

# The potential of zakat scheme as an alternative of microcredit to alleviate poverty in Bangladesh<sup>1</sup>

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## Abstract

This study assesses the effectiveness of Zakat as an alternative to microcredit in alleviating poverty in Bangladesh. Through the Propensity Score Matching (PSM) techniques, this study reveals that the impact of zakat scheme has proven higher than microcredit programs. Besides, this study also discloses that zakat scheme significantly increases both income and expenditure of the recipients in comparison to microcredit program. Hence, the study concludes that zakat based poverty alleviation program should be given more importance than that of microcredit program which virtually failed to bring any significant change in reducing poverty in Bangladesh.

**Key Words:** Microcredit, Poverty Alleviation, Zakat, Bangladesh

## 1. Introduction

Bangladesh is a developing country with high rate of population below poverty line. It was estimated that about 31 percent population of the country is living below the poverty line (Bangladesh Economic Review, 2013). It is also notable that the rate of poverty is higher in the rural areas compared to the urban areas (Bangladesh Economic Review, 2013). This impoverished community is facing multi-dimensional problems due to living in poverty. Researchers have identified some major factors behind this situation such as lack of literacy, income, skill building trainings, rural infrastructure, credit facilities and low productivity. It is due to the lack of access to the financial facilities that deprived them to

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engage in income generating activities (IGAs).

Commercial Banks of Bangladesh are yet to address the issue due to their rigid structure of fund management such as collateral system. Microcredit program in Bangladesh was evolved to provide financial support to the poor without collateral requirement. Under the microcredit program borrowers are provided small amount of loan for pursuing IGAs by the loan providers. In Bangladesh, both group based loan and individual loan system exist. Group based mechanism helps to ensure repayment through peer pressure. The repayment rate is very impressive due to strict monitoring and practice of weekly repayment system.

More than 90 percent microcredit clients in Bangladesh are women. It was expected that microcredit programs will positively affect the living standard in terms of income, expenditure, saving and employment generation. However, microcredit program although have shown some progresses but it could not bring any significant improvement in Bangladesh even after four decades of operation due to many inherent weaknesses. Microcredit program could not even reach the poorest of the poor of the society. There are many cases in Bangladesh where microcredit program not only failed to improve the living standard of the poor but also created a debt burden society due to higher interest rate. Mahmud *et al.* (2011) conducted a study on the fishermen in Bangladesh who took microloans for pursuing fishery activities and found microcredit program could not create any significant contribution to the living standard of the fishermen in terms of household expenditure. Studies were also conducted on the BRAC (Bangladesh Rural Advancement Committee) borrowers and observed that microcredit program had a positive impact on household income but the magnitude of impact was very small. Ahmed *et al.* (2009) mentioned in their study that BRAC program had failed to reach the ultra-poor in Bangladesh. Islam (2007) found that only one percent of the poor each year became successful in coming out from the poverty cycle. Hassan and Khan (2007) indicated that microcredit program had failed to stop the inequality in the society. Mesbahuddin (2010) mentioned that microcredit programs were largely dependent on the donors support and these programs ignited social and religious conflict in the rural areas. Garikipati (2008) noted that household income increased in some cases due to intervention of the program but the program failed to empower the woman due to patriarchal norms of the rural society in India. Momen and Begum (2006) criticized microcredit program

The potential of zakat scheme as an alternative of microcredit to alleviate poverty in Bangladesh for charging higher interest rate from the poor.

On the contrary, Zakat (Obligatory charity) is the only unique system which provides financial assistance to the poor community without any collateral and interest. Zakat is one of the fundamental principles of Islam (the religion based on monotheism of God). As per Islamic principle, an eligible Muslim (eligible in terms of financial capability) is obligated to provide zakat to the poor. Islamic philosophy establishes the fact that wealth is a kind of blessings of God which is supposed to be shared with the people who are striving with financial difficulties. Zakat is provided to the poor only for the achieving the grace of Almighty and thus, this system is heavily grounded on the ethical aspects of life. Unfortunately, both Muslim and Western scholars have disregarded the potential impact of zakat in poverty alleviation (Hassan and Khan, 2007). The potential benefit of zakat had hardly been explored. According to Hassan and Khan (2007), zakat funds can increase the potential of taxation of the government through improvement of productivity, employment and output. Based on the Islamic philosophy, MACCA (Masjid Council for Community Advancement) has been implementing poverty alleviation program by providing this zakat money to the poor households. It can be hypothesized that due to zakat support, the rural poor would improve their living-standard in terms of income and expenditure by pursuing IGAs properly. Thus, this study has intended to reveal inherent understanding about the following comparative questions.

- Did zakat system reach the poor people in Bangladesh?
- How effective the zakat system is in alleviating the rural poverty in Bangladesh?

This study addresses the answers of the above mentioned questions. Besides, the study assesses the impact of zakat fund from MACCA on the living-standard of the poor people (zakat recipients) in Bangladesh using econometric techniques and investigates relative worthiness of zakat system compared to the microcredit scheme. From the previous literature review, it is found that few studies are conducted in Bangladesh to assess the impact of zakat on the living standard of the poor. Thus, the findings of this paper contribute in social science research domain and initiates scholarly opportunity to rethink about the impact of zakat in poverty alleviation in Bangladesh.

## **2. The myth of poverty alleviation through microcredit – evidence from field survey on Grameen Bank**

Professor Muhammad Yunus started the microcredit program in 1976 in Bangladesh in a village called Jobra and then established Grameen Bank in 1983. Since then, a number of microcredit organizations started giving microcredit in the country to alleviate poverty. Currently, Bangladesh encompasses three World's largest microcredit organizations namely Grameen Bank (GB), Bangladesh Rural Advancement Committee (BRAC) and Association for Social Advancement (ASA) followed by more than 5,000 microcredit organizations.

However, although the expansion and financial success of the microcredit organizations are very evident in Bangladesh, the quality of life of the poor people remains unchanged. Thus, a survey was conducted to understand the impact of microcredit in our previous study. Results of field survey found that like many other development programs in Bangladesh, microcredit scheme has also failed to eradicate poverty among the target clients.

Microcredit facility was provided to the rural poor for increasing their household income though accelerating IGAs. Results showed that the amount of microcredit which was received by the borrowers had failed to create any significant impact on the household income. Lack of rural infrastructural facilities, lack of employment opportunities in the rural areas, inadequate training facilities for the borrowers, and small amount of fund for pursuing IGAs are some of the major reasons for such failure. Socioeconomic variables like age of the borrower, educational status of the borrower, loan number, years of borrowing, and number of children in the family had played a crucial role in determining household income.

The findings of the above study encouraged us to look for an alternative of microcredit to alleviate poverty in Bangladesh which is the purpose of this study. Looking at various options, zakat system is found as an alternative in this case although zakat has not been used in large scale in Bangladesh to fight poverty. Only very few small organizations are running zakat scheme to alleviate poverty in the rural Bangladesh. MACCA is such an organization and this study took them as a sample institution to investigate the impact of zakat on income generation as a mean to reduce poverty in rural Bangladesh.

### **3. Devising an Alternative to Alleviate Poverty using Zakat Scheme in Bangladesh**

Nadzri *et al.* (2012) mentioned that during the ruling period of the second Caliph Umar-bin-Khattab, zakat had been used as an effective tool to combat poverty and the poverty situation was drastically changed (entirely eradicated) in the Muslim world. They also indicated that due to the fall of Islamic empire and increasing influence of European colonialism, zakat instructions had lost its glory and became inefficient. The authors conducted another study on the zakat institutions in Malaysia for assessing its role in poverty alleviation and found inefficiency in distributing zakat to the poor, specifically to the hard core poor due to the problem of under staffing and wrong timing. According to the authors, collaboration with other organization such as NGOs, donor agencies, and microfinance organizations are required to improve the effectiveness of zakat institutions. Sarea (2012) considered zakat as the proper indicator of economic growth. According to the author, when the citizens of a country pay zakat, the economic growth would be higher and vice versa. The author also stated that zakat is such a financial system which assists reducing inflation rate, accelerating employment opportunity and thus, contributes positively in solving the social problems in the Muslim countries. Mesbahuddin (2010) opined that NGOs' micro-finance system failed to reach the extreme poor due to high interest rate, while zakat based Islamic financing system had provided instant capital to the poor at zero interest rate and also focused on social justice and equity. Hassan and Ahmed (2003) indicated that the benefit of zakat is need-based and it does not depend on contribution. The zakat system is based on the philosophy of solidarity among all the members of the society and hence zakat system can create a positive impact on the living-standard of the people. Shirazi (1996) identified several major problems in zakat collection and disbursement process in Pakistan which are (i) lack of information about the zakat organization, (ii) corruption of the official staffs, (iii) use of zakat fund for political uses, and (vi) inefficiency of the zakat institution in collecting zakat fund. Raquib (2011) considered zakat system as one of the most effective ways through which a huge amount of fund can be collected and utilized for poverty alleviating programs in the Islamic countries. The author showed that Islamic Banks in Bangladesh are operating banking activities combining with zakat and achieved a superior performance than the interest based conventional banking system. Mohit *et al.* (2011) mentioned that zakat fund collected by zakat board in Selangor province of Malaysia was mainly distributed

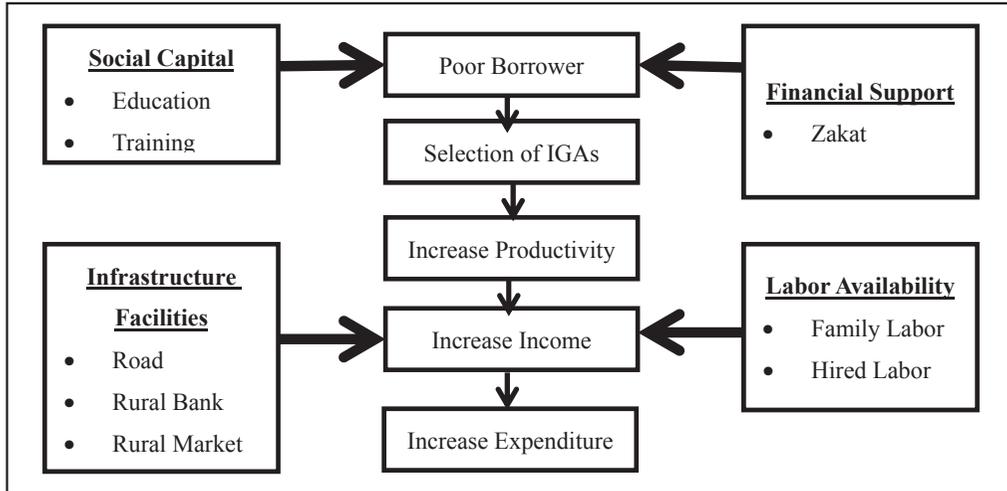
for the purpose of enhancing community and social development. The authors observed that housing program operated by zakat funding became successful in bringing benefit to the people. Thus, zakat has been effective in many Islamic societies. However, due to mismanagement and dishonest behavior of the Zakat managers, this program seems not so effective although several studies show that this program is still very effective.

### **3.1 Conceptual Framework for Alleviating Poverty using Zakat Scheme**

The beneficiaries under this study were poor. Due to poverty, they could not start IGAs despite having their adequate skills to engage in IGAs in the rural environment. They have very limited access to formal financial institutions. Zakat system will provide a unique opportunity for them to pursue IGAs properly as it requires no collateral and interest. The zakat fund would increase investment and risk bearing ability of the rural poor. This increased income would ultimately increase their purchasing ability leading to better quality of life. This system would also accelerate the employment generation opportunity for the poor household in the rural areas.

Besides zakat, there are other factors which are related to the ultimate well-being of the beneficiaries. It is expected that saving activities of the households should be considered carefully. Household investment activities and decision of selecting IGAs to a greater extent depend on the saving behavior of the households. Factors like household assets would increase the ability of the beneficiaries to invest in IGAs. Household assets of the beneficiary can be considered as crucial in determining their income since the risk management, investment and negotiation capability, to a large extent, depend on their asset-base. Family size plays a vital role in supplying agricultural labor for the production activities since hired labor is expensive. Lack of rural infrastructural facility is one of the major obstacles for the rural development in Bangladesh. Initiative to establish rural infrastructures (such as rural markets, roads, cold-storage, bank etc.) under the poverty alleviation program would assist the poor in accelerating their IGAs (Mahmud *et al.*, 2012; Mahmud, 2010 and 2011). The conceptual framework of poverty alleviation under zakat program is similar to that of microcredit shown in Figure 1.

**Figure1 : Conceptual Framework for Alleviating Poverty**



Source: Developed by author.

### 3.2 Methodology

Data were collected from the beneficiaries of MACCA, a small organization that collects zakat fund, distributes and manages. The lists of households were collected from the local office of MACCA in Manikganj district. Based on the list and simple random sampling technique, 250 households were selected as sample for this study. On the other hand, to compare the socioeconomic conditions and growth of the zakat recipients, this study also surveyed another 250 microcredit borrowers in the same area. The criteria followed to select the sample for this study were: (i) zakat recipient must be permanent resident of the village, (ii) must be involved in zakat program for the last three years, (iii) household income must be below 150 USD, and (iii) zakat recipients who did not take part in any other development program. The survey was conducted during the period of February to March 2013. Information was gathered from the zakat and microcredit recipients through questionnaires mainly focusing on the following aspects such as demographic characteristics, socioeconomic status, zakat management, opinion about zakat program and problems in participation in the zakat program.

In this study, Propensity Score Matching (PSM) technique is used. PSM is an econometric technique which solves the problem of selectivity bias. PSM technique was used by the other researchers for evaluating the impact of agricultural project in Bangladesh (Khan *et al.*, 2012 and Mendola, 2007).

### 3.3 Results and Discussions

#### 3.3.1 Descriptive analysis

Table 1 summarizes age of the borrowers which was grouped into five categories. Table 1 shows that majority of the zakat recipients were in the age group of 35 to 54 years, followed by 55 to 64 years, and 26 to 34 years age group. A smaller number of recipients were in the 65 and above years age group followed by 18 to 25 years group. On the other hand, microcredit providers preferred middle aged borrowers rather than the older groups. In this demographic categorization, microcredit organizations have been very effective to select the capable income generating poor people to disburse their microcredit loans. More than 80% of the total loan was disbursed among the relatively capable groups while for the groups that has more risk in succeeding in business were given the least preference. In this way, the poorest of the society did not get the opportunity to get microcredit loans. However, they received zakat funds as the poorest of the society are given preference in zakat disbursement.

**Table 1: Age of the Microcredit Borrowers and Zakat recipients (Number)**

| Age category              | Control Group<br>(Microcredit Recipient) | Treatment Group<br>(Zakat Recipient) | Total |
|---------------------------|--|--------------------------------------|-------|
| 18 to 25 (category 1)     | 10                                       | 10                                   | 20    |
| 26 to 34 (category2)      | 26                                       | 24                                   | 50    |
| 35 to 54 (category3)      | 181                                      | 160                                  | 341   |
| 55 to 64 (category 4)     | 37                                       | 37                                   | 74    |
| 65 and above (category 5) | 24                                       | 19                                   | 43    |
| Total                     | 278                                      | 250                                  | 528   |

Source: Survey, 2013 (conducted by author).

Table 2 summarizes the family size of the households (five categories based on the number of children). It was found that majority of the households were in category 2 followed by category 3 (See Table 2). A very few households had large family. In terms of size of crop land, the zakat recipients had smaller one compared to the microcredit receivers (See Table 3). The reason for microcredit organizations choosing the people with larger size of crop land is that if the borrowers fail to repay the loans, the organizations can force the borrower to sell that land to repay their loans. In fact, many poor people who sold their land to repay loan turned to zakat fund in the area under this study.

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**Table 2: Family size of the Microcredit Borrowers and Zakat recipients (Number)**

| Family size                      | Control Group<br>(Microcredit Recipient) | Treatment Group<br>(Zakat Recipient) | Total |
|----------------------------------|--|--------------------------------------|-------|
| 1 to 2 members (category 1)      | 16                                       | 29                                   | 45    |
| 3 to 4 members (category2)       | 156                                      | 110                                  | 266   |
| 5 to 6 members (category3)       | 78                                       | 91                                   | 169   |
| 7 to 8 members (category 4)      | 16                                       | 19                                   | 35    |
| 9 members and above (category 5) | 12                                       | 1                                    | 13    |
| Total                            | 278                                      | 250                                  | 528   |

Source: Survey, 2013.

**Table 3: Size of Crop Land of the Microcredit Borrowers and Zakat recipients (Number)**

| Size of crop land                  | Control Group<br>(Microcredit Recipient) | Treatment Group<br>(Zakat Recipient) | Total |
|------------------------------------|--|--------------------------------------|-------|
| 0 to 50 decimal (category 1)       | 16                                       | 29                                   | 45    |
| 51 to 100 decimal (category2)      | 156                                      | 110                                  | 266   |
| 101 to 149 (category3)             | 78                                       | 91                                   | 169   |
| 150 decimal and above (category 4) | 16                                       | 19                                   | 35    |
| Total                              | 278                                      | 250                                  | 528   |

Source: Survey, 2013.

### **3.3.2 Impact of Zakat on Household Income**

In this study, household income refers to the sum of all incomes earned by the households from pursuing farm and non-farm IGAs. Since most of the households under this study are poor, it is important to provide them financial and technological support for the purpose of improving their living standard through increasing their household income. MACCA provided training facilities and financial supports (in the form of zakat) to the poor household for increasing their investment capacity and skills on pursuing IGAs. It is much expected that household income of the zakat recipients would increase due to program intervention. This study shows that zakat recipients were benefited economically and their household income increased as compared to microcredit-participants. As it can be seen from Table 4, average monthly income difference between treatment group and control group was about 130 BDT (Bangladeshi currency). However, the income difference is quite small between treatment and control group which is approximately 2 dollars, but it is important to understand that the average daily

income is less than 2 dollars for the beneficiary groups. In other words, it can be said that zakat system is better than microcredit program in terms of average monthly income. Small size of the zakat amount, lack of rural infrastructural facilities, lack of proper monitoring by the field staffs may be thought as the major causes of small changes in income.

**Table 4: Impact of Zakat Program on Household Income**

| Variable | Sample    | Treated    | Controls   | Difference  | S.E.       | T-stat |
|----------|-----------|------------|------------|-------------|------------|--------|
| Income   | Unmatched | 10630.4184 | 12481.8487 | -1851.4303  | 602.787737 | -3.07  |
|          | ATT       | 10639.3697 | 10509.1345 | 130.235294  | 542.493887 | 0.24   |
|          | ATU       | 11930.0598 | 10523.761  | -1406.2988  | .          | .      |
|          | ATE       |            |            | -658.456033 | .          | .      |

Source: Survey, 2013.

#### 4. Conclusion

Microcredit facility was provided to the rural poor by the microcredit organizations for increasing their household income through accelerating IGAs. Our previous study found that the amount of microcredit which was received by the borrowers had failed to create any significant impact on the household income for various reasons. On the other hand, this study found that zakat system which ensures proper utilization of this zakat fund thoroughly pursuing IGAs properly is more effective than microcredit. This study reveals that zakat fund has more potential to improve the living standard of the poor in terms of household income compared to microcredit. However, this study also found that the magnitude of impact of zakat on the income is not significant in terms of amount of money. Some of the major causes behind such a small effect could be small amount of zakat fund, inadequate training facilities, lack of rural infrastructural facilities and lack of proper monitoring by the program staffs. In fact, zakat alone may not be much effective in reducing poverty of the rural poor unless an integrated development approach is practiced in the zakat based program. As far as the household income is concerned, it should be remembered that income is closely interlinked with other socioeconomic indicators such production, literacy, health care facilities, possession of assets, job opportunities in the rural areas, rural infrastructural facilities and economic policy of the government etc. Unless the improvement of these indicators is considered properly, income may not be

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increased to a substantial level. Ensuring educational facilities to the poor through both formal and informal ways, disseminating modern technology through increasing training facility, improvement of rural infrastructural facilities combining with the zakat support would assist in increasing the household income of the poor to a great extent.

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