

The Institution of *Zakat* and Its Economic Impact on Society

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ABSTRACT

The institution of *zakat* is the cornerstone of the Islamic economic system. The Qur'an emphasizes *zakat* as a critical component of socioeconomic justice. The institution works to ensure an equitable distribution of wealth and establishes a safety net for needy members of society. Both the sources and disbursement categories of *zakat* are specified in Islamic doctrine. The Qur'an identifies eight categories of disbursement, each of which carries clear social benefit. One positive economic effect of *zakat* is an increase in the money supply and a consequent increase in the demand for goods and services. *Zakat* also provides debt relief and enhances price stability. If accumulated in times of prosperity, *zakat* funds can aid society through times of depression. Though *zakat* has widely fallen out of use in modern times, it can have great economic impact if properly reestablished.

I. INTRODUCTION

Islamic finance is based on a belief system that regulates not only the bedroom but also the pocketbook. Only a few decades ago, it was unknown to the West and the world banking community as a better alternative to an interest-based economic system. It is ironic that forty years ago at Stanford Business School, it was impossible to find an advisor on the faculty for my proposed doctoral thesis on "Interest-free Banking." Today, universities like Harvard and Rice in the U.S. are engaged in rediscovering Islamic finance, a welcome sign of relief for a monetarily beleaguered world economy. As we know, the interest-based economic system, coupled with currency speculation, has to a large extent contributed to the recent near-collapse of the Russian, Brazilian, and Southeast Asian economies, not to speak of the hyper-recession of the 1930's which brought Hitler to power. Despite their tight grip over the world monetary system, international agencies like the IMF and the Paris Club have failed to achieve international monetary stability.

Like freedom from interest, *zakat* is also an integral part of Islamic economic system. Since *zakat* is derived from the *Shari'ah*, this paper is designed to cover some of the salient features of the economic impact of *zakat* on society within the framework of the Quranic perspective of economic justice.

II. THE QURANIC PERSPECTIVE OF ECONOMIC JUSTICE

The Qur'an itself sheds light on the economic importance of *zakat*. The commandment to establish *zakat* is mentioned more than 100 times, usually in conjunction with *salah* (prayer), as two means of purification. God commands Muslims to pay *zakat* on their total wealth in excess of *nisab*, (minimum wealth) to the poor for benefit of the society's social and economic welfare. The following Quranic verses, among others, emphasize that all resources belong to God and that these resources are thus a trust (Qur'an 57:7) that must be used to satisfy the basic needs of all those who, for no fault of their own, cannot afford the basic necessities of life in a humane and dignified manner.

For it is He who has brought into being gardens—(both) the cultivated ones and those growing wild—the date-palm, and fields bearing multiform produce, and the olive tree, and the pomegranate: (all) resembling one another and yet so different! Eat of their fruit when it comes to fruition, and give (unto the poor) their due (*zakat*) on harvest day. And do not waste (God's bounties): verily, He does not love the wasteful. (Qur'an, 6:141)

"[so that] wealth does not circulate only among your rich" (Qur'an, 59:7).

"And [would assign] in all their wealth and possessions a due share (*zakat*) unto such as might ask [for help] and such as might suffer privation." (Al Qur'an, 51:19)

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The offerings [*zakat*] given for the sake of God are [meant] only for *fuqara* [poor] and the *masakeen* [needy], and *ameleen-a-alaiha* [those who are in charge thereof], and *muallafat-ul-quloob* [those whose hearts are to be won over], and for *fir-riqaab* [the freeing of human beings from bondage], and [for] *al-gharimun* those [who are over-burdened with debts], and *fee-sabeelillah* [for every struggle] in God's cause, and *ibn as-sabil* [for] the wayfarer: [this is] an ordinance from God—and God is all knowing, wise." (Qur'an, 9:60)

Likewise we find from the sayings of the Prophet Muhammad, who once said,

"He is not a man of faith who eats his fill when his neighbor is hungry."
"A locality where a person has to sleep hungry deprives itself of God's protection."ⁱ

Ali, the fourth Caliph, expanded on this idea in saying that:

"God has made it obligatory upon the rich to pay out of their wealth whatever is sufficient for the poor. If the poor starve, or go unclad, or suffer difficulties, it is because the rich have deprived them. Hence it is proper for God, the Almighty and the Exalted, to bring them to account and to punish them."ⁱⁱ

Because the known economic resources at a given point in time are relatively limited, establishing the Quranic perspective of economic justice and providing general well-being for all members of the society requires a focus on three critical economic factors:

1. earning *halal* (permissible) income;
2. ensuring an equitable distribution of wealth; and
3. creating an economic safety net to assure need fulfillment of those who, for no fault of their own, cannot afford the basic necessities of life.

Since *zakat* primarily relates to the second and third factors, let us first briefly define *zakat*. *Zakat* is one of the five pillars of faith. It is a unique, spiritually charged filtering device primarily designed to cleanse one's possession or wealth necessary to protect the owners of wealth against spiritual poverty. While protecting the rights of "haves" and "have nots," its main objective as an act of worship are: (1) the promotion of stable economic growth through investments, employment and balance consumption, and (2) the achievement of greater income equality through an equitable distribution of wealth, thereby eliminating poverty and extreme disparities of wealth between the rich and the poor.

Zakat is a cornerstone of the values that govern Islamic economics. Being directional and normative, *zakat* defines the norms of economic activity and, through its effects on economic variables, determines the direction along which the economy should move. On the revenue side, it specifies the manner in which revenue (*zakat*) is to be raised and who pays it, and on the expenditure side, it sets forth the uses (recipients) of the revenue. Like any modern budget, it describes the economic order that it attempts to establish and express the ideals and aspirations of society.

From a microeconomic perspective, *zakat* is a mechanism for self-help. Everyone contributes to need fulfillment and the general well being of society according to one's ability. And from a macroeconomic perspective, similar to the inheritance laws in Islam, the institution of *zakat* is designed to deal with the distribution of wealth in society. Being a re-distributive fiscal policy based on wealth and not on income, it provides insurance against unjust alliances between economic monopolies and political power, which leads to a social imbalance, exploitation, and eventually anarchy.ⁱⁱⁱ As such, it guards against the concentration of wealth in the hands of a few persons, families, or even the state.

Finally, as a fiscal mechanism, *zakat* performs some of the major functions of modern public finance, which deals with social security entitlements, social assistance grants for childcare, food subsidy, education, health care, housing, and public transportation in a welfare state. It separates public welfare expenditures from other budgetary items and puts the burden of meeting the economic welfare needs of the society where it belongs. Unlike tax levied by the government for the services provided to tax payers on a quid pro quo basis, *zakat* and its heads of expenditure are determined by the Qur'an and *Sunna*, irrespective of the economic conditions of the society. That *zakat* is distinct from taxes can be seen from a saying of the Prophet Muhammad that "in your wealth there are also obligations beyond *zakat*."^{iv} By paying *zakat*, a *zakat*-payer fulfills his/her *fard*, (religious obligation), whereas a taxpayer by paying his/her taxes only enables the state to perform its functions effectively.

To better understand the institution of *zakat* as an economic safety net for the society, the present paper will now look at the sources of *zakat* and its disbursement categories.

III. SOURCES OF ZAKAT

As noted above, God commands Muslims to pay a certain percentage of their net worth above *nisab* (the poverty line) as well as a certain percentage of the net output of agricultural and mineral production. This payment is not as a favor, but rather an appropriate use of their wealth which God has given them as a trust (Qur'an, 57:7). This percentage varies from 2.5% to 20% depending upon the asset category.

Nisab, the dividing line that separates the basic necessities of life from luxuries, differs from society to society and changes over time. It sets an acceptable standard of living, which covers all necessities of life compatible to a particular community at a particular economic period. As a general rule, it includes food, clothing, household effects, a house for personal use, medical care, education, means of transportation, and tradesman's tools and equipment. (Large and medium size manufacturing plants are not considered tradesman's tools and equipment.)

By its very definition, *nisab* is a dynamic, not a static concept. While an automobile today may be a necessity in the United States, it may be a luxury in a country like Sudan or India. Similarly, a horse used as a means of transportation, and therefore a necessity in a country like Afghanistan, could be considered a luxury in the upscale suburbs of San Francisco. Simply stated, as ordained in the Qur'an, those who have more than *nisab*, no matter how modest it may be, must understand and accept that poor members of the society have a right to a portion of all of their wealth (Qur'an, 57:7). Nowhere do we see the term *manafi'a* (net profit) used in Qur'an in the context of *zakat*. Since Qur'an uses the term *amwa'al* (wealth), the basis for calculating *zakat* is clearly one's total net worth and not just on their annual income or net profits.

IV. DISBURSEMENT CATEGORIES OF ZAKAT

Just as it outlines the source of *zakat*, the Qur'an also defines its disbursement categories in the following verse:

The offerings [*zakat*] given for the sake of God are [meant] only for *fuqara* [poor] and the *masakeen* [needy], and *ameleen-a-alaiha* [those who are in charge thereof], and *muallafat-ul-quloob* [those whose hearts are to be won over], and for *fir-riqaab* [the freeing of human beings from bondage], and [for] *al-gharimun* those [who are overburdened with debts], and *fee-sabeelillah* [for every struggle] in God's cause, and *ibn as-sabil* [for] the wayfarer: [this is] an ordinance from God—and God is all knowing, wise." (Qur'an, 9:60)

The eight categories mentioned in this verse clearly defines the disbursement of *zakat* as an economic safety net to assure need fulfillment of those who, for no fault of their own, cannot afford the basic necessities of life.

The first two categories, namely *fuqara* (the indigent/the poor) and *masakeen* (the needy) includes those people who, being underemployed or unemployed, have no means of support or insufficient income to meet their basic necessities of life and therefore are indigent or live below the poverty level. This may be because they are incapacitated, disabled, orphans, sick, homeless, or of similar status.

To maintain the integrity and the independence of collection and disbursement of *zakat*, the third category *ameleen-a-alaiha* refers to those expenses that are necessary to administer the *zakat* fund, including personnel salaries. *Muallafat-ul-quloob*, the fourth category, includes those people whose hearts are to be won over. According to some scholars this apparently means such non-Muslims who are to close to understanding and perhaps accepting Islam, and for whose conversion every effort should be made, either directly or indirectly (i.e., by means of the widest possible teaching of Islam).^v The fifth category *fir-riqaab* relates to both ransoming prisoners of war and freeing slaves.^{vi} The sixth category, *al-gharimun*, includes those people who are overburdened with debts contracted in good faith, which - through no fault of their own—they subsequently are unable to redeem. The seventh category *fee-sabeelillah* embraces every kind of struggle for a righteous cause, both in war and in peace, including expenditures for the propagation and defense of Islam and for all charitable purposes.^{vii} This may include education, medical care, and social welfare work. Finally the eighth category *ibn as-sabil* (son of the road) denotes any person who is far from his/her home and who, because of circumstances beyond his/her control, does not have sufficient means of a livelihood at his/her disposal. In its wider sense it describes a person who, for any reason whatsoever, is unable to return home either temporarily or permanently: for example, a political exile or refugee.^{viii}

V. ECONOMIC IMPACT OF ZAKAT

When a certain percentage of one's wealth is spent annually over the foregoing eight categories as prescribed in the Qur'an, *zakat* has a significant economic impact on society. Income support provided to the poor and needy would result in a measured increase of the money supply in the economy causing upward shift in demand for goods and services. To support this upward shift in the demand for basic necessities of life such as food, clothing, shelter etc., the production facilities would gradually expand and begin to absorb the idle capital. To support the increased production, the economy would generate more jobs and new employment opportunities. This added employment in turn would generate more demand for goods and services, more room for additional investments, and finally, the growth cycle based on balance consumption would contribute to a balance economic growth.

As noted above, *fir-riqaab*, the fifth category of *zakat* expenditures, (in addition to ransoming prisoners of war), relates to freeing of slaves.^{ix} Today, obviously, human beings are no longer bought and sold as property. But by extrapolating the intent of this category, it can be safely stated that one of the basic purposes of *zakat* is to free human beings from economic slavery as well. The majority of people living in poor countries suffer from abject economic slavery at the hands of many local landlords, rich industrialists, and multinational corporations^x that exploit natural resources. One of the best ways to free people from economic slavery is to first give these oppressed people temporary relief and then, for economic rehabilitation through essential financial resources to acquire training, equipment, and material. For example, small businesses or privately owned "cooperatives" could be created. A regular flow of income of these entities would accrue to the recipients. Depending upon the rate of profit and retained earnings, the value of these enterprises would progressively grow. The income multiplier effect not only would benefit the economy several times the original investment in these enterprises, it would enable the poor to eventually become self-sufficient and free themselves from economic slavery while contributing to the economic stability of the society.

Expenditure on the sixth category, *al-gharimun*, is designed to assist those people who, being overburdened with debts, are unable to fulfill their obligations. A closer understanding of this category would reveal that Islam does not allow bankruptcy where creditors, whether individuals or financial institutions, eventually pass on their bad debts to the consumers in the form of increased prices. Such increases, if not offset by other elements of consumer price index, eventually contribute to inflation.

To provide for such contingencies where debtors who contracted debts in good faith but due to conditions beyond their control, such as sudden sickness, natural or economic catastrophes, cannot redeem them, expenditure of *zakat* for redeeming the debts of *al-gharimun* not only helps maintain price stability, it eliminates one of the important factors which contributes to inflationary cycle.

To satisfy the seventh category, *fee-sabeelillah* (in the cause of God), *zakat* funds when spent for education, medical care, and social welfare of those who otherwise cannot afford them or are oppressed, provide moral stability and human dignity to the recipients, essential elements in maintaining economic harmony. Likewise, by providing financial assistance to *ibn as-sabil* who may be refugees or political exiles, the expenditure of *zakat*, while maintaining the human dignity and general well being of the recipients, contributes toward their economic self-sufficiency. Over a period of time they no longer will be a burden on the society.

That *zakat* is universal in its scope can be seen in the manner in which it is collected and distributed. After providing for the needs of eligible near kin, the *zakat* fund is designed to cover the needs of those who live in the community where *zakat* is collected and then to those eligible recipients living in the county, state, country, and finally the world at large.^{xi}

Through accumulation of surplus in *zakat* funds during prosperous years, the institution of *zakat* provides necessary contingency funds during depressed economic conditions when *zakat* revenues may not be sufficient to meet the required needs of the society.

The levy of *zakat*, particularly on the idle portion of an individual's wealth, induces the *zakat* payer to seek a return on his wealth at a rate at least as high as the rate of *zakat*, so as to be able to pay *zakat* without reducing his/her wealth.

VI. REESTABLISHING THE INSTITUTION OF ZAKAT

Due to a variety of eroding factors, the institution of *zakat*, which once provided an economic safety net to society, has lost its meaning. Today, it has an ad hoc and irregular function reduced to almost a ritual practiced

individually by a small minority of Muslims.^{xii} Many who pay *zakat*, unfortunately, do not even know how to accurately calculate it, let alone its potential economic impact on society.

To re-establish the institution of *zakat*, it is essential that we first understand the importance of *zakat* in terms of its economic impact upon society. Also, in order to properly apply its rules and regulations to many forms of wealth, we must recognize that there are new categories of wealth (such as intellectual property and other intangible assets) which did not exist in early Muslim society, and for which we need to use appropriate evaluation methods (book value, replacement values, market value, present value of future earnings, etc.) in computing *zakat*.

Can the institution of *zakat* achieve its stated objectives of establishing economic justice and the general well being of all members of the society through equitable distribution of wealth in today's economic environment? Since there is no contemporary empirical data, this question can be answered only through simulation or extrapolation of the cumulative economic impact of a redistribution of wealth. To test if it is as valid as it was fourteen centuries ago, let's go through a simple accounting exercise. If we conservatively assume that collective net-worth of one of the forty industrial families of Pakistan has an estimated value of \$500 million and earns \$75 million annually in net profits (15% rate of return on equity)^{xiii} a 2.5% *zakat* on this family's net-worth would be \$12.5 million. On the national level, the forty families' combined net-worth of \$20 billion (40 x \$500 million) would produce an annual *zakat* of \$500 million (or 4.4585% of Pakistan's 1993 budget). If we were to distribute this money among various categories of recipients of *zakat* as prescribed in the Qur'an over, say, every year for the next ten years, the cumulative result of this annual redistribution of wealth will substantially reduce unemployment, expand investment base, eliminate poverty and extreme disparity of wealth between rich and poor by the end of the tenth year. This projection is however based on the premise that this goal is achievable in a reasonable length of time provided the system of collection and distribution of *zakat* is credible, cost-effective, loophole-free and supported by strong accountability mechanisms to assure its integrity.

In this context, we may recall that in Madinah and Basra during the caliphates of Umar ibn Al-Khattab and Umar ibn Abdul Aziz (717-720 C.E.), respectively, there were years when there was a surplus in the *zakat* fund but no eligible recipients to receive it.^{xiv} We may not attain this ideal condition within a projected ten-year period as suggested in this example, but we would certainly be on the road for reaching contentment. The institution of *zakat* when fully operational would become a fountain of economic harmony and contentment.

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- ⁱ Al-Nisaburi, *Mustadrak al-Hakim*, vol.2, p. 12, from Ibn'Umar
- ⁱⁱ Abu Ubayd, *Kitab al-Amwal* (1353 A.H.), p. 784:1909
- ⁱⁱⁱ George Knuffer, *The Struggle for World Power, Revolution and Counter Revolution*, p. 113, The Plain-Speaker Publishing Company, 1975, London. See also book title: *Quest for Oil*.
- ^{iv} Al-Darimi, *Sunan al-Darimi* (1349 A.H.), vol 1, p 385; and Abu Ubayd, *Kitab al Amwal*, p. 495:926
- ^v Muhammad Asad, *The Message of The Qur'an*, 9:60, note 85, p 270, Dar Al Andalus, Gibraltar, 1984.
- ^{vi} Ibid, note 85
- ^{vii} Muhammad Asad, *The Message of The Qur'an*, 9:60, note 86, p 270, Dar Al Andalus, Gibraltar, 1984.
- ^{viii} Ibid, The Qur'an, 2:17, note 145
- ^{ix} Ibid, note 85
- ^x *Multinational Enterprises and Social Policy*, an ILO publication on multinational enterprises, p. 70-71, 75-78
- ^{xi} Muslim, vol. 2
- ^{xii} Sabzwari, M.A., 1979. *A Study of Zakat and Ushr with Special Reference to Pakistan*. Industries Printing Press. Results of this study made among middle-class educated Muslims in sub-division of Karachi show that while almost (95%) had heard of *zakat*, fewer than 25% had even heard of *ushr* (*zakat* on produce and mineral extraction).
- ^{xiii} *Zakat* is calculated on an individual's net worth. To simplify calculations in this example we have used net-worth of a family instead of net-worth of each member of a given family.
- ^{xiv} Dr. S.A.Q. Husaini, *Arab Administration*, Ashraf Publications, Lahore, Pakistan. See also Tanzil-ur Rehman, *Introduction of Zakat in Pakistan*, Islamabad: Council of Islamic Ideology 1981,