

RECENT INTERPRETATIONS OF THE ECONOMIC ASPECTS OF ZAKAH

Sabahaddin Zaim(*)

This paper is a survey of literature pertaining to assessment, collection and disbursement of Zakah together with the issues that emerged from them. The paper discusses the basis of Zakah assessment including nisab, productivity and ownership of Zakatable assets. It also deals with conditions of eligibility to pay Zakah, and the different rates of Zakah on various kinds of wealth varying from articles of trade to windfall profits. In this context, some controversial points such as the changing values of gold and silver, Zakah on industrial assets, income from stocks and bonds etc. are raised from the fiscal point of view, Zakah is contrasted with secular taxes using a number of criteria. The macroeconomic impact of Zakah is also examined. The paper refutes the argument of some scholars who favor that Zakah rates should be made flexible and responsive to the state of economic condition. It is argued, however, that the proper management to Zakah proceeds can conceivably serve as an economic tool for stability as well as a measure to counter cyclical changes in economic growth. It is maintained that Zakah proceeds have a multiplier effect on the national economy if they are productively invested. Zakah is seen to have a positive role not only in the fair reallocation of scarce economic resources, but also in the redistribution of income in favor of the poor and the disadvantaged.

I. INTRODUCTION

Zakah is one of the five pillars of Islam. Its importance can be judged by the fact that at different places in the Qur'an, the injunction to perform prayers is followed by the commandments regarding *Zakah*.

In Islam, *Zakah* payment is compulsory, levied on the members of the Muslim community, so as to take the surplus money from the comparatively well-to-do members of the society and to give it to the destitute and the needy.

Zakah literally means "growth" and "increase" as well as "purity".

(*) Prof. Dr. Sabahaddin Zaim is a Professor at the Istanbul University,

Sadaqah is a synonym for *Zakah*. The general usage however, is to consider *sadaqah* is a more generic term applying to alms whose payment is a *fard* (compulsory), as well as to alms the giving of which is entirely voluntary. In other words, while all *Zakah* is *sadaqah*, only the *sadaqah* which is *fard*, is *Zakah*.

Zakah, being a compulsory payment becomes the right of the entire community or society in the wealth of individuals, as prayer is the right of Allah from Muslims.

Zakah is regarded by some as mere alms giving. But this is a wrong interpretation of the tenets of *Zakah* as enunciated in the Qur'an. Although private charity and payment by individuals is permissible, *Zakah* does not fall in this general category.

The definition of *Zakah* is precise; the amount collected by way of *Zakah* is also distributed in a precise manner. Its chief beneficiaries are specified in the Qur'an.

II. BASIS OF ZAKAH AND ZAKAH LIABILITY

Zakah becomes obligatory when an individual freely owns and possesses a productive *nisab* (minimum) of property. The possession and ownership of productive assets or property, apparent or non-apparent, constitutes the extent and degree of wealth of an individual, creating the obligation to pay *Zakah*.

1. Productivity

Productivity is either real, as in procreation and trade or hypothetical as in case where productivity is possible, though not actual, in that the property has been in the possession of the owner or his agent. Productivity, real or hypothetical, is considered to be present when one of the following three conditions exists: (1) when property is gold or silver, (2) when animals are pastured, (3) when property is intended for trade.

2. Possession and full ownership

In addition to being productive, the *nisab* must also be owned in full ownership, that is, ownership combined with possession. Consequently, mere possession of property does not subject it to *Zakah*. According to Abu-Hanifah ownership without possession, is not subject to *Zakah* since the calculating of *nisab* in that case may not be possible.

3. The *nisab*

For *Zakah* obligation, the property must be above *nisab*. The *nisab* must be above *nisab*. The *nisab* must be over and above what is necessary

for the satisfaction of the primary necessities of life. The *nisab* must also be free of debt. However, according to Al-Shafi, indebtedness does not affect the obligation of *Zakah*. According to one Shafite view, indebtedness suspends *Zakah* as is the case of non-apparent property.

There is disagreement as to whether a debt of *Zakah* should continue a cause of exception. Al-Balkhi establishes a distinction between the *Zakah* due on "apparent" property consisting of *sawaim* animals and tithe on the one and "non-apparent" property consisting of the rest of the property such as gold, silver and articles of trade on the other. He thinks that only the debt due on apparent property exempts from *Zakah*, because, according to him, only the latter kind of *Zakah* is subject to demand for payment on the part of the tax collector. Al-Sarakhsi takes exception and claims that *Zakah* is "due" on both apparent and non-apparent property.

According to the accepted Hanafite view, debt is applied against the property which is subject to *Zakah* and not against property which is destined for the satisfaction of necessities and consequently exempt from *Zakah*.

III. CONDITIONS FOR ZAKAH

The following conditions must be fulfilled before *Zakah* becomes *fard* (compulsory) on an individual:

1. Reason and maturity

There can be no responsibility without reason and maturity. Children and the insane are not responsible for *Zakah*-obligation. But there are some differences of opinion:

— According to Abu Ubeyd, children and the insane are not responsible, even if they are rich. According to Abu Gafer and El Sha'bi, the property of orphans is not *Zakatable*. According to Abu Hanifa, only agricultural products of orphans are *Zakatable*.

— *Niyyah* (intention), is necessary for *Zakah* as for *salat*. The intention of the child and the insane are not acceptable.

— According to a Hadith, a child is not responsible.

— Purification of property is not required for children and insane.

— Their property will gradually get decreased, if their property becomes *Zakatable*. However, according to Malik Hanbalis and Al-Shafi'is, properties of minors and the insane are subject to *Zakah*.

2. The state of being a Muslim

Because the payment of *Zakah* is a divinely ordained act, it can be performed by a Muslim. Non Muslims are not liable to pay *Zakah*.

3. "Dimar" property

"Dimar" is a property which has slipped out of one's possession with little chance of recovery. Examples of *dimar* property is property fallen into sea. *Dimar* property is exempted from *Zakah* according to Abu Hanifah, Abu Yusuf and Mohammed Ibn Al-Hasan, because the condition of productivity is absent. According to Zufar and Al-Shaffi, however, *dimar* property is subject to *Zakah* for past year, when recovered, because upon its recovery, the cause of *Zakah*, namely a complete *nisab* has come into existence. But, if the property is deliberately hidden or buried, it does not qualify for such exemption.

4. Property which lacks productivity, and basic essentials of life are exempt from *Zakah*

This includes dwelling houses, wearing apparel, household utensils, slaves, employed tenants, riding animals, arms kept for use, food used for oneself and family, articles of adornment, if not made of gold and silver; gems, pearls, emeralds and the like; coins other than those of gold and silver, if intended for personal expenditure, books and tools. The principle behind the exemption is to avoid hardship on the part of the Muslim to pay *Zakah* on items which he needs to meet the daily necessities of life, (e.g. items required in trade but not intended for trade). Taxable limits or exemptions as developed in modern theory of taxation are based on this principle.

5. The property of minors and insane

The property belonging to minors, and the insane is exempt from *Zakah*, since they lack respectively maturity, reason and the conditions of being Muslim. According to Shafites and the Malikites, minors are subject to *Zakah* on the grounds that *Zakah* is an obligation connected with property, irrespective of ownership. However, the Hanafites, on the other hand, hold that *Zakah* is an act of worship and therefore it is obligatory only on those who can exercise intention (*niyyah*) in its discharge.

6. Condition of completion of one year.

Once the conditions enumerated above are met, the property becomes subject to *Zakah*, but only if a year has elapsed over the *nisab* of productive property. There is an explicit *Hadith* to the effect that "no *Zakah* is due on property before a year has elapsed". The elapse of a year is essential, because time is indispensable for productivity to materialize. According to the Hanafite view, *Zakah* payment may elapse after it becomes due if the de-

ceased owner has not left any will making settlement of the *Zakah* from his estate. Shafites and Hanbalis differ on this. They believe that *Zakah* debt of the deceased person may be collected from the entire estate, whether or not he left any will.

IV. RATES OF ZAKAH

The rates of *Zakah* depend upon the type and capital that has gone into the creation of the property. The concept is similar to the value added tax, although it differs in substance. The rates vary anywhere between $1/5$ to $1/40$, depending upon the source of income or the extent of property accumulation. For example, if a person has unearned income or windfall income of some kind, the rates are higher as in the case of a discovered treasure, a war-booty, etc. which are subject to *Zakah* at the rate of 20 % whereas the rate of *Zakah* on gold, silver and articles of trade is $1/40$. Similarly, the rates of *Zakah* on agricultural land including horticultural plots vary between $1/10$ to $1/20$ depending upon the type of irrigation facilities. It is appropriate to mention that the economy of an Islamic state during those days was basically agricultural and to some extent commercial, but certainly lacked the complexity of modern business. If the land has been irrigated and the irrigation facilities have been developed through investment of capital and labor, the rate of *Zakah* on such land would be lower say to $1/20$ of the total produce, but if the irrigation facilities were developed either by the state or wholly dependent on rain, the rates would be higher upto $1/10$ of the entire produce.

Rate of *Zakah* on articles of trade is the same as on gold or silver. The same applies to transactions relating to sale and purchase of horses etc., carried out on business.

The *nisab* of gold is 20 *mithqals* (85 gram) and *nisab* of silver is 200 *dirhams* (595 grams). There is no *Zakah* for less than 20 *mithqals* of gold and 200 *dirhams* or silver. In determining whether or not the *nisab* is complete and *Zakah* is due, it is the weight and not the value or number that is taken into account. There is, however, a difference of opinion as to the basis of payment. According to Abu Hanifa and Abu Yusuf, it is the weight that serves as the basis. Zufar claims that the value is relevant, whereas Muhammed Ibn-Hasan contends that the one that is more favorable to the poor should serve as the basis.

Here, we do not want to go into the details of how to measure the *nisab* for each item only some of the areas will be discussed.

Some areas requiring further attention

a) According to Malikis and Shafi'is, *nisab* in respect of articles of trade, is necessary only at the end of the year. Decrease of *nisab* at the be-

ginning of the year is not important. But, according to Hanbalis *nisab* is necessary for the whole year.

b) In our time, relative value of silver and gold is subject to wide fluctuations. There are some debates about the selection of gold or silver for the measurement of *nisab*. Muslim scholars like Muhammad Abu Zahra are of the opinion that gold should be the criterion to establish the *nisab* both for money as well as for articles of trade. But, some other scholars on the other hand, do not defend the measurement of *nisab* through monetary calculations, due to the cyclical variations in gold value.

c) As for agricultural lands on which *ushr* or *kharaj* taxes are to be levied, Shafiis, Malikis and Hanbalis, held the view that since the legal status of land does not affect the *Zakah* obligation whether the land tax is *ushr* or *kharaj*, all agricultural produce is *Zakatable*. For example, if a Muslim produces in *kharaj* land, he would pay both *kharaj* and *Zakah* (*ushr*). But according to Hanafis, only *ushr* land is *Zakatable*. Muslims' produce from *kharaj* land has no *Zakah* obligation.

d) Assessment of *Zakah*: Income from different sources are added to each other and a unified assessment is made. If a trader, for example, has profits from trade and animal wealth, then both are added. This is known in modern language as unified assessment.

e) Controversy over whether *Zakah* should be paid on paper money or not should not exist any longer, since paper money is now an easy instrument that can be used as a means of payment and all our holdings are valued in terms of this type of money. For example, Mymoon Ibn Mahran, one of the early Muslim scholars is reported to have said that when *Zakah* was due, a trader should calculate all his monetary holdings as well as other assets which will be evaluated in monetary values and whatever loans he gave to credit worthy individuals should be added. Out of this sum, a trader should subtract all that he owes to others, the remainder is *Zakatable*. Not all trader's capital is subject to *Zakah*, only circulating capital is subject to *Zakah*, but assets like buildings and furniture, for example, are exempted.

f) Whether *Zakah* should be imposed on a narrow base or broad-base: Muslim jurists are divided on this issue. Those who call for a narrow base rely on what is being narrated from the Prophet (PBUH) that he imposed *Zakah* on a few types of agricultural produce. Imam Malik and Al-Shafei argued that *Zakah* should be paid on all edible crops that can be stored. On the other side, Imam Ahmad argued that *Zakah* be paid on all crops that could be dried or can be stored and weighed. As such no *Zakah* was imposed on fruits like apricot, peaches, apples and vegetables according to those criteria. But, Abu Hanifah extended the application of *Zakah* on all produce. Al-Qaradawi views that what Abu Hanifah held was the nearest to the spirit of the *Shari'ah* and conforms to what was said by Khalifah Omar Ibn Abudl Aziz, Mujahid, Hamad and Dawud Al-Nakhie that all produce is subject to *Zakah*. But some jurists have argued that *Zakah* on vegetables and

fruits which could not be stored, should be paid out of the value of the crops and not in kind.

g) *Nisab* for minerals According to Imam Shafei, Malik and Ibn Hanbal, *nisab* condition is required for mineral wealth to pay *Zakah* obligation. And this *nisab* is calculated as in the case of gold and silver, that is, if the value of minerals is above 200 *dirhams* or 20 *mithqals*, they are *Zakatable*. But according to Hanefites, *nisab* conditions are not required for minerals, for whether their value is over or under *nisab*, they are *Zakatable*.

h) *Zakah* on industrial wealth: There is a difference of opinion about the rate of *Zakah* on industrial wealth. According to Abu-Zahra, Khallaf and Abdurrahman Hasan, the income of industry is *Zakatable*, not the industrial machines, plants etc. The rate of *Zakah* should be five percent on net income or ten percent for total aggregate income. In their evaluation, they did make comparison with agricultural land, According to Yusuf Al-Qaradawi, comparison with agricultural land is acceptable provided we reduce net income by deducting the expenditure for the basic needs and yearly depreciation, the rest of net income is then subject to ten percent *Zakah*. If income net of expenses cannot be calculated exactly, the rate of *Zakah* should be five percent of gross income always after deducting depreciation. On the other hand, some Muslim economists argue that two and a half percent *Zakah* rate should be imposed on the value or machines, and other industrial assets.

i) *Zakah* from real estate, buildings and vehicles: The income from this kind of property has recently increased very much. There is no difference of opinion on the necessity to pay *Zakah* in respect of such incomes. As regards difference related to the rate of *Zakah* there are two views:

aa) to pay *Zakah* out of income at 2.5 percent if that income is retained, in money form, for one year;

bb) to pay *Zakah* at 10 percent of net income.

j) Income from shares and bonds: This kind of income is very popular nowadays. If shares are used as a trade article, 1/40 *Zakah* has to be paid annually on their current market value. But if they are saved and kept to get dividends out of them, then 10 percent *Zakah* should be paid on the dividends. Some of the Muslim economists argue that after a period of one year, out of current value of shares, 2.5 percent *Zakah* should be paid. Of course, bonds are not permissible in Islam, as they carry interest. But, if there is interest income, still *Zakah* should be paid. According to Yusuf Qaradawi 10 percent *Zakah* should be paid out of the net income shares of all companies, whether trading or industrial. According to some other jurists, The nominal value of shares in respect of trading companies, plus their dividends, should be levied 2.5 percent *Zakah*. But in respect of shares of industrial companies, only out of total dividend, 10 percent *Zakah* should be levied.

V. THE EXPENDITURE OF ZAKAH INCOME

The Qur'an has laid down that *Zakah* is to be paid for the benefit of:

- (a) The poor
- (b) The needy (*miskin*)
- (c) Those, who are appointed to collect *Zakah*
- (d) Islamic propagation (*Al Muallafatu Qulubuhum*)
- (e) Freeing slaves
- (f) The indebted
- (g) In the way of Allah
- (h) The wayfarer

According to this classification, the first to come are the poor and the needy. Abu Yusuf, Zufar and some Malikites define the poor as the person whose income is not enough to satisfy his basic needs, or whose income is below the level of *nisab*. On the other hand, needy (*miskin*) means the person who has no income and property at all. But, Shafies and Hanafis argue just the reverse and say that poor has no income and property and needy has not enough income to satisfy his needs. Some scholars like Hamidullah claim that the concept of *miskin* includes non-Muslim needy as well. However, in either way, it is definite that people who have no income or not enough income are eligible to get *Zakah*. So there are three categories of people; one group, whose income does not satisfy their basic need; they are entitled to *Zakah*. The second group, who can satisfy their basic needs but having income below *nisab*, they do not pay *Zakah*, neither do they receive *Zakah*. The third group, whose income is above *nisab*, they pay *Zakah*.

In an Islamic state, *Zakah* collectors are paid out of *Zakah* income. This happens where the state collects *Zakah* compulsorily. According to majority of jurists, this category of people is limited to those who are dealing with the collection of *Zakah*. It does not include other civil servants.

Islamic propagation is very important today especially in Africa and Asia. To spread and defend Islam, it is necessary to spend some portion of *Zakah* income in this area also.

Some parts of *Zakah* should be paid to provide freedom to slaves and to relieve the debtor from his debt. According to some other jurists, the Muslim who wants to free slaves also can benefit out of *Zakah* income. Some scholars like Rashid Riza and Mahmoud Shaltout argue that, to provide freedom and independence to the colonized nations can also be included into this category. But Qaradawi holds the view that this kind of expenditure should be in the category of way of Allah (*fi sabeelillah*). Some of the jurists argue that as we use the *Zakah* income to pay the debt of a Muslim, we can also lend to the Muslims out of the *Zakah* fund.

For the wayfarer, some jurists have broader interpretation. Shafeis, for example, are inclined to such a view. Some scholars like Rashid Riza argue that even orphans can be included in this category. According to Shafeis, *Zakah* income should be equally distributed among the above mentioned eight groups.

IV. FINANCIAL ASPECTS OF ZAKAH

Zakah provides the base of the fiscal system and defines its scope of operation within the general institutional framework of an Islamic economy. It has been argued by some that a fiscal system beyond what is defined by *Zakah* is un-Islamic. The argument relies on the sanctity of private property recognized by the Islamic *Shari'ah* and contends that any compulsory government charge on it is patently unjust, since taxes constitute the core of modern fiscal policies, an Islamic fiscal policy is a contradiction in terms. According to some other Muslim economists like Faridi and Metwally this is not acceptable. According to them, other taxes on income and property may be levied for several purposes, based on Islamic principles; e.g. (a) double or multiple assessment of the same base is not permissible in one stipulated period of *Zakah*; (b) in the calculation of assessable income "expense" items shall have to be deducted as is done under the *Zakah* law; (c) no additional levies on personal or collective income can be imposed on those whose incomes fall below the *nisab* stipulated in *Zakah*.

According to Faridi, the socioeconomic policy goals of an Islamic state are as follows:

- i) Justice and equity;
- ii) Provision of the socioeconomic needs or socioeconomic welfare of the community;
- iii) Enhancement of the community's economic resources and economic growth;
- iv) Improvement in the cultural milieu of the community.

These policy goals have been derived from the Qur'an and *Sunnah* and implemented in the simple socioeconomic system prevalent during the Prophet's life (PBUH) and that of Khalifate-e-Rashidah. Later, as the Islamic society became more complex, Islamic thinkers such as Al-Ghazzali, Abu Ubaid, Imam Yusuf, Ibn Taymiah, Al-Shatibe suggested appropriate devices for their attainment. Recent additions to this literature provide extremely valuable view of their contemporary relevance and modern exposition. We can take them as given and envisage the path along with the fiscal mechanism in an Islamic state which is likely to operate. Faridi, correctly argued that *Zakah* is the most important fiscal necessity and a means to alleviate poverty, in certain situations it may be necessary to impose certain subsidia-

ry welfare levies. Moreover, *Zakah* collections may sometimes fall short of resource requirements. For welfare expenditure has been recognized by the Qur'an itself in as much as it has exhorted the Muslims to expend voluntarily a part of their resources. Although such situations may not ordinarily arise, they are nevertheless important in the context of many Islamic countries today, where the phenomenon of mass poverty coexists alongside a relatively small number of wealthy people, which calls for additional mobilization of resources. Moreover, equitable distribution of income in a situation where exogenous developments have led to an unprecedented rapid accumulation of personal income, may not be wholly attainable through *Zakah* levies alone. In such a situation *Zakah* may be interpreted as the minimum rather than the maximum effort to alter the situation. But, it seems probable on the basis of evidence recorded in the early Islamic literature that a compulsory additional charge on such extraordinary income is permissible under the Islamic law.

A. The difference between *Zakah* and tax

Three are generally many differences between *Zakah* and tax.

a) *Zakah* is a religious duty and worship in terms of finance. Tax is an economic and financial responsibility.

b) *Zakah* is only for Muslims; tax is for all citizens.

c) Tax can be forgiven, *Zakah* can never be waived.

d) The rate, the way of payment of *Zakah* which are clear and definite, cannot be altered; but tax is relatively changeable.

e) The methods of distribution and spending of *Zakah* are definite, while tax is not.

f) *Zakah* is taken from the rich and paid to the poor, while in respect of tax, it is not necessary to be always so.

g) *Zakah* payer cannot get direct benefit out of it, whereas with tax payer, it is a possibility.

h) *Zakah* is taken only out of productive wealth, but tax can be taken out of consumption expenditure.

i) Exemptions in respect of *Zakah* are organic, elastic and realistic, but in case of a tax the exemptions are not flexible but accountable.

j) The limit of minimum responsibility is definite in *Zakah*, but does not exist in the case of tax, as is the case with indirect taxes.

k) Evasion is a real possibility in tax, but *Zakah* is paid by the believer as a form of worship.

l) Zakah is the divinely granted right of the poor on the wealth of the rich; tax is the non-divine right of the state to collect money to meet state needs.

m) Tax burden can be transferred by the tax payer to the consumer or producer; but in *Zakah*, there is no such transfer of *Zakah* burden.

n) From the practical point of view, the collection of *Zakah* appears to be cheaper than tax collection.

o) Comparing *Zakah* with progressive taxes, Metwally claims that *Zakah* has a wider base than progressive taxation; it is imposed not only on income, but also on idle assets. The proceeds of *Zakah* go mainly and directly to the poor and the needy and hence act immediately to raise the propensity to consume. *Zakah* falls heavily on assets which are capable of growing, and would therefore have a stimulating rather than discouraging effect (as with taxation) on investment.

B. Negative tax and Zakah

The transfer of funds through *Zakah* or other taxes may redistribute real income among the members of the society via the redistribution of purchasing power. Faridi claims that *Zakah* payment may be conceived in terms of what is described as a "negative tax". Under this concept an individual is considered to be capable of making a positive tax contribution, to the government if his personal income exceeds poverty level. But he is considered eligible to receive the negative transfer of funds from the government if his personal income is below the designated poverty level of income. Under *Zakah* transfer payment, the Government may similarly designate a poverty-line based on current living standards and make payment to those individuals whose income falls below the poverty line so designated. But Zarqa claims that we should be careful in applying the concept of negative income tax since it has been found to be disincentive to work. This will not be so in the case of *Zakah*. There is a moral nuance in the case of *Zakah*. According to some other Muslim economists, any poverty line designated with reference to current standards of living will have to be adjusted in the light of *nisab*. According to them, *nisab* allows a dynamic interpretation in term of cost of living index, and reasonably defines current standards of living. But sometimes, there is a loose limit between current incomes which exceed *nisab*. Hence, the disbursement of transfer payments is required to take into account both of these factors. But most of the Muslim economists do not accept such an adjustment system according to cost of living indices.

VII. ECONOMIC CHARACTERISTICS OF ZAKAH

Muslim economists argue that Zakah increases productivity, redistributes and reallocates the national income in favor of the poor, decreases

particularly the conspicuous consumption of the rich, increases investment and utilizes idle *Zakatable* income and stimulates aggregate demand.

A. Income elasticity of *Zakah*

As was mentioned before, *Zakah* is not a tax only, it is a worship as well. No change in it is permissible. In the second place, *Zakah* is not an inflexible fiscal measure. Its base is net savings or net wealth of the assessee. These bases are variables in size and likely to grow or decline in response to variation in income. In addition, the reductions allowed on account of trade or consumption do not vary in a magnitude proportionate to the fluctuations in the scale of economic activity or incomes. The marginal propensity to consume bears a stable relationship to income in the short period and may decline, other things being equal, after a certain level of individual income. Thus, deduction allowed on account of consumption expenditure has little likelihood of substantial growth to the detriment of *Zakah* collections. The case of trade expenses is not so clear, but certain items of cost are subject to economies of scale. Hence, every change in the scale of economic activity may not cause a proportional rise or fall in such a cost. These considerations have led to "built-in flexibility" to the statutory rate of *Zakah* although its degree of sensitivity of yield in response to changes in income may not be so high as that of some other taxes.

B. Stability and countercyclical use of *Zakah*

The statutory rate of *Zakah* and fixed nisab for exemption limit, accords to a fiscal policy a much needed stability. While a fiscal system based on *Zakah* involves an automatic fluctuation in state revenues in response to changes in the size of its base depending on changes in income together with appropriate combinations and permutations of other taxes, it may work for an automatic stabilization of total income and employment. In addition, it may also lead to a stable budget. The latter point may be understood more accurately in terms of specific items of *Zakah* disbursement. Quite a few of these are intended as transfer payments to the poor or the unemployed. As economic prosperity increases, the required volume of *Zakah* transfer payments may decline, thereby causing an accumulation of budget surpluses. This accumulated budgetary surplus on account of *Zakah* may be held over during these years and used when recession or depression sets in and causes hardship to the people. Of course, under *Zakah* not all unemployed people will benefit, for those who would be entitled to benefit will be only those who do not have *nisab*. Nevertheless, the budgetary surpluses or deficits arising out of *Zakah* collections may be disbursed in a countercyclical manner or more appropriately as an element of compensatory fiscal policy. According to Metwally, there are two curves for inflation in Islamic economies. The first is through an increase in the rates of dues on personal incomes. This will result in a decline in consumption which will cause a

shift in aggregate demand towards the equilibrium (full employment) price level. This would result in a high degree of economic stability. According to Faridi, in deflationary conditions, the total *Zakah* collection would decline in spite of its fixed rate. While during the period of rising incomes, *Zakah* levies may be paid out of the current flows of income during the downward swing of the economy. They may constitute a charge on hoarded wealth and / or net savings. This is likely to reduce the assessable wealth and hence *Zakah*, collections. Together with this development, greater deductions on expense account may be allowed in view of the falling individual income. Thus, the number of people assessable and the total *Zakatable* wealth would tend to decline. The stable tax rate combined with a variable amount of disbursement of *Zakah* funds in response to rise or decline in total employment in an advanced economy serves as an automatic regulator of government expenditure. This characteristic of *Zakah* tax, if judiciously combined with similar fiscal devices is likely to work for stability without major dislocations in the economy.

C. *Zakah* and inflation

Some of the Muslim economists like Akram Khan argue that *Zakah* may have some inflationary tendencies. According to this view, out of the eight heads of *Zakah* expenditure, at least three (that is, the *fukarah*, the *miskin* and *gharimin*) pertain to the poorer sections of the society. Even the rest of the five could be poor. Anyhow, *Zakah* is a transfer of wealth from the rich to the poor. The poor have a higher propensity to consume than the rich. Therefore, the institution of *Zakah* is a potential source of increasing aggregate demand in the economy which could be inflationary. According to the same opinion, the concept of just wages contains seeds of inflation as well. The just wage besides being related to productivity has been mainly construed to provide the basic necessities of life to everyone. Moreover, the profit participation, bonus, subsidies on the produce of the employee and social security from *Zakah* are all inflationary in character as they will directly boost demand for consumer goods industries. It is further argued that *Zakah* benefits are inflationary in character. And during the period of rising prices, a careless distribution of these benefit from erosion, one proposal could be to prepare a surplus *Zakah* budget. According to these economists, time lags can be introduced between collection and distribution of *Zakah*. Expenditure on defense (*fi sabilillah*), communication (*webnes-sabil*) and (*muallafatu-qulubuhum*) may be reduced and share of *fuqara*, *masakin* and *gharimin* may be kept intact. The surplus *Zakah* budget will have the effect of reducing aggregate demand in the economy and consequently may dampen the price level. But, some Malikis and Hanafies do not accept time lag between collection and spending of *Zakah* without any valid reason. According to these jurists a time lag of a few days is permissible. The Muslim economists who defend the surplus budget also propose the application of *Zakah* Certificates. The fund so mobilized may

be invested in industries to provide employment to the poor people. The profits of these industries may be distributed among the *fuqura*, *masakin* and *gharimin* in the form of annual dividends. In its initial periods, such a policy will be inflationary as there will be time lags between investment and production and the aggregate demand may outstrip the aggregate supply. But subsequently the dividends of these industries may be used as a fiscal device. It can be argued that during periods of rising price level, the dividends are not distributed in cash. Instead, *Zakah* certificates may be issued at par value, cashable at the option of the holder after a period of three to six months. In this way, demand can be dampened for a short period. These Muslim economists, in order to curb inflationary influence of *Zakah*, propose the application of *Zakah*-benefit ratio system as well. According to this proposal, the Qur'an has ordained eight heads for *Zakah* expenditure. This provides wide operational freedom to the state. Therefore, in an Islamic economy, comparative effects on aggregate demand of expenditure under these heads should be studied and in the light of the findings, a suitable *Zakah* mix should be prepared. On the face of it, it can be said that expenditure on *fuqura* and *masakin* is more inflationary than, for example, expenditure on *muallafatu-qulubuhum* or *gharimin*. The *muallafatu-qulubuhum* may have a smaller propensity to consume than *fuqura* and *masakin*. Similarly, *Zakah* to *gharimin* will be passed on to the creditors who can normally be expected to have a better economic position and thus a lower propensity to consume than *fuqura* and *masakin*. But all this needs to be worked out in the light of empirical evidence. Once these indicators are available, a suitable mix can be devised for *Zakah* expenditure to control inflation. According to the Muslim jurists, this is possible. Although, Imam Shafei favors equal division among the eight groups, according to the majority, the state may arrange the share of each group bearing in mind the need of the hour. Some jurists are of the opinion that surplus *Zakah* fund can be utilized for the establishment of factories or companies, land reclamation, construction projects or any others which can be owned at least in part by the poor themselves and provide them with a steady flow of modest income. As can be seen, this is a broader explanation of the spending of the *Zakah* funds which is similar to the idea of *Zakah* Certificates.

D. The impact of *Zakah* upon consumption, saving and investment

Some Muslim economists like Metwally argue that *Zakah* will have two effects on total consumer expenditure in an Islamic economy. Firstly both the average and the marginal propensities to consume would be higher in an Islamic economy than in a non-Islamic economy which does not have a similar fiscal measure. Secondly, the investment gap at each level of income would be smaller in an Islamic economy. But according to some other Muslim economists, the consumption pattern of society is determined by a host of factors other than transfer of purchasing power to poorer sections of so-

ciety through *Zakah* which tend to reduce the inequality of income and wealth. It is also argued that the overall propensity to consume would not necessarily be higher in an Islamic economy.

Abu Ali refers to the work of Dusenberry who shows, with the use of Veplén's demonstration effect, that consumption at a given level of income could be higher in a society characterized by larger inequalities of income and wealth. He claims that in an Islamic economy, consumption would be less compared to other economies with the same level of income. Most of the Muslim economist believe that Islam's emphasis on simple living and avoidance of ostentatious consumption would serve to keep the overall propensity to consume lower in an Islamic economy. It appears that in this field the actual situation can differ from country to country depending on the state of country's development, its historical background and the attachment of its people to moral values of Islam.

According to Faridi, *Zakah* levies may have two opposite effects on private saving and investment. An annual *Zakah* levy on net saving (or net wealth) above the nisab limit is likely to strengthen the propensity to consume. An individual saver may derive greater satisfaction from extravagant expenditure to avoid the yearly *Zakah* levy which threatens to cut away his net savings. Thus, the consumption functions has an upward shift. But, it may produce an entirely different reaction in him. In order to protect his wealth from gradual erosion, he may turn his idle wealth into active real or financial resources. His willingness to invest may be intensified. Both these tendencies would in the ultimate analysis, cause an upward shift in the demand for goods and services produced in the economy. Increased demand for consumer and capital goods would contribute to greater production. Considered from another angle, the power of *Zakah* to erode idle wealth, and its punitive imposition on hoarded precious metal would tend to increase the supply of savings (in an economic sense) in comparison to its demand. This effect of *Zakah* would be beneficial in as much as it would reduce the expected rate of return, from the investment on socially productive sector. Of course, there would be a minimum profitability limit of such investments. Its rate of return must not be below the *Zakah* rate but must be above by the cost of inconvenience involved in such investment.

Looked from another angle, the punitive nature of *Zakah* would exercise a healthy and positive impact on people's willingness to work harder in an effort to protect one's net savings. In this way, idleness would be discouraged and productivity would increase.

The most important aspect of the matter is the mode of disbursement of *Zakah* funds. If *Zakah* funds flow into investment channels, it would reduce its negative effects of savings and add to gross national product. On the other hand, investment oriented disbursement of these funds would have cumulative effect on reducing poverty.

In conclusion, it can be said that abolition of interest and functioning of *Zakah* system can be expected to provide powerful stimulus to growth. The

interaction between the incentive and disincentive effects arising from these two basic features of an Islamic economy serves to promote growth. By penalizing idle resources, the *Zakah* system discourages hoarding and stimulates investment. The demand for investment at a given expected rate of profit will be higher in an Islamic economy compared to other economies. Since investment is one of the most important determinants of the rate of growth, an Islamic economy would have a pronounced growth orientation. But one has to bear in mind that a full-fledged Islamic economy does not exist anywhere in the world at present. Many of the propositions advanced by Muslim economists are therefore in the nature of hypotheses rather than definitive conclusions from observed behavior of an Islamic economy.

E. Multiplier effect of *Zakah*

Some Muslim economists believe that a certain amount of *Zakah* funds invested according to the overall production priorities of an economy would benefit the poor in particular and the economy, in general, through its multiplier effect on employment and incomes. In this way it would gradually eliminate poverty instead of providing recurring financial support to the same set of people. It would increase employment and income in the economy thereby raising the standard of the people and eventually it would enhance the aggregate volume of the *Zakah* collection.

F. Welfare function of *Zakah*

Zakah ensures redistribution of income. Actually, Islam aims at achieving an equitable distribution of resources between present and future generations. Islam also emphasizes the need to give the poor their rights in such a way that their pride and dignity are well preserved. It is clear that the state is entrusted with the task of alleviating poverty. *Zakah* is used for this purpose and designed to promote the welfare function of the public expenditure. According to some Muslim economists, like Ahmad Saqr, Islamic government can embark on a range of productive projects in industry and agriculture which will create a continuous flow of income. By this way, for example, M. A. Mannan believes that *Zakah* funds may be allocated to those avenues of public expenditure which can improve the working conditions and the efficiency of the eligible recipients. Improved housing facilities, health services, training programs, educational institutions and a number of similar services may be initiated for this purpose. In this way, the welfare function of the public expenditure can be promoted. A survey of the poor economies of today reveals the alarmingly low ratio of such expenditure to GNP in many of them. If, even one percent of the national wealth, net current national income, is earmarked yearly for such services, it will account for a reasonably high level of welfare expenditure in the state bud-

ger. It would be useful if an attempt is made to improve the ratio of *Zakah* revenues to total public revenues in an Islamic economy. According to some Muslim economists, this can be done by keeping in view the following features of *Zakah* levy:

a) It is tax (say at a constant rate of 2.5%) on net national wealth (that is, investible goods).

b) Most of this amount is specifically earmarked for expenditure on the welfare of the poor. Assuming that GNP is equivalent to net national wealth (minus, those owned by authorities) and that public revenues constitute about 25% of GNP, about 10% of the total public revenue could be spent on the welfare of the poorer sections of an economy.

Zakah also can be used as an effective instrument in the fulfillment of the allocative as well as distributive functions of fiscal policy. Although the ratio of disbursement of *Zakah* fund is not fixed, it is said that the Qur'anic numeration of eight heads of expenditures serves as an indicator that as a starting point 12.5 percent of the total may be earmarked for each for head of disbursement. However, the disbursement authority shall be competent to authorize the transfer of funds from one alternative use to the other in the interest of the eligible recipients themselves and to serve its objective better. But, to use *Zakah* as an instrument for eradicating poverty and income redistribution depends on some other factors despite the fact that *Zakah* is one of the most important components of the social security system of Islam. However, ability of *Zakah* alone to eradicate poverty depends on the number of people who need *Zakah* assistance in a particular country. If the teachings of Islam are faithfully followed in a system, the glaring income inequalities would not exist nor would there be many people to receive *Zakah*. In such a situation, proceeds from *Zakah* should suffice to eradicate poverty. However, if for historical reasons and neglect of Islamic teachings, the number of poor people in a country is very large, it is the duty of an Islamic state to supplement the resources obtained through *Zakah* by other means to meet the minimum basic needs of the poor. If glaring inequalities of income and wealth exist in a society, *Zakah* alone may not be sufficient to achieve the desired reduction in such inequalities, especially because the *Zakah* rates are fixed and cannot be changed. It follows from this that an Islamic state would have to use other fiscal policy instruments, including progressive taxation for redistributive purposes. Social justice is the hallmark of the Islamic economic system and abolition of interest and establishment of the *Zakah* system are seen as two major institutional devices to establish a social order. Islam seeks to promote virtues of *Adl* and *Ihsan* among its followers and any society which is permeated with these qualities would need a minimum state intervention to establish a just social and economic order. It is the responsibility of the state however, to ensure social justice. But in the context of prevailing conditions, it is empowered to take all necessary actions within the framework of the Islamic *Shari'ah* to achieve this objective. Payment of *Zakah* is of course obligatory on Muslim, but they are exhorted to spend as much as possible, beyond this compulsory

levy, on the general of the community for their own spiritual uplift and to attain beneficent reward in the hereafter. Therefore, some Muslim economists attach so much importance to such welfare oriented resource transfers in a Muslim community that their view of an Islamic economy should be composed of three sectors, namely, public sector, private sector and voluntary sector. The private sector is characterised by public sector, profit motive is substituted by considerations of social welfare. "The third" or "voluntary sector" encompasses all such individual and social activities (alms and *Zakah*) as are not motivated by material considerations but are undertaken for securing reward in the hereafter. The concept of the third sector reduces the role of the market forces in the allocation of this sector are intended directly to raise the general economic and social welfare of the community, it leads to a more socially optimum allocation of resources. The composition of the national output is more need-oriented and less luxury-dominated. The government is relieved of a lot of social welfare expenditure which means that resort to taxation can be kept low in an Islamic economy. Although Muslim economists agree with this voluntary sector idea, there are some question about its quantitative significance in the context of the present state of Muslim societies. Therefore, the volume of resources flowing through a voluntary sector will be a function of the state of *taqwa* of an Islamic society. A fiscal policy mainly based on *Zakah* will have to play a major role in present day Muslim societies in alleviating mass poverty and modifying the pattern of income distribution in line with the egalitarian objectives of an Islamic society.

MAIN BIBLIOGRAPHIES

1 – **Studies in Islamic Economic**, edited by Khurshid Ahmed, A Selection of Papers, presented to the First International Conference on Islamic Economics held at Makkah under the auspices of King Abdul Aziz University, Jeddah, February 21-26, 1976. Published by International Center for Research in Islamic Economics, King Abdul Aziz University, Jeddah and the Islamic Foundation, United Kingdom, Printed in UK, 1980.

2 – **Monetary and Fiscal Economics of Islam**: Selected papers presented to the First International Seminar on the Monetary and Fiscal Economics held at Makkah in 1978, edited by Muhammed Ariff, published by International Center for Research in Islamic Economics, King Abdul Aziz University, Jeddah, 1982.

3 – **Fiscal Policy and Resource Allocation in Islam**: Edited by Ziauddin Ahmad, Munawar Iqbal, M. Fahim Khan. Selected papers presented to the first Seminar held in Islamabad 1981, International Center for Research in Islamic Economics, King Abdul Aziz University, Jeddah, and Institute of Policy Studies, Islamabad, prited in Raawalbindi, 1983.

4 – **Unpublished papers**: Which are presented to the above mentioned conference, on two seminars related to *Zakah* and Fiscal Policy.

- 5 – **The Muslim World and the Future Economic Order:** Published by Islamic Council of Europe, printed in UK, 1979.
- 6 – **Proceeding of the Third National Seminar:** Held in Gray Indiana, 1974, published by the Association of Muslim Social Scientists, in USA 1974.
- 7 – **Islamic Social Framework** by Prof. M. Raihan Sharif, published by Sh. Muhammed Ashraf, Lahore, Pakistan, 1963.
- 8 – **Muslim Economic Thinking:** Survey of Contemporary Literature, by M. Nejatullah Siddiqi, published by Islamic Foundation, UK, 1980.
- 9 – **Islamic Economics:** Annotated sources in English and Urdu, by Muhammed Akram Khan, The Islamic Foundation, Leicester UK, 1983.
- 10 – **The Making of Islamic Economic Society:** Islamic dimensions in Economic Analysis by M. A. Mannan, published by International Association of Islamic Banks, Cairo, Egypt and International Institute for Islamic Banking and Economics, Turkish Federated State of Kibris, 1984.
- 11 – **Hundred Questions and Hundred Answers:** Concerning Islamic Banks by International Association of Islamic Banks, Cairo. Egypt, 1980.
- 12 – **Literature on Islamic Economics in English and German:** by Volker Nienhaus, Al-Kitab Verlag-Koln, 1982.
- 13 – **Publications in Turkish Language related to Zakah.**
- 14 – **Fikhu-z-Zakah,** Y. Qaradawi, Turkish Translation.
- 15 – **Some Aspects of the Economics of Zakah,** Zaman, M. R. American Trust Publication, Indiana, USA, 1980.