no access to formal financial institution such bank. The conventional banking usually requires collateral and legal formal requirements and most of micro enterprise and informal economic activities cannot fulfill these requirements ([Amri, 2019](#); [Padmanty, Irawati, Murwanti, Sulton, & Sholahuddin, 2020](#)).

IV. FIELD SURVEY: A BRIEF PREVIEW

The economic research center The Indonesian Institute conducted research in exploring the role of *Baitul Maal wat Tamwil* in local fostering local economic development in 2006. The research picked up two provinces in Java the most populous inhabited island in Indonesia - and South Sulawesi which well known as Moslem society though in Toraja there is a small

population of Christian. Each province has three BMTs sample. Besides Moslem population as the consideration, the choice of sample were because the high number of BMTs operating in these three provinces.

The main criteria are that the BMTs which have operated no less than five years. The research conducted with the following three considerations; firstly, the development of Islamic microfinance has a positive role in poverty alleviation through micro enterprise run by poor people. Secondly, as an input for government, concerning on micro finance development needed by the lower and middle class societies. Thirdly, to enrich the understanding about Islamic microfinance institutions development in Indonesia based on empirical facts ([Suhianto; 2022](#); [Setya & Widiastuti, 2022](#)).

Given the strategic role Baitul Maal wat Tamwil as micro finance institution particularly in serving the poor and its double role both for non-profit and profit motives, this research has following two research questions first, how does the impact of the existence and role of Baitul Maal wat Tamwil to socio-economic conditions especially towards its clients.

Secondly, about the effectivity of Baitul Maal Wat Tamwil in conducting its socio-economic role. Islamic Microfinance Institutions (IMFIs) demonstrated relatively high growth in terms of number in Indonesia. In addition to the growing demand for Sharia rule application in economic and business transaction, the explanation why IMFIs are favorable in Indonesia is that this kind of micro finance institution has mission not only for business but also social motives. The underlying of utter moslem values which place muamalat and strong brotherhood, transparency, kindness, trust as taught by the Prophet Muhammad PBUH. In social aspect, IMFIs can reach the marginalized people who have no strong access to formal banking and financial institution. Moslem teaching

also put the principle to help the disadvantaged by contributing some proportion of wealth through Zakah.

Ahmed (2002) referred to (El-Ghazali, 1994) mentioned that Zakah and sadaqah in Islam are important tools for the redistribution of income and growth. Zakah is one of the five pillars of Islam and obligatory on every wealthy Muslim. Zakah and other forms of charities can be used to increase the participation in production of the poor Zakah can be integrated into the microfinance program in a variety of ways to benefit the poorest beneficiaries. It can be transferred to the poor as outright grants or given as qard hasan and can be used either for consumption or for investment purposes. In case of the extreme poor, zakah can be given as grants to stop the diversion of funds for consumption purposes so that the funds from IMFI can be used exclusively in production. As zakah will reduce the need for diverting funds meant for investment to unproductive use, it is expected that investments in productive activities will increase the overall return decreasing the probability of default. Thus, integrating zakah with microfinancing will not only improve the economic condition of the poor, but also ensure the repayment of the funds to the IMFI (Ahmed, 2002).

V. BAITUL MAAL WAT TAMWIL IN INDONESIA

The total number BMTs in Indonesia, 40,3 % has asset between 50–250 million of Rupiahs folowed by BMTs with asset range from 250–500 million of Rupiahs. These BMTs can be classified as the micro level and these facts are accordance with the reality that BMTs core business mainly dealing with micro enterprise. In addition, there were some BMT which have asset considered as medium with its asset reach 1 billions of Rupiahs

(approximately USD 100.000). The source of BMTs funding came from governmental program (Ministry of SMEs) and alms funding from moslem adherents. BMTs also conduct service like conventional banks such as providing saving services for Moslems who are not want to engage in interest based banking. The rate of return of saving is more competitive than prevailing interest rate in conventional banking. Furthermore, by the spirit of religious and strong commitment from its officers, BMTs in three observed provinces have proven to sustain in fierce economic and business competition (Dawami, Razak, & Hamdan, 2021; Martiana, Panena & Fuadi, 2022).

In three observed provinces (Central Java, West Java, And South Sulawesi), the clients of BMTs predominantly utilized the loan for working capital which are 78.8%, 78.9% and 88.9% respectively and the remaining for investment and other purposes. Unlike the conventional banking, micro finance proactively reach the clients who typically have difficulties in accessing banking supports. BMTs offer a simple procedure for micro enterprise without any burdening requirements such as legal foundations and physical collaterals. As a NGO, BMTs officers usually have strong relationships with the society in which BMT exists (Khilmia, Buchorie, Musthofa, & Imari, 2022). They also know about the characters of the clients who live nearby the BMT office. The following Table 1 depicts the assets growth of observed BMTs sample in three provinces. All observed BMTs showed the increasing asset growth. This phenomenon can be explained by two factors both internally and externally. Internal factor supporting BMTs asset growth related to spiritual aspects by applying honesty (*sidhiq*), trustable (*amanah*), conveying (*tabligh*), and wisdom (*fathonah*). These are behaviors taught by Prophet Muhammad PBUH and

implemented operationally by doing (Ginanjar & Kassim, 2020; Seuhaeni, 2020; Febianto, Johari, & Kefeli, 2019).

VI. CONCLUSION

Based on field observation in the three provinces in Indonesia (West Java, Central Java, and South Sulawesi) demonstrated that BMTs have strong positive impact on local economic development. Most of respondents assured that BMTs were helpful in supporting their business growth. BMTs have simple procedure in terms of loan procedure for the micro enterprise, fair, and have no burden for interest charge like conventional financial institutions. However, in addition to the positive images of BMT, one should pay attention about the need for insurance or guarantor institution in likely credit crunch event.

Given that important role of BMTs in supporting local economic development, in the future, it is expected that government has intensify its support to IMFI, in this case are BMTs. Rather than pouring the money to the people without strong rationale and base, government can channel a proportion of public budget through IMFI (BMTs) which will then administer and manage the fund for the appropriate clients. In addition, Indonesia as the largest Moslem country has potential in mobilizing charitable fund based on the rule of Islam such as Zakah, Shadaqah, Infaq, and Waqf to productive economic activities. These potentials may lead to greater boosting of economic development since it can reach the poorest community of society. By growing real business activities in all part of societies.

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Overcoming poverty is not a gesture of charity. It is an act of justice. It is the protection of a fundamental human right, the right to dignity and a decent life.

Nelson Mandela

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All authors declared that this work is original and has never been published in any form and in any media, nor is it under consideration for publication in any journal, and all sources cited in this work refer to the basic standards of scientific citation.