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## Zakat as a Benchmark to Evaluate Economic Growth: An Alternative Approach

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### Abstract

*The purpose of this paper is to determine the need of Zakat as a financial system in order to evaluate the growth of economic. Reviewing the conceptual framework of Islamic economic to propose an alternative model in order to contribute significantly to the Ummah and serving the nations. This paper concludes to be regarded Zakat as one of the proper method to measure the economic growth, which means, when people pay Zakat the level of economic growth will be higher and vice versa. In other words, the commitments of Muslims to pay Zakat to the eight categories to achieve sustainable development in terms of redistribution of wealth between Muslims as well as bridging the gap between the rich and the poor in the society. This paper also contributes to consider Zakat as a proper index to measure economic growth through a number of methods to evaluate the economic growth.*

**Keywords:** Economy, Islamic Economics, Zakat.

### 1. Research Overview

This paper is to present a proposed model shows the possibility to benefit from Zakat as a financial system in order to evaluate the growth of economic. The research question is how to use Zakat as index to evaluate the economic growth?

Reviewing books of Islamic Economics will guide us to find a number of interpretations of the Conceptual Framework of Zakat (levy) as the benchmark of the Islamic Economics. by way of example, not exhaustive enumeration, Muslim jurist Abu Yusef's Kitaab al Kharaj "Book of Taxation", Muslim jurist and historian Al Maqrizi in his letter about the history of money, and Muqaddimah Ibn Khaldun "Ibn Khaldun's Introduction" Ibn Khaldun in his book discussed the topics of Sharia (Islamic law) and Fiqh (Islamic jurisprudence). Abu Ubaid in his book Al-Amwal (Funds) and Ibn Ashur's 'Maqasid al-Shariah al-Islamiyah (Objectives of Shariah), they have discussed a number of issues related to the Islamic Economics as the mother of science as well as contributed significantly to Muslims societies and existing literature.

**What is Zakat?** In reference to Sayyid Sabiq (1991) as quoted by (Bakar and Rahman, 2007) Zakat is portion of a man's wealth which is designed for the poor, Zakat is an obligation in respect of funds paid for a specified type of purpose and for specified categories. It is a specified amount prescribed by Allah the Almighty for those who are entitled to Zakat as specified in the Qur'an. The word Zakat is also used to indicate the amount paid from the funds that is subjected to Zakat" (AAOIFI, 2010). The obligation to pay zakat is linked with the order to perform prayer as stated in the Holy Quran. As such, a strong emphasis is placed to abide such obligation among Muslims. Prayer is an act of worship expressing a Muslim's gratitude for the bodily blessings bellowed by Allah, while zakat is an act of worship expressing a Muslim's gratitude for Allah's financial gifts (Awang and Mokhtar, 2012). Zakat is the third of the five pillars of Islamic faith, relating to wealth and welfare of the society, Zakat is essential as a social welfare levy imposed to Islamic society's wealthier members and more prosperous businesses and thus helps to close the gap between the poor and the rich (Abdul Rahman and Awang, 2003). However, Zakat refers to the amount of money that Muslims men and women who are mentally stable and financially able to contribute a sum of money in order to support specific groups of people according to eight categorizes (Ghani and Said. 2011). The practice and management of Zakat are different from country to other, although in early Islamic states, Zakat funds were collected and managed by the state, Zakat management has gone through historical challenges after the extinction of early Islamic states (Hassan, 2010).

After the colonial era, a few Muslim countries such as Yemen, Saudi Arabia, Libya, Sudan, Pakistan, and Malaysia have opted for mandatory Zakat management through government. Other countries such as Egypt, Jordan, Kuwait, Iran, Bangladesh, Bahrain and Iraq, have formed specialized state institutions but participation of public is made voluntary (Hassan, 2010). However, Zakat could contribute positively to the Ummah, for instance, in developing countries such as Bangladesh, Zakat funds could have contributed up to 21% of the Annual Development Plan (ADP) in 1983/1984 and up to 43% of ADP in 2004/2005 (Hassan, 2010).

## **2. Research Methodology**

The importance of Zakat as a source of financing to meet public expenditure in terms of the eight categories as mentioned in the Quran. Allah S.W.T says, "Take sadaqah (obligatory alms) out of their wealth through which you may cleanse and purify them" [al-Tawbah: 103]. However, pay Zakat means growth of faith and then growth of zakat fund and then zakat contribute significantly to economic growth, redistribution of income and wealth and reducing the phenomenon of inflation as well as reducing the poverty and other social and economic problems. Based on that, the practice of Zakat globally needs to be investigated in order to emphasize the need for Zakat as financial system to evaluate the growth of economy. Thus, this paper is an attempt to set alternative approach to consider Zakat as one of the proper method to evaluate the economic growth. In this paper, data will be obtained by using previous studies to provide a comprehensive answer for the research question. However, in Malaysia according to Hamat (2009), there are two types of business Zakat accounting methods which are commonly practiced, namely, the adjusted working capital method and the adjusted growth capital method in the collection of Zakah by the authorities. On the other hand, according to AAOIFI<sup>(1)</sup> requirements on computing of Zakat, there are two methods to compute Zakat, which are:

**Net assets method:** Using the net assets method, the Zakah base shall be determined as follows:

Zakah base = Assets subject to Zakah – (liabilities that are due to be paid during the year ended on the date of the statement of financial position + equity of unrestricted investment accounts + minority interest + equity owned by government + equity owned by endowment funds + equity owned by charities + equity belonging to not-for-profit organizations excluding those that are owned by individuals). (para 3, AAOIFI, 2008)

**Net invested funds method:** Using the net invested funds method, the Zakah base shall be determined as follows:

Paid-up capital + reserves + provisions not deducted from assets + retained earnings + net income + liabilities that are not due to be paid during the year ended on the date of the statement of financial position – (net fixed assets + investments not acquired for trading, e.g. real estate for rent + accumulated losses). (para 7, AAOIFI, 2008)

Zakat is payable on the business irrespective of whether profit has been earned or unearned (Awang and Mokhtar, 2012), therefore, both methods either working capital or growth capital method as well as using the net assets method and the net invested funds method both based on the information extracted from balance sheet end of the financial period. Therefore, the data obtained by using previous studies to provide a comprehensive analysis for the research question, on the other hand, empirical examination by using these methods (working capital or growth capital method and using the net assets and the net invested funds method) should be conducted for future research.

## **3. Research findings: Zakat as a financial System**

The institutions of zakah have been existed since time immemorial. The Qur'an presents many verses that are addressed to various Prophets, from Adam to Muhammad, telling their people to give zakah, for example Adam (QS: 2:37, 47); Abraham (QS: 21:69, 71-73); Ismael (QS: 19:54-55); Moses (QS: 7:155-156) and Muhammad (QS: 2:277) (Hudayati and Tohirin, 2010). Allah says "O you who believe, Spend of the good things which you have earned" al-Baqarah, 2: 267).

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<sup>(1)</sup>The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), based in Bahrain, AAOIFI as an independent international organization, is supported by institutional members (200 members from 45 countries, so far) including central banks, Islamic financial institutions, and other participants from the international Islamic banking and finance industry, worldwide.

According to Kahf (1999) as quoted by (Bakar and Rashid, 2010) the main objective of zakat is the achievement of socioeconomic justice. No doubt of that, Zakat funds might be used in development projects, educational services, and health care services as long as the beneficiaries of such projects fulfill the criteria to be recipients of Zakat (Hassan, 2010). In this regard, it is needed to be emphasized that zakat has been proven as a unique mechanism of wealth distribution in the history. Whenever Muslims truthfully applied the system of zakat as ordained by Allah and His messenger, the splendid objectives of zakat were fulfilled (Bakar and Rashid, 2010) in line with that, Zakat serves as a unique mechanism of compulsory transfer of income and wealth for bridging the gap between the rich and the poor in the society (Bakar and Rahman, 2007).

Measurements of the growth of economy, generally measured by a number of indicators, some of these indicators give a clear picture about the economic growth to help the government to set a clear policy to leading the nations. On the other hand, some of these indicators give misunderstanding picture and then confused the public about the rate of economic growth. Based on that, As Muslims, we have Zakat to be considered as new measurement in order to evaluate the growth of economic, Zakat is one of the proper indicators to measure economic growth, when people pay Zakat the level of economic growth will be higher and vice versa. In other words, Zakat as financial system will integrate to bridge this gap and the reduction of social problems in Muslims world as well as may contribute in economic activities in order to achieving sustainable development.

In short: according to Zaim (1989) as as quoted by (Bakar and Rahman, 2007) Zakah also has a multiplier effect to the economy; 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, Bakar and Rahman (2007) stated that, Zakat it would gradually eliminate poverty instead of providing recurring financial support to the same set of people. Consequently, employment and income will be increased in the economy thereby increasing the standard of living of the people and eventually it would enhance the aggregate volume of zakah collection. Thus, Zakat would affect positively the rate of growth of economy in terms of poverty alleviation, reducing of unemployment and the rate of inflations:

### **3.1 Contribution of Zakat to Poverty Alleviation**

Zakat have a more significant role to play as poverty alleviation tools in micro-perspective, the approach to tackle poverty will depend on the type of resources and entitlements a household possesses (Ahmed, 2004). Islam establishes zakat as a compulsory charity tool that can be used on eight purposes. Among them, five are meant for poverty eradication such as the poor, the needy, the debtors, the slaves (to free them from captivity), and the travelers in need (Hassan, 2010). Other heads are the administrative cost of Zakat and in the way of Allah. Although eight heads for spending Zakat revenue have been mentioned in the Qur'an, there is general agreement that the first priority in the use of Zakat funds has to be accorded to the alleviation of poverty through assistance to the poor and the needy (Hassan, 2010).

The analysis of the phenomena of extreme poverty and absolute poverty are procedural definitions of this phenomenon without finding a sufficient indicators to be interpreted and find appropriate solutions to this phenomenon, since the international organizations have identified some of the criteria to measure that in terms of the rate of income but these indicators developed on the basis of classification the world either developed countries or developing countries.

However, to building a vision to explore this phenomenon, we need to provide ambitious vision with great services to deliver high performance in order to determine the mechanisms of treatment and eliminate poverty. As a result, we are working on this paper to introduce zakat as a financial index to be the most effective solutions in dealing with this phenomenon and the reduction gap between the nations. As stated in the verse, "but charity to the poor, the needy and those employed and those whose hearts and necks and debtors in the way of Allah and the wayfarer an obligation from Allah and Allah is Knowing, Wise"(Al-Tawbah:60). Thus, the Zakat as a system integrated financial would reduce poverty through the redistribution of wealth as well as Zakat investment and distribution have a role in moving the economic activities and alleviate problems of poverty.

### 3.2 Contribution of Zakat to reduce unemployment

In this paper we are not going to provide explanations of the concept of unemployment and mechanisms of reduction of this phenomenon in the traditional economy. This research to evaluate Zakat contribution in order to reduce the phenomenon of unemployment, reduction and how to achieve this goal through the best use of resources of Zakat and employ them to achieve sustainable development.

The best way to reduce the phenomenon of unemployment is the exploit Zakat in activating the role of the three elements of production (labor, capital and natural resources). As Zakat is working on the mixture between the two elements of production "labor and capital" in the verification process where the interests of owners and workers speculators. Thus, Zakat contribute in finding a job by searching for the means of production, investment or re-invest that. The third element is natural resources that are directly related to the Zakat Rikaz<sup>(2)</sup>.

### 3.3 Contribution of Zakat to reduce inflation rate

Zakat can be used in the positive impact in reducing the phenomenon of inflation as monetary instruments used to alleviate that by affecting the methods of supply and demand of money. However, in order to manage the monetary policies in terms of money, Zakat collections and distributions or management of Zakat to be considered as one of the monetary policies to reduce the inflation rate by imposing Zakat to be paid to recipients.

## 4. Conclusion

This research may be considered as a first attempts to analyze the Zakat as benchmark to evaluate the economic growth. Therefore, it can be clearly seen that this research will contribute to the Ummah and the existing literature due to the lack of empirical and theoretical data on Zakat. The finding seems to demonstrate that, Zakat as benchmark could estimate the economic growth and contribute in economic development in terms of poverty alleviation, reducing of unemployment and the rate of inflations. Although the results of this paper are theoretically, empirical examination should be conducted for future research. This paper may contribute to evaluate economic growth as new index to measuring the growth of economic among Islamic countries.

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<sup>(2)</sup> Zakat Rikaz: all items mined out of the earth including oil or other valuable fluid items.