

Impact of Zakat on Economy: Structure and Implementation in Pakistan

Ayesha Tarar¹ Madiha Riaz²

1.Lecturer at Federal Science College, Gujranwala, Pakistan.

2.PhD candidate, School of Social Sciences, University Sains Malaysia, Penang.

* E-mail of the corresponding author: madihatarar@hotmail.com

Abstract

Zakat is one of the five pillars of Islam; this act required a Muslim to demonstrate submission to Allah. Its primary traditional function is an act of piety. It also reinforces the responsibility of Muslims for each other's physical and social well beings. Zakat as a traditional religious institution involve both the payments and distribution. Muslim Jurists have defined it as a complete unilateral and unconditional transfer by a Muslim of ownership, as an act of holiness of a prescribed portion of property to a poor. Zakat is to be paid once a year during the holy month of Ramadan on wealth held more than a year. The Zakat rate is fixed 2.5% on the money, gold, silver and other precious items. While it is 20% On the produce of mines, there is an elaborate schedule of rates for animals, depending on the species, age, and sex of animals. In this study we have defined the structure of Zakat in Pakistan and also find the nature of Zakat tax which is flat and its burden in the connotation of marginal utility of money is declining so Muslims should willingly pay the Zakat for the sake of Pleasing Allah.

Keywords: Zakat, Nature of Zakat, Structure of Zakat, Benefits of Zakat.

1. Introduction

Islam is the world's second largest religion, with nearly more than one billion followers worldwide. Under Islam, individuals have five fundamental duties, called Pillars of the Faith. One of these is a special duty falling on those most able to bear it that is to share *Allah's* bounty with those less fortunate. Most important of them is Zakat, an annual tax levied on wealth above some threshold, the proceeds of which were distributed to the needy. Zakat and related forms of religiously-mandated charity survive today, in one form or another, as central elements of economic life in Muslim societies

Zakat is understood to include a levy on "idle" wealth, and 2.5 percent per year is considered something of a benchmark. The traditions of Islam, the *Sunnah*, call for payment of Zakat on some forms of "productive wealth," as well. Nonetheless, all Muslims are aware that they have some such obligation, whether broadly or narrowly conceived, and all recognize that the object of that obligation is to reduce economic inequality and alleviate misery within their community.

A high proportion of the population in Pakistan responds to its religious obligation in regard to charity and takes some action upon it. Across the income spectrum, the proportion of the population in each income class giving religiously motivated charity is high and increases with the level of income considered. The system of religiously-motivated charitable giving in Pakistan appears to reduce both intra- and inter-province income inequality and so fulfills some part of its intended social function..Zakat is taken to be used or helping the destitute and for creating a safety net to catch those that a modern economic system found to reach. Ushar is to be used counted on for tapping the sector of agriculture for increasing domestic savings.

In the year 2010-2011 in Pakistan Zakat funds worth over Rs2.82 billion have been collected from 36 districts of Punjab(province).The break-up of zakat funds under different heads is Rs1 billion for subsistence allowance, Rs36,760,800 for educational scholarships, over Rs160,000,000 for scholarships of students of religious institutions, Rs122,537,000 for patients treatment, Rs163,381,000 for marriage grant, Rs102,114,000 for special subsistence allowance on Eid-ul-Fitr, over Rs1,000,000 for patients in Ahatta Korian, Rawalpindi. (Source is Ministry of Religious Affairs Pakistan)

The Zakat System was introduced in Pakistan with the vision to eliminate the poverty and provide assistance to the marginalized and deprived population of the country. It was introduced as first step to achieve the goal of a Welfare State in one hand and to implement the 4th pillar of Islam on the other. Zakat fund is provided to an adult Muslim living below poverty line with special preference to Widows, Disabled, Orphans, and Unemployed. The Zakat Funds are provided for Guzara Allowance, Educational Students, and Stipends to Deeni Madaris, Health Care, Social Welfare, Marriage Assistance, Special Grant for Eid.

This paper presents empirical evidence on the degree to which Zakat achieve their intended objectives in Pakistan, one of the most populous Islamic republic's in the world. We also attempt in this study via the simple calculation on hypothetical data for assessing the nature of Zakat tax.

2. Structure of Zakat in Pakistan

Zakat & Ushr system was enforced in the country after promulgation Zakat & Ushr Ordinance 1980 (No. XVIII of 1980), The collection of Zakat base compulsory levy of Zakat at source from 11 types of assets detailed in 1st schedule of Zakat & Ushr Ordinance 1980. Ministry of Religious Affairs. Zakat & Ushar (MORA) Islamabad manage collection of Zakat and maintenance of relevant accounts. The disbursement of Zakat takes place by transfer of funds to the Provincial Zakat Council which in turn transfers it to District Zakat Committees (DZCs). The actual disbursement is made at Local level through LZCs and other institutions. MORA allocates funds to the province according to the percentage of population of each province for its disbursement according to the law and the provisions of Zakat Disbursement Procedure approved by the Central Zakat Council (CZC). There are 35 DZCs and approximately 25267 Local Zakat Committees (LZC) engage in disbursing Zakat money among mustehqeen (beneficiaries). The Zakat is disbursed on following grounds in Pakistan.

2.1 Guzara Allowance

- 60% of total allocated budget to a DZC, is fixed for Guzara Allowance.
- Payment of Guzara Allowance is made by the LZC to the Mustehqeen which have been residing in jurisdiction of LZC.
- Istehqaaq of a mustehiq / beneficiary shall be determined by the LZC concerned.
- An adult Muslim living below poverty line is eligible for this allowance with preference to widows and disables.
- Not more than one mustehiq is selected from one house for the selection of Guzara Allowance.
- Two person quotas of funds allocated for GA is allocated for disabled

2.2 Educational Stipends

- School, Colleges, University, Poly tech and other training and provincial institutions established or recognized by the Government are eligible to receive Zakat stipend.
- Istehqaaq of the students is determined by the LZCs of the residence area of the student.
- Zakat fund for education are disbursed by the DZC according to the following proportion:- Primary to Middle 50%, Science, Arts & Professional Education 25%, Higher Education 25%

2.3 Educational Stipends Technical

- Funds to the DZC are released on the basis of population of each district for award of educational stipend to musthiqs getting training in VTIS working under the control of Punjab Vocational Training Council and Teva institutions.
- Istehqaaq of the student is determined by the LZC of the residence of the concerned LZC
- MORA Scholarship Committee (MSC) is constituted in each district which segregates and determines the size of annual Zakat grant and admissible.

2.3 Stipends for Madaras

- 8% of the total allocated budget to a DZC is fixed for Educational stipends to the students of deeni madaris.
- Istehqaaq of the student is determined by the LZC of the residence are of the concerned student.
- The rate of stipend is based on the status of the madrisas that is they are either Primary to Matric, Above matric and upto B.A. (or equivalent), M.A. (or equivalent) and above or Hafzo Nazira, Mouqoof Aleh and Dura Hadit.

2.4 Health Care

- 6% of total allocated budget to a DZC is fixed for Health Care.
- DZC transfer funds to the hospitals on the basis of share of each DHQ, s (District Head Quarters) and THQ's (Tehsil Head Quarters).
- Funds in balance after released to DHQ and THQ is distributed among all LZCS for their transfer to BHUs / RHCs functioning in their area.

The funds are transferred from Provisional to Local level step by step.

Provincial Zakat Funds (PZF) is maintained at provincial level bearing title "Provincial Account No. 03-Provincial Zakat Fund Punjab" with the State Bank of Pakistan, Lahore. Then Personal Ledger Accounts (PLA) of District Zakat Fund (DZF) is being maintained at district level with District treasury / accounts Office for transfer of funds to its local tires for disbursement among Mustehqeen which is jointly operated by the Chairman DZC and the District Zakat Officer (DZO) and Local Zakat Fund (LZF) is being maintained by a Local Zakat Committee (LZC) for disbursement of Zakat funds among Mustehqeen transferred from DZF. It is operated jointly by the Chairman LZC and a cosignatory member as designated by the concerned LZC. The account of LZC is opened in the nearest branch of the locality for a schedule bank. The structure of Zakat reveals that its grassroots level access to poor makes this system superior to all others in the world as in this way no pocket remains empty due to personal linkages at local level.

3. Main Sources of Zakat in Pakistan

- i) Saving Bank Accounts (Option given in compliance to Superime Court Judgement).
- ii) Notice Deposits Receipts and Accounts
- iii) Fixed Deposit Receipts and Accounts (e.g. Khas Deposit Certificate).
- iv) Savings / Deposit Certificate (e.g. Defense Saving Certificates. National Deposit Certificates).
- v) Units of the National Investment Trust (NIT).
- vi) I.C.P Mutual Fund Certificates.
- vii) Government Securities (other than prize bonds).
- viii) Securities including shares and debentures (e.g. T.F.C).
- ix) Annuities.
- x) Life Insurance Policies.
- xi) Provident Funds

4. Zakat Role in dropping the inequality

Zakat as a means of income distribution from sahib-e-Nisab (Rich) to Mustahqeen (poor) is a powerful source in reducing the income inequality between intra and inter regions of country. Zakat and related forms of charitable giving encouraged by Islam affected the distribution of income in Pakistan and proved helpful in reducing the income inequality.

Geoffrey (1994) explains and examines the impact of Zakat on income inequality in Pakistan. Data from 1987-88 are used to construct two income distributions, one that would have obtained if zakat had not been given, and one that did obtain when such giving took place, Atkinson-Kolm-Sen relative indices of income inequality are computed. Which show that zakat does reduce measured income inequality in Pakistan, Both intra-province and inter-province components of over-all inequality decline, though the amount of change was small.

To measure the overall effect, ethical relative indices of income inequality were computed and compared under two alternative scenarios: first, on an income distribution that would have obtained, had there been no Islamic institution of Zakat in place—i.e. if no individual felt any special obligation to give out of their income to others as required of them by Islam—and, second, the distribution of "disposable" income that actually did obtain after those individuals who responded to it acted upon their Islamic obligations. The former income distribution is referred to as the distribution "without Zakat," and the latter the distribution "with Zakat."

An important class of ethical indices of inequality has developed out of work by Atkinson (1970), Kolm (1969), and Sen (1973). AKS indices depend upon the "equally distributed equivalent income," defined by reference to some explicit social evaluation function over incomes reflecting the investigators distributional values. This index was decomposed, in order to isolate both inter- and Intra group components of overall inequality within arbitrary (exhaustive) partitions of the population.

Blackorby, Donaldson and Auersperg (1981) (BDA) measured intra-group inequality by the percent of income saved in moving (with social indifference) from the initial distribution to one with no intra-group inequality. Inter-group inequality is measured by the percent of income saved in moving (with social indifference) from no intra-group inequality to no inequality at all.

"As a final perspective, study considers the separate impacts of zakat on inter province and intra-province income inequality in Pakistan. Study reports BDA decompositions of the AKS indices into intra- and inter-province components for various values of "r". Comparing the values of "r" it was clear that intra-province inequality in Pakistan was by far the largest factor in determining overall income inequality in the country. By comparing the index values, results reinforce the Zakat in reducing the income inequality. Since it seemed reasonable to suppose that most giving is done close to home, Zakat expect to have its greatest impact on intra-province inequality.

4.1 Zakat role in neutralizing the consumption

Aggregate consumption is a major component of the aggregate demand in an economy and as such plays a crucial role in determining the level of income and prices. Furthermore, the value of the marginal propensity to consume (or its counterpart, marginal propensity to save) is one of the major determinants of the rate of growth of national income. The stability of national income is also linked with the stability of the marginal propensity to consume through the interaction of multiplier and accelerator. Therefore, Islamic economists are genuinely interested in investigating as to how the consumption function would behave in an economy which is governed by Islamic values and injunctions as compared to secular economy. How the Zakat and other charitable obligations work in Islamic systems, etc. In recent years some very useful contributions have been made in this field (for example, Metwally 1981 & 1985; Khan 1984; Ahmad 1985 and Darwish & Zain 1985).

Iqbal (1985) critically review the writings on the subject matter of effect of certain Islamic injunctions on consumption. The study refuting the conclusions of some previous writers established that the effects of *zakah* and *infaq* (charitable spending) on consumption, *ceteris paribus*, are expansionary, and that of Islamic moderation contractionary. The study reveals net effect cannot be determined *a priori* because it depends on

empirical values of some parameters. Sensitivity analysis was performed on likely values of relevant parameters, confirmed that the net effect of Islamic injunctions on the marginal propensity to consume is neutral.

After reviewing various opinions about the effects of *zakah*, moderation and *infaq* on the aggregate consumption function and the propensities to consume and examining these theories critically, study leaned to conclude that effect of *Zakah* and *infaq* depends on empirical values of a number of parameters. What was even more important the fact that the magnitude of the net effect on the marginal propensity to consume of the Islamic injunctions taken together will be very small. Contrary to the prevalent opinions, study tended to conclude that the net effect of Islamic injunctions on the marginal propensity to consume will be neutral i.e. MPC will not be significantly different from a comparable secular economy. The sensitivity analysis performed on the likely values of the relevant parameters tends to confirm this conclusion. This was so because the expansionary and the contractionary effects of various injunctions tend to cancel out each other. so in this way *Zakat* effect is not contradictory to the theories of secular economics. It is in fact balancing the consumption between very high MPC group (Rich-*Zakah* Givers) and very Low MPC group (Poor-*Zakat* Receiver).

4.2 Nature of *Zakat* (Tax)

A tax can be progressive, regressive, or proportional. By a progressive tax it means that the *percentage* of income an individual (or household) pays in taxes tends to increase with increasing income. Not only do those with higher incomes pay more in total taxes, they pay a higher *rate* of taxes. This is the essence of a progressive tax. For example, a person making \$100,000 in a year might pay 25% of her income in taxes (\$25,000 in taxes), while someone with an income of \$30,000 might only pay a 10% tax rate (\$3,000 in taxes).

A tax system may also be regressive or proportional. A regressive tax system is one where the proportion of income paid in taxes tends to decrease as one's income increases. A proportional, or flat, tax system simply means that everyone pays the same effective tax rate regardless of income. In order to access the nature of *Zakat* tax we generate a hypothetical data and estimate it average and marginal rate.

The lower income level is considered on the basis of current obligation of *zakat* for *sahib-e-Nisab* (*zakat* payers) in Pakistan at current prices of 2012. We found by simple calculation the *Zakat* tax is neither progressive nor regressive as its average and marginal tax rate is fixed for all income groups so we can infer it is flat or proportional. In the sense of burden it generates is decreasing for higher income group and vice versa.

Table 1

Calculation of *Zakat* Tax

Income	Tax rate	Amount paid	Average tax	Marginal tax
500000	2.5%	12500	0.025	-
1000000	2.5%	25000	0.025	0.025
1500000	2.5%	37500	0.025	0.025
2000000	2.5%	50000	0.025	0.025
2500000	2.5%	62500	0.025	0.025

5. Conclusion

The main objective of this study was empirically covering the subject of *Zakat* which is being neglected by researchers in the factual sense. Muslims understood their obligation of paying *Zakat* but have no knowledge of its ultimate benefits which it confers to society. *Zakat* provides financial assistance for increasing the possibility of work for those who cannot afford and it also plays a role in economic rehabilitation of those who may be able to work to support themselves. It tries to eliminate the beggary and redistribution of wealth in the society. Viewed as a public welfare system, Pak's *Zakat* has been modestly successful. It has helped some people achieve financial independence, provided some income to help the poorest citizen survive, and enabled social welfare institutions to expand. *Zakat* has established a nationwide infrastructure blending volunteers committees and professional civil servants. Mobilizing over a quarter million members of the general population involving directly in *Zakat* implementation. The *Zakat* system has promulgated eligibility criteria based on Quran, and Sharia's. That is reasonable and fair. *Zakat* collections have demonstrated that the government can collect a tax impartially and efficiently. *Zakat* is not a burden especially for high income group who usually have little knowledge of this obligation of Islam. The high income group has to suffer less in the connotation of money utility as the *Zakat* tax is proportional/flat. Gov should take action to regularize it and make it compulsory for everyone who can pay, so that its true benefits can be achieved.

Limitations

The program is critically underfunded to achieve even the most modest interpretation of its goals. Local Committees express frustration over having insufficient funds to meet enormous needs.

Almost all local committees are composed of men, who may not be sensitive to the needs of widows, the largest single group of Mustahqeen. One other problem is the subjective decision of committee in disbursement of Zakat which make it prejudiced.

Zakat is not a poverty eradication programme, however, can be rationally dealt with to produce a more viable welfare system, as long as realistic expectations are set for it. If the Zakat system can be separate itself from national politics, rampant rhetoric, and Islamic fantasy then possibly doing well the things that this system can do, it could be a very positive, modest force, doing a lot of good for many people who need help.

Pakistan has demonstrated by its initial achievements that the more modest goal is possible. However, if Zakat alone is expected to eliminate all poverty and beggary without other structural changes in the society, it will surely fail and the opportunity to explore the potential for Zakat as a welfare system in a modern state will be lost.

The system of Zakat has some accountability and audit problems hence People are reluctant to pay Zakat through the system develop in Pakistan, they prefer to do it own which is weakening the objective of Zakat structure defined. Zakat Account should be more transparent and free from corruption, Nepotism and misuse. There is need of more accountability and auditing practices in this system.

Future

Several unexplored questions remain, and these may be fruitful avenues for future research. For one, just how "progressive" is the actual system of voluntary Zakat in Pakistan, relative to some appropriate standard of comparison. It would be natural to appropriately adapt methods to more carefully explore the separate and combined effects of Zakat-giving, Zakat-receiving, and overall effective progressivity in the zakat system as a whole. In addition, one might ask how voluntary systems such as that in Pakistan compare with compulsory, state-run systems currently in place in other Muslim countries. This evidence needs to be carefully examined.

References

- Atkinson, A. B., On the Measurement of Inequality, *Journal of Economic Theory*, 2, 244-63, 1970.
- Ahmed, Ausaf: *Income Determination in an Islamic Economy*, Jeddah, Scientific Publishing Center, King Abdulaziz University, Under Publication.
- Blackorby, C, Donaldson, C. and Auersperg, M., A New Procedure for the Measurement of Inequality Within and Among Population Subgroups, *Canadian Journal of Economics*, 14, 665-85, 1981.
- Darwish, Ahmad Fuad and Zain, Mahmud Siddiq: "Effects of Zaah on Aggregate Consumption Function in an Islamic Economy", *Journal of Research in Islamic Economics*, Vol. 2, No.1, Summer 1404H/1984, Arabic Section, pp. 52-59.
- Darwish, Ahmad Fuad and Zain, Mahmud Siddiq: Comments on Metwally in *journal of Research in Islamic Economics*, Vol. 2, No. 2, Winter 1405H/1985, Arabic Section, pp. 121-130.
- Geoffrey a. Jehle(1994);" Zakat And Inequality: Some Evidence From Pakistan" *Review of Income and Wealth Series* 40, Number 2, June 1994.
- Iqbal, Munawar: *Economic Activity: An Islamic Perspective*, International Institute of Islamic Economics, Islamabad, Discussion Paper Series No. 1, 1985.
- Kolm, S. C, The Optimal Production of Social Justice, in Margolis J. and Guitton, H. (eds.).*Public Economics*, Macmillan, London, 1969.
- Kuran, T., The Economic System in Contemporary Islamic Thought: Interpretation and Assessment, *International Journal of Middle Eastern Studies*, 18, 135-64, 1986. Sen, A. K., *Economic Inequality*, W. W. Norton, New York, 1973.
- Khan, M. Fahim: "Macro Consumption Function in an Islamic Framework", *Journal of Research in Islamic Economics*, Vol. 1, No.2, Winter 1404H/1984, pp.1-24.
- Metwally, M.M.: *Macroeconomic Models of Islamic Doctrines*, London, J.K. Publishers, 1981. Metwally, M.M.: Rejoinder to Darwish and Zain, *Journal of Research in Islamic Economics*, Vol. 2, No. 2, Winter 1405H/1985, Arabic Section, pp.143-146.