

Welfare Potential of Zakat: An Attempt to Estimate Economy wide Zakat Collection

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Abstract

Islamic economics literature is rich in highlighting the welfare potential of Zakat, but very few empirical studies have undertaken the quantitative estimation of potential Zakat collection. In this study, we attempt to estimate potential Zakat collection at economy wide level to explore the welfare potential of the institution of Zakat. We attempt to estimate economy wide Zakat collection by including heads like Zakat on agriculture produce, value of livestock, tradable inventory, currency in circulation, foreign exchange reserves, estimated gold and silver deposits, value of livestock and financial assets like investment in National Savings Scheme (NSS), mutual funds, stock market capitalization and pension schemes. Our estimates suggest that approximately Zakat collection in Pakistan could reach 9% of total GDP and the institution of Zakat system can also have positive effects on flow of investment, promoting entrepreneurship culture and making capital markets and real estate markets more competitive. At the macroeconomic level, we also discuss the role of institution of Zakat as automatic stabilizer.

Keywords Zakat, Welfare, Fiscal Policy, Public Finance

JEL Codes E6, H2, H3

1. Introduction

Zakat is an important institution in an Islamic economic framework for poverty alleviation and economic welfare. In Islam, Zakat is a religious obligation to pay a part of wealth and production to the government which can spend the Zakat funds on specified heads. In its economic character, Zakat is a combination of a net worth levy and a production levy.

Covering the period of earlier Islamic history, Kuran (2003) mentions that the institution of Zakat in pious caliphates' times was very dynamic. In Umer (rta) and Abu Bakar (rta) period of government, Zakat was collected by the government, but, in Usman (rta) period, people were allowed to pay Zakat privately. Horses were exempted from Zakat in Prophet's time, but, Umer (rta) brought them in the Zakat net in His period. Similarly, Mahmud (2001) argued that institution of Zakat is flexible to a certain degree as Umer (rta) levied Zakat on horses and skins and at the time when Arab was hit with a drought and famine, he exempted poor from Zakat and suspended Zakat from the rich. Usman (rta) also levied Zakat on the production in forests (Nadvi, 1996) which was not the case in the earlier period.

This brief review of the management of institution of Zakat in earlier times reveals there is flexibility that a policy maker can use to maximize the welfare benefits of Zakat system.

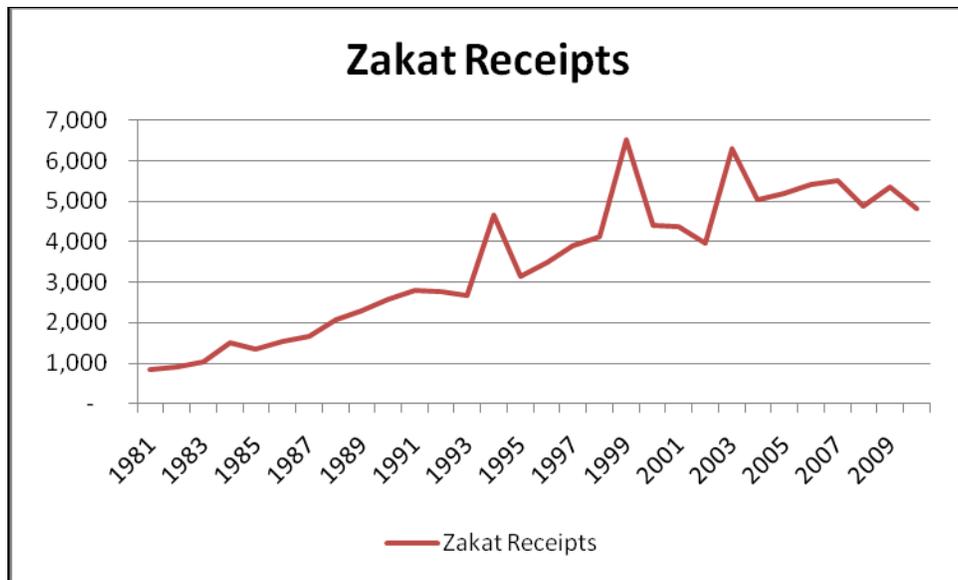
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Islamic economics literature is rich in highlighting the welfare potential of Zakat, but very few empirical studies have undertaken the quantitative estimation of potential Zakat collection. Among the few studies that had attempted to estimate Zakat at the aggregate level, Firdaus et al (2012) estimate the potential of Zakat in Indonesia by surveying 345 households. Their results show that Zakat collection could reach 3.4% of Indonesia’s GDP. For Pakistan, Kahf (1989) use different Zakat categories and according to his estimate, Zakat collection can be between 1.6% of GDP to 4.4% of GDP.

In most countries, Zakat is not collected by the government and is not considered a compulsory payment (Powell, 2009) to the government. One of the potential reasons for this is that mainstream Islamic scholarship allows taxes to be levied other than Zakat for public finance. Respected Muslim scholar Ab-ul-ala Maududi (1970) reasoned that Zakat is a religious obligation and is not a substitute of tax. Taxes other than Zakat can be imposed in an Islamic economy if these taxes are levied by the legislative council and used for public welfare. He reasoned that the taxes discouraged in Ahadith are those which were imposed by autocratic kings for their own lavish consumption and this kind of usurpation of public property was discouraged.

Another reason why Zakat collection is low at the central level in Pakistan is that there is a big and growing trust deficit between the central government and the people. As can be seen from Figure 1, Zakat collection and its disbursement is very low in Pakistan at the government level.

Figure 1: Zakat Receipts (in mln Rs.)



In this study, we attempt to estimate potential Zakat collection at economy wide level to explore the welfare potential of the institution of Zakat.

2. Mathematical Computation of Zakat

Lifetime wealth Zakat function for an individual 'i' can be represented as:

$$Z_i = \sum_{t=1}^n 0.025 (NZW_t)$$

Here,

Z_i is Zakat liability of an individual 'i'.

Time period 't' runs from t=1 (current time period) to 'n' (terminal point of life).

NZW_t represents net Zakat wealth. It is computed as ($W_t - N_t$).

Where W_t is the gross amount of wealth and N_t is the value of Nisab amount.

Nisab is minimum threshold of wealth which is not subject to Zakat.

Zakat function of an economy can be represented as:

$$Z_T = \sum_{i=1}^n 0.025 (NZW_i)$$

For a particular individual 'i', net Zakat wealth at a point in time is given by:

$$W_t = I_t - 0.025(NZW_{t-1}) + W_{t-1} - C_t$$

Here,

I_t is income of individual 'i' in time period 't'.

NZW_{t-1} is the base of wealth that will be used for Zakat deduction.

W_{t-1} is the wealth of individual 'i' in previous time period.

C_t is the consumption in time period 't'.

Simplifying the above equation, we get:

$$\begin{aligned} W_t &= I_t - 0.025(W_{t-1} - N_{t-1}) + W_{t-1} - C_t \\ W_t &= I_t - 0.025W_{t-1} + W_{t-1} + 0.025N_{t-1} - C_t \\ W_t &= I_t + 0.975W_{t-1} + 0.025N_{t-1} - C_t \end{aligned}$$

Expanding it iteratively forward, we get

$$\begin{aligned} W_{t+1} &= I_{t+1} + W_t - 0.025(W_t - N_t) - C_{t+1} \\ W_{t+1} &= I_{t+1} + 0.975W_t + 0.025N_t - C_{t+1} \\ W_{t+1} &= I_{t+1} + 0.975(I_t + 0.975W_{t-1} + 0.025N_{t-1} - C_t) + 0.025N_t - C_{t+1} \end{aligned}$$

$$W_{t+1} = I_{t+1} + 0.975I_t + 0.950625W_{t-1} + 0.024375N_{t-1} + 0.025N_t - 0.975C_t - C_{t+1}$$

It can be seen that the wealth function will decumulate base year wealth and overall wealth can only increase with increase in income, labor plus non-labor.

3. Issues in Estimation of Zakat

Wealth or Assets subject to Zakat include Cash in hand, Cash in Bank, gold and silver not in daily usage (for women), gold and silver owned by men, held-for trade inventory, property/plot purchased for the purpose of resale.

Production is not limited to agriculture nowadays, but the major part of it is coming from industries as well as services sector. Therefore, industrial production could also be taxed just like agriculture. Services income could also be taxed on the same principle.

Khan (2005) stated that investment in stocks should be interpreted as any other investment with some means of earning income. Stock is a means of earning dividend or capital gains. Just like means of production/income are exempt from Zakat, investment in stocks should be exempted from Wealth Zakat as investment in stocks means that the money is not kept idle rather it is invested and even its value could reduce to zero or increase by a long way theoretically. Therefore, any income arising from investment in stocks i.e. capital gains or dividend must be subject to Income Zakat. Similarly, this argument could be extended to introduce Income Zakat on mutual funds, investment in NSS, debentures, bonds etc. Furthermore, if land/building/house is leased, the land/building/house becomes the means of earning rent. Hence, income Zakat could also be introduced on rental income on houses, assets, buildings etc.

Therefore, in my opinion, any income arising from investment in stocks i.e. capital gains or dividend must be subject to Income Zakat i.e. "Ushr". Similarly, this argument could be extended to introduce Income Zakat on income from mutual funds, income from investment in National Saving Schemes (NSS), income from investment in debentures, bonds etc.

Furthermore, if land/building/house is leased, the land/building/house becomes the means of earning rent. Hence, income Zakat i.e. "Ushr" could also be introduced on rental income on houses, assets, buildings etc. In all such cases, the invested amount or the value of asset leased out will not be subject to Wealth Zakat.

It is to be noted that Income Zakat has two variants, i.e. 'Ushr' (10%) and 'Khums' (5%). If investment is made in a business venture as a sleeping partner or by purchasing common stock of the company, the participation in the business venture is only by way of providing capital. Hence, I am in favor of levying 'Ushr' on income from investment in stocks which arise in the form of capital gains or dividend income.

However, if employees/directors are given bonuses in the form of stock ownership or own stocks, they will have to pay 'Khums' (5%) on income from investment in stocks which arise in the form of capital gains or dividend income. It is due to the fact that in this case, the participation in the business venture is not only by way of providing capital but also by providing

labor (physical/mental exertion by contract for consideration in the form of wage/salary). One crucial advantage to this is that Directors will be willing to make the company grow and own its stock to benefit not only from dividend/capital gains, but pay less tax on that income i.e. 5% than 10%. This will magnify the benefit of making directors more responsible by offering them ownership in the company. This will also solve the agency problem as well in an effective way.

Regarding exemptions on personal wealth, if a person owns 100 cars, the government could allow exemption of one car for personal use, but could levy Zakat on other cars in his/her ownership. If a person owns a multistoried bungalow, the government could specify that a person could avail exemption for one normal house, but, for the value of house beyond that limit, he/she should pay Zakat on that excess value. Likewise, government could legislate that wearing 10 gram of Gold is normal with a woman. Hence, all Gold in women ownership beyond that will be Zakatable no matter whether it is personally used regularly or not.

If diamonds were not there in Arab commonly, does that mean we cannot make them subject to Zakat if found in other countries afterwards (when Islam spread outside of Arab). If production was just limited to agriculture in those times, does that mean we cannot make production from industries subject to Zakat? If the people usually owned only certain types of wealth in those times, does that mean we cannot make other forms of wealth subject to Zakat? Does that mean we need to purify only certain types of wealth and production found in Arab commonly at that time and not others? If diamonds were not found in Arab or if industrial production was not prevalent then, it must by no means restrict us to use our reason and make them subject to Zakat.

4. Estimation of Zakat

Going into estimation of potential Zakat from agriculture produce, we first present some data that gives us an idea of how much Zakat could be collected both with present production and with enhanced production due to efficient utilization of land. It can be seen from the following data that 8.31 million hectares are unutilized cultivable land in Pakistan. If agriculture's share is approximately 21% of GDP utilizing 22.04 million hectares, an addition in production through utilization of that idle farm land can be computed assuming constant returns to scale on average.

Table 1: Land Utilization (Million Hectares)

Year	Total Area Cultivated	Culturable Waste
1991	20.96	8.85
1992	21.06	8.86
1993	21.4	8.83
1994	21.51	8.74
1995	21.55	8.91
1996	21.68	8.87
1997	21.98	9.06
1998	21.96	9.15
1999	21.93	9.23
2000	21.96	9.09
2001	22.13	9.17
2002	22.27	8.95
2003	22.21	8.95
2004	22.12	9.1
2005	22.13	8.94
2006	22.65	8.21
2007	21.88	8.3
2008	21.28	8.18
2009	21.38	8.19
2010	21.4	8.09
2011	22.03	8.98
2012	22.04	8.31
2013	22.04	8.31

Source: Ministry of Food, Agriculture & Livestock

Next, we move to estimate potential Zakat from individuals on their wealth including Cash in bank, investments in Shares, NSS, gold deposits etc.

4.1. Calculation of Nisab for Individuals (Exemption Amount)

In Table 2, we show Nisab computation. Nisab amount is computed by taking market value of 612 grams of silver in Pakistan as on March 18, 2014.

Table 2: Nisab Computation

Nisab Computation	
Price of Silver (10 Grams) in Rs.	670
Nisab of Zakat in Silver (612 Grams) in Rs.	41,017

4.2. Zakat Computation on Gold

It is difficult to obtain micro data on gold holdings in Pakistan. For this, we use a proxy using an informal survey technique. We assume that given a family owns 3-5 room housing unit, it will possess on average 100 gram of silver. Most definitely, some families will own more or less than this, but, for Pakistan, this assumption seems to be close to the mean based on informal survey done for few families and spending on gold in marriages. With our estimates, we arrive at Rs 3.43 trillion as the Zakatable value of gold in Pakistan as reported in Table 3.

Table 3: Estimation of Zakat in Gold

Estimation of Zakat on Gold	
Number of 3-5 Room Housing Units in Pakistan	7,642,948
Per Housing Unit Gold in Grams	100
Amount of Gold in Grams	764,294,750
Amount of Gold in Grams (00s)	76,429,475
Price of 10 grams Gold	45,000
Amount of Gold Value (Mln Rs.)	3,439,326

4.3. Zakat Computation on Tradable Inventory

It is very hard to compute value of unsold inventory at a particular date. Wholesale and retail trade comprises 17% of total national income in Pakistan. Moreover, most of the informal sector is engaged in trading and that contribution does not usually show up in national income accounts.

To get a minimum estimate, we take the head ‘change in inventories’ from national income accounts. In national income accounting, ‘inventory investment’ represents value of production in a particular year that remains unsold during that year. It is assumed that firm has itself purchased that inventory from itself. However, that gives an estimate of tradable inventory for production that had taken place only in that year. The actual tradable inventory could be much more than that.

In Table 5 as well as in 6, we report the estimation of Zakat on tradable inventory. We apply 2.5% rate of Zakat on the estimated value of tradable inventory.

4.4. Zakat Computation on Produce

If potential Zakat collection is estimated using the classical method in which all liquid holdings like cash, bank deposits, equity investments, mutual fund investments, annuities investments, fixed income securities investments etc are subject to wealth Zakat, the estimation of Zakat is shown in Table 5. For estimating the value invested in stocks, mutual funds, national saving schemes, we take KSE market capitalization, Assets Under Management (AUM) of mutual funds and outstanding balance of national saving schemes respectively.

However, if our proposal is applied, the results will be different as reported in Table 7. In our proposal, invested capital will be considered a means of earning income and only income from that invested capital shall be subject to Ushr (i.e. a 10% levy).

Likewise, produce from agriculture, industry and services shall also be subject to Khums and Ushr. The production from irrigated lands shall be subject to Khums (i.e. a 5% levy). The production from rain-fed lands shall be subject to Ushr (i.e. a 10% levy). Since industries (manufacturing as well as services) are both labor and capital intensive, industrial production shall be subject to Khums (i.e. a 5% levy).

4.5. Zakat on Livestock

There are different rates of Zakat on different types of livestock. But, at least 2.5% Zakat is applied on different categories of livestock. Hence, we apply the conservative rate of 2.5% on livestock. We have the data on number of different types of livestock and their market prices. However, it is difficult to find micro data for livestock holding. For this, we use the quintile income distribution as a proxy for livestock distribution. Table 4 gives the quintile income distribution in Pakistan.

Table 4: Quintile Income Distribution

Income Category	% of Total Income
Top 20%	39.98
Second 20%	12.94
Third 20%	16.36
Fourth 20%	21.12
Bottom 20%	9.6

Source: World Bank, Development Research Group

Since top 20% of the people get approximately 40% of the total income, we apply livestock Zakat on 40% of livestock at a constant average rate of 2.5%.

4.6. Estimation of Aggregate Zakat

4.6.1. Classical Method

In Table 5, we show the computation of aggregate Zakat from classical method.

Table 5: Estimation of Zakat Based on Classical Approach

Report Date	Category	Quantity	Amount (Mln Rs.)	Zakat Collectible (Mln Rs.)
	Zakat on Wealth			
	Gold		3,439,326	
End-Jun 2013	Currency in Circulation		1,938,222	
15-Mar-14	KSE Market Capitalization		6,277,437	
18-Mar-14	Open End Funds		378,187	
18-Mar-14	Closed End Funds		19,894	
18-Mar-14	Pension Schemes		6,275	
End-Jun 2012	NSS		1,676,361	
14-Mar-14	Foreign Exchange Reserves		964,000	
End Jun 2013	Changes in Stocks/Inventories		366,545	
End-Jun 2013	Livestock Value (Cattle at Rs 40,000/Unit)	38,300,000	1,532,000	
End-Jun 2013	Livestock Value (Buffalo at Rs 40,000/Unit)	33,700,000	1,348,000	
End-Jun 2013	Livestock Value (Sheep at Rs 10,000/Unit)	28,800,000	1,152,000	
End-Jun 2013	Livestock Value (Goat at Rs 10,000/Unit)	64,900,000	2,596,000	
End-Jun 2013	Livestock Value (Camel at Rs 40,000/Unit)	1,000,000	40,000	
	Less: Nisab Amount ($P_{MNA} \times MNA$)		492,204	
	Net Amount Subject to Zakat		21,242,044	
	Total Wealth Zakat			531,051
	Zakat on Produce			
	Ushr			
End-Jun 2013	Produce on Rain-fed Land		684,714	68,471
	Khums			
End-Jun 2013	Produce on Irrigated Land		1,597,666	79,883
	Total Zakat Collection by Classical Method			679,406
End-Jun 2013	Import Duty on Tariff		4,311,757	431,176
	Total Zakat Collection by Classical Method & Import Tariff			1,110,581

4.6.2. Proposed Method

In Table 6, we show the computation of aggregate Zakat from the proposed method. In this method, the only change is that income from invested capital in bank accounts, stock market, mutual funds, national savings scheme etc is subject to Ushr (i.e. a 10% levy). Average return on these investments had remained close to around 10%. Hence, Ushr on that 10% return makes up 1% of invested capital. Hence, Ushr is computed as 1% of total KSE market capitalization, mutual fund assets and outstanding balance of national savings schemes.

Table 6: Estimation of Zakat Based on Proposed Approach

Report Date	Category	Quantity	Amount (Mln Rs.)	Zakat Collectible (Mln Rs.)
	Zakat on Wealth			
Estimated (2014)	Gold		3,439,326	
End-Jun 2013	Currency in Circulation		1,938,222	
14-Mar-14	Foreign Exchange Reserves		964,000	
End Jun 2013	Changes in Stocks/Inventories		366,545	
End-Jun 2013	Livestock Value (Cattle at Rs 40,000/Unit)	38,300,000	1,532,000	
End-Jun 2013	Livestock Value (Buffalo at Rs 40,000/Unit)	33,700,000	1,348,000	
End-Jun 2013	Livestock Value (Sheep at Rs 10,000/Unit)	28,800,000	1,152,000	
End-Jun 2013	Livestock Value (Goat at Rs 10,000/Unit)	64,900,000	2,596,000	
End-Jun 2013	Livestock Value (Camel at Rs 40,000/Unit)	1,000,000	40,000	
	Less: Nisab Amount ($P_{MNA} \times MNA$)		492,204	
	Net Amount Subject to Zakat		12,883,889	
	Total Wealth Zakat			322,097
	Zakat on Income/Production			
	Ushr			
End-Feb 2014	Total Deposits of Scheduled Banks		7,599,393	75,994
18-Mar-14	KSE Market Capitalization		6,557,000	65,570
18-Mar-14	Open End Funds		378,187	3,782
18-Mar-14	Closed End Funds		19,894	199
18-Mar-14	Pension Schemes		6,275	63
End-Jun 2012	NSS		2,011,263	20,113
End-Jun 2013	Produce on Rain-fed Land		684,714	68,471
	Total Ushr			234,192
	Khums			
End-Jun 2013	Produce on Irrigated Land		1,597,666	79,883
End-Jun 2013	Ushr on Industry		4,665,733	233,287
End-Jun 2013	Ushr on Services		11,476,125	573,806
	Total Khums			886,976
	Total Zakat Collection			
				1,443,265
End-Jun 2013	Import Duty on Tariff		4,311,757	431,176
	Total Zakat Collection & Import Tariffs			1,874,441

We have to make an estimate of how many people have the wealth from various sources mentioned above exceeding Nisab Amount. For instance, if we assume that top 20% people in labor force have the wealth exceeding Nisab amount; then:

$$P_{MNA} = \text{Number of people in labor force} \times 20\%$$

$$P_{MNA} = 60,000,000 \times 20\%$$

$$P_{MNA} = 12,000,000$$

$$MNA = \text{Rs. } 41,017 \text{ (as calculated above)}$$

From Zakatable assets that are subject to wealth Zakat, we have to deduct the product $[P_{MNA} \times MNA]$,

$$P_{MNA} \times MNA = \text{Rs } 492.2 \text{ Billion}$$

We make this deduction in the computation of Zakatable value of assets and wealth.

6. Economics of the Proposed Zakat Based Taxation System

Adam Smith in his monumental work “*An inquiry into the nature and causes of wealth of nations*” discusses the cannons of taxation. The proposed Zakat based taxation system goes very well with Adam Smith’s cannons of taxation. It has a proportional tax which can be maneuvered to be progressive as well. It does not tax production heavily (i.e. lenient tax rates) which is in line with Smith’s assertion that production must not be taxed heavily. It is simple and certain. It is convenient to collect and more so, because it is a religious obligation than just involuntary tool of fetching wealth. It only taxes those who have the ability to pay i.e. it does not tax those who do not reach a minimum threshold of wealth in their hands.

On the macroeconomic front, proportional Zakat linked with income acts as an automatic stabilizer. When aggregate personal disposable income increases, more Zakat is collected and more amount remains at the disposal of government to allocate as transfer payments to *Fuqura* (poor and needy), *Masakeen* (extremely poor and needy) and *Gharimeen* (borrowers in trouble).

When personal disposable income decreases, obligatory Zakat also decreases and thereby providing an automatic relief to the income earner who is going through a lean patch.

Besides, the proportional income levy, Zakat on wealth redistributes wealth too. So, if an economy is in disequilibrium and policies fail to immediately recover and boost incomes, wealth Zakat enables the distributive allocation that works independently of business cycles and help stabilize the extremes of business cycles.

When the personal disposable incomes decline in recessions, more people will become eligible for Zakat. Since Zakat is levied on both income and wealth, the redistribution of wealth will always be functional and operative in an Islamic economy due to wealth Zakat irrespective of

the phase of business cycle. Transfer payments to unemployed, poor, needy, debtors etc will continue when the economy faces a recession.

Besides this, a consistent and credible low tax rate policy with broader Zakat base will ensure in minimizing distortions, boost aggregate demand, encourage investment by decreasing costs of doing business and this could also simultaneously solve microeconomic problems of imperfection in markets by increasing competition and helping to reduce market power.

One possible question may arise here as to how such lenient tax rates would increase substantial revenue. If the government has a fiscal deficit of 6% of GDP when corporate tax rates are 35%; then, how can reducing tax rates increase the revenue? The answer to this is given by the Laffer curve. Dr. Arthur Laffer, a supply side economist, himself noted that Muslim philosopher Ibn Khaldun wrote about it in "The Muqaddimah".

Higher tax rates discourage entrepreneurship as they decrease the incentive to produce. Lower tax rates encourage entrepreneurship and hence increase the size of producing sector and hence production. With the increase in production, tax revenue in amount increases. Lower tax rates can still ensure high tax to GDP ratio. This is evident from Table 8 which lists countries with corporate tax rates below 20% and their tax to GDP ratio.

Table 7: Corporate Tax Rate & Tax to GDP Ratio

S.No.	Country	Tax to GDP Ratio	Corporate Tax Rate
1	Chile	17.1%	17%
2	Bulgaria	34.4%	10%
3	Czech Republic	36.3%	21%
4	Georgia	21.7%	15%
5	Greece	33.5%	22%
6	Hong Kong	12.8%	16.5%
7	Hungary	37.3%	16%
8	Iceland	40.4%	18%
9	Ireland	34%	12.5%
10	Kazakhstan	26.8%	15%
11	Netherlands	39.5%	20%
12	Poland	33.8%	19%
13	Romania	28.1%	16%
14	Russia	36.9%	20%
15	Serbia	34.1%	10%
16	Singapore	13%	17%
17	Slovakia	29.5%	19%
18	Switzerland	30.1%	13%-25%
19	Turkey	32.5%	20%
20	Uzbekistan	21%	12%

Source: International Tax & Business Guides- Economic Data – Statistics – Tax – EIU – The Economist

If this system is enforced with utmost sincerity by the government, along with the commitment of the general public and the public/private sector partnership, this can put an end to deficit financing. It could also result in price stability and improvements in living standards.

6.1. Effects of Proposed Zakat System on Property Market

If the tax (Zakat) program implemented as proposed, there will be a 10% income tax on the proceeds of sale of a property. The tax will be more if the property is kept than when it is sold. This will increase the supply of land that was not presented for sale before. The increase in supply will bring the prices of properties down. Hence, affordable housing and commercial facilities i.e. office premises, factories etc will come in the reach of consumers and commercial enterprises respectively.

A simplified numerical example is presented below:

Property value at t_0 : USD 1,000,000
Property Prices increase at t_1 by 10%: USD 1,100,000
If property kept at t_1 , 2.5% tax on property: USD 27,500
If property sold at t_1 , 10% tax on Gain : USD 10,000
Net Tax Gain: USD 17,500

If the property owner does not want to sell the asset and use it in future, but still wants to benefit from the fiscal incentive, he can give it on rent. It will be considered an investment and hence instead of wealth tax, 10% income tax will be charged.

Property value at t_0 : USD 1,000,000
If property given on rent @10%/year of property value
If property kept at t_1 , 2.5% tax on property: USD 25,000
If property rented until t_1 , 10% tax on Rent: USD 10,000
Net Tax Gain: USD 15,000

6.2 Effects of Proposed Zakat System on Investment

Private sectors including both local and foreign investors have an essential role to play in achieving the desired growth and development targets. The goal is not only to redistribute the pie, but to increase the pie is well.

The lenient tax rates will decrease the tax expense and free more resources for reinvestment and profit distribution among shareholders i.e. dividend. Lenient tax rates will help increase in the inflow of FDI. This will increase the competition and convert the major oligopolistic industries into more competitive industries.

It can be seen from fiscal models presented above that if any form of wealth i.e. property, fixed asset, cash etc is put into investment, its nature for fiscal treatment changes and tax saving of at least 2.5% results on the gross investment i.e. if there is no income on investment, 2.5% tax saving results and no income tax is paid since there is no income.

6.3 Effects of Proposed Zakat System on Equity Markets

With interest-based deposits discontinued, savers will have to make a choice between keeping their money idle and pay wealth tax or invest it in some asset and pay the tax only on income if it is earned. A simplified numerical example is presented below:

Value of Stock of Company A at t_0 : USD 100	
Stock Prices increase at t_1 by 10%: USD 110	
If no investment in stock or other assets	: USD 2.5
If stock sold at t_1 , 10% tax on Gain on Sale	: USD 1
Net Tax Gain: USD 1.5	

If the shareholder does not want to sell the stock, but still wants to benefit from the fiscal incentive, he can keep the stock and pay tax on dividend. Purchase of stocks for capital gain/dividend will be considered an investment and hence instead of wealth tax, 10% income tax will be charged. A simplified numerical example is presented below:

Value of Stock of Company A at t_0 : USD 100	
Company A is profitable & pays 10% dividend	
If no investment in stock or other assets	: USD 2.5
If stock kept at t_1 , 10% tax on Dividend	: USD 1
Net Tax Gain: USD 1.5	

Conclusion

Islamic economics literature is rich in welfare potential of Zakat, but very few empirical studies have undertaken the quantitative estimation of potential Zakat collection. In this study, we attempted to estimate potential Zakat collection at economy wide level to document the welfare potential of the institution of Zakat. In our estimation exercise, we attempted to estimate economy wide Zakat collection by including heads like Zakat on agriculture produce, value of livestock, tradable inventory, currency in circulation, foreign exchange reserves, estimated gold

and silver deposits, value of livestock and financial assets like investment in National Savings Scheme (NSS), mutual funds, stock market capitalization and pension schemes. Our estimates suggest that approximately Zakat collection in Pakistan could reach 9% of total GDP and the institution of Zakat system can also have positive effects on flow of investment, promoting entrepreneurship culture and making capital markets and real estate markets more competitive. At the macroeconomic level, we also discussed the role of institution of Zakat as automatic stabilizer and countercyclical support mechanism to deal with welfare issues.

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