UNLOCKING

THE POTENTIAL OF ZAKAT AND OTHER FORMS OF ISLAMIC FINANCE
to Achieve the SDGs in Indonesia
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Authors:
Francine Pickup (Deputy Country Director of UNDP Indonesia)
Irfan Syauqi Beik (Director of Centre of Strategic Studies of Baznas)
Greget Kalla Buana (Islamic Finance Specialist of UNDP Indonesia)

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ABSTRACT

Indonesia’s economy is growing and the country’s citizens are well known for their generosity, especially for religious giving—including zakat and waqf. Indonesia has an unparalleled opportunity to alleviate poverty and achieve SDGs using the untapped potential of Islamic finance and funds, as funding from the Government and international development partners alone will not be enough. In this regard, zakat and the other forms of Islamic finance (waqf, microfinance, sukuk) offer an important key to achieving the SDGs. The quest for the United Nations Development Programme, Baznas and partners is to bridge that gap by unlocking the abundant resources of the country’s private sector and religious giving.

Zakat, Islamic microfinance, waqf and sukuk are Islamic financing and funding instruments that can complement each other in eradicating poverty and promoting inclusive and sustainable economic growth. Zakat management in Indonesia has undergone major changes in approach and impact with promising results. Zakat can combine with other sources of Islamic finance to support entrepreneurship and expand financial inclusion. Waqf also is a charitable form of giving and is more flexible than zakat, which means it can be used for economic growth and income generation. While zakat, Islamic microfinance and waqf are largely charitable forms of funding, sukuk (Islamic bonds) are a commercial instrument that can attract financing to socially responsible development that also supports the SDGs.
Indonesia has an unparalleled opportunity to alleviate poverty using the untapped potential of Islamic finance and funds. This follows the global adoption of Agenda 2030 and the Sustainable Development Goals (SDGs), for which a universal agenda to “leave no one behind” aims to end poverty, reduce inequalities, and fully incorporate not only social goals but also goals of environmental and economic sustainability. Yet between US$3 trillion and $4.5 trillion is needed annually to achieve the SDGs, while current investment in relevant sectors is around $1.4 trillion, creating a financing shortfall of about $2.5 trillion.

The implementation of the SDGs is well underway in Indonesia with a Presidential regulation (Peraturan Presiden Nomor 59 Tahun 2017) on SDG implementation. Yet when it comes to financing, governments and international development partners alone cannot be responsible for the SDGs, leaving ample opportunity for increased and more effective philanthropic giving, social finance and private sector investment.

In this regard, zakat and other forms of Islamic finance (waqf, microfinance, sukuk) offer an important key to achieving the SDGs, by embodying socially responsible development, and by bridging opportunities for economic growth and social welfare, particularly for the poorest and most vulnerable.

Striking commonalities exist between zakat and other forms of Islamic finance, and the SDGs, with their common focus on alleviating poverty and hunger and reducing inequality by redistributing wealth. Zakat and the SDGs overlap in terms of the five foundational goals of Islam, namely, protection of:

1. faith, through reducing vulnerabilities, particularly to poverty, hunger, poor health, unsafe water and inequality (SDGs 1, 2, 3, 6, 10);
2. life, through eradicating food insecurity, ensuring healthy lives, tackling water scarcity, poor water quality and inadequate sanitation, ensuring decent work for all and making cities safe and sustainable (SDGs 2, 3, 6, 8, 11);
3. progeny, through promotion of peace and protecting the environment (SDGs 3, 5, 7, 11, 12, 13, 14, 15, 16);
4. intellect, by facilitating access to healthy nourishment and quality education to build human capital (SDGs 1, 2, 9); and
5. wealth, through generating economic activity and a social safety net (SDGs 1, 3, 8, 10).

Islamic finance also offers an underlying philosophy and rich partnerships that support the

SDGs. The Islamic finance industry is expanding rapidly, at a rate of about 10 to 12 percent annually.\(^5\) However, this extraordinary potential is largely untapped and overlooked, and has yet to be fully realized, even in Indonesia, as the world’s largest Muslim-majority country,\(^6\) in part because informal giving of zakat remains much larger than contributions made through formal Islamic organizations (e.g. Badan Amil Zakat Nasional (Baznas), the national zakat board; Dompet Dhuafa; Rumah Zakat; Pos Keadilan Peduli Umat).

Indonesia is exploring the connections between the SDGs and Islamic finance. An excellent start has been made: Baznas in mid-2017 extended its first contribution (US$350,000) to support the SDGs in Indonesia, focused on renewable energy.\(^7\)

The United Nations Development Programme (UNDP) in Indonesia, which promotes human-centred development to improve the quality of life for all, offers experience in strengthening institutions that are responsible for delivering services, as well as in reducing poverty through sustainable livelihoods programmes. It also offers access to first-class global resources, technology, knowledge and experience. UNDP is working with impact investing, crowdfunding and blended finance to support national and Islamic organizations to invest in development initiatives that benefit society, the economy and the environment alike, with an emphasis on communities and households in the greatest needs.\(^8\)

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5 Alawode, 2017.
6 A voluntary zakat system through formal organizations is currently in place in Indonesia.
2. **Zakat**: A Powerful Force for Wealth Redistribution Witnessing a Paradigm Shift

_Zakat_—mandatory giving comprising at least 2.5 percent of income or wealth—should be paid by every eligible Muslim earning above a certain threshold, transforming _mustahik_ (beneficiaries) into _muzakki_ (givers). Put simply, _zakat_ helps reduce poverty by redistributing wealth to all parts of society.

Globally, 22 percent of the population is Muslim, and Islamic finance, including _zakat_, reached an estimated value of around US$2 trillion in 2015, with assets of US$3 trillion expected by 2020. The worldwide value of _zakat_ alone is potentially US$200 billion to US$1 trillion annually.

In Indonesia, _zakat_ has shown a sharply increasing trend. More broadly, there are different estimations on the potential of _zakat_ in Indonesia. One study by the State Islamic University Syarif Hidayatullah, Jakarta, found the national potential of _zakat_ ranged from US$1.4 billion (Rp19.3 trillion) up to US$16.2 billion (Rp217 trillion), or 3.4 percent of Gross Domestic Product (GDP). Similar with the finding by Islamic Development Bank (IDB), the potential of _zakat_ in Indonesia alone is US$16 billion (Rp217 trillion). Yet only 3 percent of this potential was realized in 2017, as reported by Baznas, and informal giving remains the norm.

<table>
<thead>
<tr>
<th>Year</th>
<th>IDR (billion)</th>
<th>USD (million)</th>
<th>Growth (%)</th>
<th>GDP Growth (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>68.39</td>
<td>4.98</td>
<td>-</td>
<td>3.7</td>
</tr>
<tr>
<td>2003</td>
<td>85.28</td>
<td>6.21</td>
<td>24.70</td>
<td>4.1</td>
</tr>
<tr>
<td>2004</td>
<td>150.09</td>
<td>10.92</td>
<td>76.00</td>
<td>5.1</td>
</tr>
<tr>
<td>2005</td>
<td>295.52</td>
<td>21.51</td>
<td>96.90</td>
<td>5.7</td>
</tr>
<tr>
<td>2006</td>
<td>373.17</td>
<td>27.16</td>
<td>26.28</td>
<td>5.5</td>
</tr>
<tr>
<td>2007</td>
<td>740</td>
<td>53.86</td>
<td>98.30</td>
<td>6.3</td>
</tr>
<tr>
<td>2008</td>
<td>920</td>
<td>66.96</td>
<td>24.32</td>
<td>6.2</td>
</tr>
<tr>
<td>2009</td>
<td>1200</td>
<td>87.34</td>
<td>30.43</td>
<td>4.9</td>
</tr>
<tr>
<td>2010</td>
<td>1500</td>
<td>109.17</td>
<td>25.00</td>
<td>6.1</td>
</tr>
<tr>
<td>2011</td>
<td>1729</td>
<td>125.84</td>
<td>15.30</td>
<td>6.5</td>
</tr>
<tr>
<td>2012</td>
<td>2200</td>
<td>160.12</td>
<td>27.24</td>
<td>6.23</td>
</tr>
<tr>
<td>2013</td>
<td>2700</td>
<td>196.51</td>
<td>22.73</td>
<td>5.78</td>
</tr>
<tr>
<td>2014</td>
<td>3300</td>
<td>240.17</td>
<td>22.22</td>
<td>5.02</td>
</tr>
<tr>
<td>2015</td>
<td>3700</td>
<td>269.29</td>
<td>12.21</td>
<td>4.79</td>
</tr>
<tr>
<td>2016</td>
<td>5000</td>
<td>363.90</td>
<td>35.14</td>
<td>4.98</td>
</tr>
</tbody>
</table>

Table 1. **Zakat, Infaq, Sadaqa (ZIS) Collection in Indonesia (2002-2016)**

Source: Baznas (2017)

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12. A study by the Public Interest Research and Advocacy Centre (PIRAC), based on surveys in 10 major cities across the country, demonstrated that the average potential of zakat per individual giver rose some 60 percent between 2004 and 2007 alone, from US$31 (Rp416,000) to US$51 (Rp684,550).
13. The latter amount includes potential receipts from households, private companies and State-owned enterprises.
Between 2002 and 2016 zakat, infaq and sadaqa (ZIS) accumulation grew by 38 percent annually, far outstripping GDP growth (Table 1) and indicating a heightened level of public awareness to pay zakat through zakat management organizations or agents. In 2005 and 2007, ZIS accumulation grew by 100 percent each year following the tsunami in Aceh and the Yogyakarta earthquake.

Zakat can potentially play an important role in preventing poverty. However, a paradigm shift was needed in the management of zakat, moving from a focus on the charitable act of giving to its impact in expanding the rights of the recipients. A shift was also needed from individual spending on consumption for basic needs, to broader focus on productive activities.

In 2011, a new law was passed (Undang-Undang Nomor 23 Tahun 2011) mandating Baznas as the one national institution responsible for collecting, distributing and coordinating the management of zakat through 34 Baznas offices in provinces and 514 Baznas offices in districts and cities as well as through private zakat institutions. Since that time, Baznas has promoted a programmatic and professionally managed approach that goes beyond the predominant zakat model of one-time, individual consumptive donations for short-term needs. Now, the emphasis is on more sustainable approaches, such as student capacity building, training and the provision of initial capital for small and medium enterprises (SMEs). This principle of productive zakat seeks to empower the mustahik so that they can sustain sources of income in the long term.

Already, Baznas has benefited 6.8 million poor people, or 22.6 percent of Indonesia’s poor population. Of these, the overwhelming majority of mustahik (89 percent) are considered poor and/or needy (fakir/miskin). This has been achieved by dividing the disbursement of zakat into five major areas: economy, education, dakwah (proselytizing), humanitarian support and health (Table 2). Zakat distribution programmes implemented by Baznas range from Disaster Emergency Response and Baznas Active Service, which offers one-stop service to mustahik, within an estimated time of seven days, to the Baznas Cost-Free Hospital in six locations and Zakat Community Development (ZCD).

Baznas programmes are adapted to the needs of the community and may be productive, consumptive or both. For example, the economic sector aims at productive programmes, whereas the health sector is fundamentally consumptive; education includes scholarships (consumptive, for tuition fees and daily needs) as well as student and staff coaching (productive).

<table>
<thead>
<tr>
<th>Sector</th>
<th>Consumptive</th>
<th>Productive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy</td>
<td>√</td>
<td></td>
</tr>
<tr>
<td>Education</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Dakwah (Proselytizing)</td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>Humanitarian support</td>
<td>√</td>
<td></td>
</tr>
<tr>
<td>Health</td>
<td>√</td>
<td></td>
</tr>
</tbody>
</table>

Table 2. Classification of Zakat Allocation

Source: Baznas (2017)

15 Zakat is the wealth or property of persons of a certain standard, which, when it has reached or exceeded a specified amount, is commanded by Allah to be given to persons such as the poor and needy. Infaq is voluntary spending or disbursement of wealth or property by persons of any means, simply to please Allah, without any expectation of reward or return. Sadaqa means a good deed and is not limited to giving away wealth or property, but rather, can encompass a smile or pleasant speech.

The proportions of zakat distributed to the five sectors have shifted from 2015 to 2016 (Table 3), moving to longer-term purposes of education and the economy, and with short-term humanitarian assistance decreasing. The benchmark is not simply the number of zakat beneficiaries who have received assistance, but rather, the number of beneficiaries who have increased their standard of living after receiving zakat. In all, between 2015 and 2016 alone, productive zakat increased from 36 percent of Baznas distributions US$55 million (Rp2.1 billion) to 50 percent US$109 million (Rp2.7 billion).

### Table 3. Comparison of Zakat Allocations Based on Sector, 2015-2016

<table>
<thead>
<tr>
<th>Sector</th>
<th>Allocation 2015</th>
<th>Allocation 2016</th>
<th>Growth (%)</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total Fund (US$)</td>
<td>%</td>
<td>Total Fund (US$)</td>
<td>%</td>
</tr>
<tr>
<td>Economy</td>
<td>23,516,940</td>
<td>15.11</td>
<td>36,796,641</td>
<td>18.30</td>
</tr>
<tr>
<td>Education</td>
<td>32,243,880</td>
<td>20.72</td>
<td>62,908,955</td>
<td>31.28</td>
</tr>
<tr>
<td>Dakwah (Proselytizing)</td>
<td>22,653,582</td>
<td>14.56</td>
<td>31,227,910</td>
<td>15.53</td>
</tr>
<tr>
<td>Humanitarian Support</td>
<td>63,137,164</td>
<td>40.57</td>
<td>53,303,507</td>
<td>26.51</td>
</tr>
<tr>
<td>Health</td>
<td>14,080,970</td>
<td>9.05</td>
<td>16,865,970</td>
<td>8.39</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>155,632,164</strong></td>
<td><strong>100.00</strong></td>
<td><strong>201,103,134</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: Baznas (2017)

A good illustration of the potential of productive zakat is found in Langkat District, North Sumatra Province, where the giving of funds to fisherfolk has been accompanied by assistance to ensure the funds are used to buy boats or canoes for enhancing their work. Under this initiative, Baznas has prioritized five villages in the district’s coastal area (Secanggang, Selotong, Pantai Gading, Jaring Halus, Kwala Besar) and is focused on improving fisherfolk’s lives as a whole, particularly in the economic, education and health sectors.

Through Baznas’ ZCD, zakat and Government funds are being used for a comprehensive community development programme that includes productive activities such as procurement of fishing boats and support to marine product SMEs as well as consumptive activities including support to health clinics, scholarships, early childhood education, house renovation and assistive equipment for persons with disabilities. Altogether, 63 fisher families, or 285 persons, are expected to benefit from the programme, for which Baznas provided US$22,014 (Rp295 million).

*Zakat* funds are used to provide free healthcare services for mustahik (the poor and needy) at Rumah Sehat health centres across Indonesia. (Photo: Baznas)
In the same geographic area, zakat is being productively utilized through the establishment of Z-Mart and Z-Cafe to serve mustahik. Z-Mart—a minimarket with the concept of empowerment for the poor, both traders and buyers—is operated by 33 mustahik. Since its establishment in April 2017, the Z-Mart has increased its turnover, which now reaches US$223-300 (Rp3-4 million) per day, with an average profit of 12.5 percent and dividends to mustahik of 10 percent. Mustahik benefited from Z-Mart in the form of US$4 (Rp50,000) per person per day from sugar or rice wrapping activities, purchase of goods at a 30 percent cheaper price and from monthly wages of US$56 (Rp750,000) per person for working in the shop.

The collaboration between Baznas, Bank Jambi and UNDP on renewable energy also is working to eliminate poverty in Merangin and Sarolangun, Jambi Province. A poor area of the country, more than 1 in 7 of Merangin and Sarolangun’s people do not have electricity, compared to about 1 in 12 nationally. With zakat and Bank Jambi’s funding offered as part of corporate social responsibility (CSR), the partners are supporting establishment of four micro hydro power plants to raise the proportion of people benefiting from electrification and bolster rural livelihoods.

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**Picture 3.**
Z-Mart program in Bojong Gede Village, West Java Province, receives zakat funds to support the business managed by mustahik. (Photo: Baznas)

**Picture 4.**
Baznas provides zakat funds to a coffee peddler in Jakarta as part of its Economy programme. (Photo: Baznas)

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3. Impact of Zakat on Development in Indonesia

Despite its middle-income status, Indonesia still faces daunting development challenges. In the Poverty Profile Report in Indonesia issued by the Central Bureau of Statistics (BPS, 2017), March 2017, the poor comprised around 27.7 million of the country’s 261 million people, or 10.64 percent. The maternal mortality rate remains high, at 305 women dying per 100,000 live births, and the prevalence of malnutrition and under-nutrition in children younger than age 5 years is 3.4 percent and 14.4 percent.

Zakat can play a role in complementing Government assistance. For example, of the 28 million poor in 2014, 15.53 million received rice (Raskin) or Community Temporary Direct Assistance (BLSM). Equally, the possibility of overlapping targeting between the Government and Baznas is being addressed through data integration between the Ministry of Social Affairs and the Ministry of Home Affairs with the zakat body.

Impact of zakat is understood by zakat organisations both in terms of spiritual and material needs. Evidence shows that zakat has a significant impact on poverty (Tables 4, 5). Average monthly income among mustahik in all 13 areas rose 27 percent following the programme, from US$199 (Rp2,660,770) to US$241 (Rp3,231,438). This was above the average rise recorded in all families’ income. In some districts (Sumedang), income soared by as much as 119 percent, from around US$22 (Rp300,000) to US$59 (Rp800,000). Further, average material value and average spiritual scores also rose, by some 12 percent and 9 percent respectively.

Table 4. Average Spiritual Score of Mustahik After Receiving Zakat

<table>
<thead>
<tr>
<th></th>
<th>Average Spiritual Scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before Programme</td>
<td>3.84</td>
</tr>
<tr>
<td>After Programme</td>
<td>4.21</td>
</tr>
</tbody>
</table>

Source: Baznas (2016b)

22 According to data from the National Team for the Acceleration of Poverty Reduction, 2014.
23 According to the National Population and Family Planning Board, the indicator for prosperous family includes spiritual needs. However, the spiritual needs are not elaborated. Center for Islamic Business and Economic Studies developed a CIBEST Quadrant, which represents Islamic concept on poverty and prosperity, consisting four indices: welfare index, material poverty index, spiritual poverty index and absolute poverty index. The total value of those indices to be equal to 1.
24 Baznas, 2016b.
Table 5. **Average Income of Mustahik**

<table>
<thead>
<tr>
<th>No.</th>
<th>Monthly Income</th>
<th>Before Programme (Rp)</th>
<th>After Programme (Rp)</th>
<th>Impact (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Bandung Barat</td>
<td>1,678,791</td>
<td>2,059,585</td>
<td>22.68</td>
</tr>
<tr>
<td>2</td>
<td>Bantul</td>
<td>1,998,558</td>
<td>2,550,077</td>
<td>27.60</td>
</tr>
<tr>
<td>3</td>
<td>Tabanan</td>
<td>3,894,061</td>
<td>4,626,192</td>
<td>18.80</td>
</tr>
<tr>
<td>4</td>
<td>Sumedang</td>
<td>371,605</td>
<td>814,553</td>
<td>119.20</td>
</tr>
<tr>
<td>5</td>
<td>Sukabumi</td>
<td>3,516,859</td>
<td>4,237,977</td>
<td>20.50</td>
</tr>
<tr>
<td>6</td>
<td>Gresik</td>
<td>1,754,850</td>
<td>2,103,600</td>
<td>19.87</td>
</tr>
<tr>
<td>7</td>
<td>Semarang</td>
<td>2,188,077</td>
<td>2,882,885</td>
<td>31.75</td>
</tr>
<tr>
<td>8</td>
<td>Aceh</td>
<td>7,494,553</td>
<td>8,043,250</td>
<td>7.32</td>
</tr>
<tr>
<td>9</td>
<td>Nusa Tenggara Barat</td>
<td>4,464,753</td>
<td>4,964,753</td>
<td>11.00</td>
</tr>
<tr>
<td>10</td>
<td>Kutai Timur</td>
<td>2,471,800</td>
<td>3,948,828</td>
<td>60.00</td>
</tr>
<tr>
<td>11</td>
<td>Gorontalo</td>
<td>1,614,286</td>
<td>1,731,429</td>
<td>7.00</td>
</tr>
<tr>
<td>12</td>
<td>Sijunjung</td>
<td>1,590,333</td>
<td>2,014,917</td>
<td>27.00</td>
</tr>
<tr>
<td>13</td>
<td>Siak</td>
<td>1,551,482</td>
<td>2,030,648</td>
<td>31.00</td>
</tr>
<tr>
<td></td>
<td><strong>Average</strong></td>
<td>2,660,770</td>
<td>3,231,438</td>
<td>27.00</td>
</tr>
</tbody>
</table>

*Source: Baznas (2016a)*

Although no studies yet have examined the knock-on impact of the increased income on improving access to basic needs such as health care and education, such impact seems likely. The impacts of zakat are also seen in the growth in muzakki, although the numbers of mustahik have expanded as well (Tables 6 and 7).

Table 6. **Total Muzakki in Indonesia**

<table>
<thead>
<tr>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>700</td>
<td>33,492</td>
<td>28,033</td>
<td>56,837</td>
<td>119,332</td>
</tr>
<tr>
<td>Institutional</td>
<td>520</td>
<td>3,396</td>
<td>2,143</td>
<td>3,066</td>
<td>7,568</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,220</td>
<td>36,888</td>
<td>30,176</td>
<td>59,903</td>
<td>126,900</td>
</tr>
</tbody>
</table>

*Source: Baznas (2017)*

Table 7. **Total Mustahik in Indonesia**

<table>
<thead>
<tr>
<th>Year</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>428</td>
<td>20,557</td>
<td>9,487</td>
<td>42,270</td>
<td>104,145</td>
</tr>
<tr>
<td>Institutional</td>
<td>25</td>
<td>2,218</td>
<td>3,291</td>
<td>3,332</td>
<td>5,772</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>453</td>
<td>22,775</td>
<td>12,778</td>
<td>45,602</td>
<td>109,917</td>
</tr>
</tbody>
</table>

*Source: Baznas (2017)*

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26 Institutional muzakki are non-individual zakat payers, such as companies. Institutional mustahik are non-individual beneficiaries, such as communities.
4. Remaining Challenge to Zakat for Poverty Prevention

Despite zakat’s tremendous potential, numerous challenges remain. These include low awareness of the need to pay zakat despite its mandatory nature as a pillar of Islam and a wariness with regard to channelling funds through formal zakat institutions. This is exacerbated by the preference of most muzakki toward short-term, interpersonal offerings as well as by a low tax incentive for muzakki in Indonesia to pay zakat; muzakki are offered a tax deduction, which is subject to double payment, rather than a tax credit.⁷

Zakat should not be perceived as a corrective measure to reduce poverty, but rather, as a positive measure to redistribute wealth in order to prevent poverty (preventive/anticipatory).²⁸ When there are more poor people, the amount of zakat collected will not be sufficient. Thus, there exists no built-in, counter-cyclical increase in formal expenditures, which is the weakness of zakat alone as a poverty prevention measure.

Expanding access to the unbanked segment of the population is also a challenge. Nearly two in three Indonesian adults (64 percent) do not have a bank account²⁹, and have relatively low financial literacy and inclusion compared to other countries in the region. In 2016, the national financial literacy index stood at 30 percent—lower than both Malaysia and Singapore, at 65 and 98 percent respectively—and the financial inclusion index at 68 percent.³⁰ In addition, sharia financial literacy and inclusion were at 8 percent and 11 percent respectively.³¹

The introduction of zakat into the next generation of financial inclusion programmes offers the breakthrough required, providing a branchless banking system that will improve the process of collection and distribution of zakat. This can be complemented by technological advances through online banking and mobile money, which can make it easier for people to make zakat contributions, particularly through formal channels.

Improving efficiency and effectiveness in the performance of zakat institutions is also important. People must be convinced that giving through a formal organization is better than through informal networks. Moreover, the collection of zakat continues to focus only on zakat fitra (payment at the end of fasting during Ramadan) overlooking other types of zakat, such as zakat maal (an obligation applicable to all financial belongings, including from trade, agriculture, livestock, gold, silver and income). Greater trust, transparent and effective governance, and demonstrating impact are critical for zakat and to get closer to achieving its full potential.

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²⁷ However, a tax deduction cannot be obtained without a valid letter from Baznas demonstrating the zakat payment, as required by the Directorate of Taxation.
²⁸ Buana, 2017.
²⁹ Indonesia Financial Services Authority (OJK), 2016. National Survey of Literacy and Financial Inclusion (SNLIK).
³⁰ Ibid.
³¹ Ibid.
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fter receiving zakat as an initial lift, people may also need other forms of finance and capacity building to stay out of poverty, moving beyond survival to grow their livelihoods and businesses. Zakat can combine with other sources of Islamic finance to support entrepreneurship and expand financial inclusion.

Financial inclusion can be achieved through the following sharia compliant approaches: (1) redistribution of wealth, such as zakat, sadaqa, waqf and qard hasan, and (2) risk-sharing as a substitute for debt-based financing, through microfinance, small and medium enterprise financing and microinsurance.²²

Microfinance can support the poor³³ by contributing to productive activities, increasing revenues and savings, and allowing households to generate capital. However, microfinance generally charges interest rates higher than banks. For a Muslim community that prohibits paying interest, it is difficult to access microfinance.³⁴

Islamic microfinance offers interest-free contracts. There are three sources of finance: 1) Donations based on tabarru (a voluntary charitable action) can include zakat, infaq, sadaqa, waqf (an endowment made by a Muslim to a religious or charitable cause) and hibah (gift or donation); 2) Deposits including wadiah (safekeeping/custody/trust), qard hasan (benevolent loan) and mudarabah (a partnership where one party provides capital/funding, while the other party provides expertise/personal effort); and 3) Equity including musharakah (a partnership where each party contributes to the capital).

Among the several types of Islamic microfinance, some of the most popular include Islamic cooperatives and Baitul Maal wat Tamwil (BMT). The difference between the two is that BMT can encompass zakat institutions while Islamic cooperatives cannot collect zakat. BMT can play a financial role and also engage in capacity building. BMT consists of two bodies: Baitul Maal and Baitut Tamwil. It is owned by the community, collecting members’ deposits and redeemings them to the members through financing or credit products. The Baitul Maal seeks to collect funds from members of the community in the form of zakat, infaq and sadaqa, and to redistribute the funds to those entitled to receive them, or to loan to members who particularly need them due to financial distress, through qard hassan financing products (benevolent loan or zero-percent interest). At the same time, the Baitut Tamwil seeks to collect public funds in the form of principal savings, mandatory savings, voluntary and time deposits and grants.

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²² Mohieldin et al, 2011.
³⁴ El-Komi and Croson, 2013.
In several countries as well as Indonesia (Bosnia and Herzegovina, Islamic Republic of Iran, Pakistan, United Kingdom), *qard hassan* is being used to extend microfinance. In Aceh Province, Baznas acts as *Baitul Maal*, offering *qard hassan* as well as productive *zakat*.

A successful example is BMT Beringharjo in Yogyakarta Province. A *sharia* financial service was established in 2004 and by 2011 had accumulated assets of US$4.6 million (Rp62 billion), serving 30,000 people and with 110 employees. Analysis showed that turnover received by BMT members after financing by BMT Beringharjo (ZIS, investment) had increased, and SMEs that obtained financing expanded, with growing numbers of customers and workers.

In addition to BMT, Bank Rakyat Indonesia (BRI) also provides Islamic microfinance. BRI formed ‘village units’ to expand access and target the poor in suburban areas and has achieved high repayment performance.

Nonetheless, challenges again remain: Overall, Islamic microfinance requires both strengthened accounting standards and more qualified staff, while further efforts are needed to attract clients. A lack of institutional investor participation, as well as high administrative fees have kept *qard hassan* from gaining wider popularity in financial lending.

In addition to BMT, there are some good practices, which comply with *sharia*, that have been implemented in Indonesia. Amartaha.com in Jakarta is a fintech-based peer to peer, or person to person (P2P) lending for microfinance. Amartaha.com has been the pioneer of P2P lending for the unbanked community. It can reach people who live in the countryside and connect micro-entrepreneurs in remote areas with individual investors who are interested in both making profit and providing social impact.

Kredit Mesjid Sejahtera (Mesra) by BPR Kota Bandung was officially launched in August 2017. It channels credit through Islamic cooperatives, which are located in mosques around Bandung. The initiative came from the idea of mosque as the centre of economic growth.

Pembiaya Usaha Syariah (Pusyar) Islamic Rural Bank (BPRS) Kota Mojokerto is a third example. It is a collaborative project between PT BPRS Kota Mojokerto with Badan Amil Zakat Kota Mojokerto. It has provided capital financing using *qard hassan* (benevolent loan) contracts to Micro, Small, and Medium Enterprises (MSMEs) since 2012.

UNDP also has worked on Islamic microfinance in Palestine to support entrepreneurs to establish their own SMEs by providing technical assistance, business development, training, awareness and capacity building, and monitoring activities. UNDP Palestine, the Islamic Development Bank Group, and the Organization of Islamic Cooperation collaborate on this project that combines *waqf* with microfinance to support enterprise development.

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35 Umam, 2013.
36 Nurromah, 2015.
37 Maysita, 2012.
While the potential role for zakat is increasingly being harnessed for sustainable development, the role of waqf is less so. The guidelines on utilizing waqf are explained in the Qur'an Surah Ali-Imran: 92, “You will not attain virtuous conduct until you give of what you cherish. Whatever you give away, God is aware of it.”

Waqf is also a charitable form of giving and is more flexible than zakat while also being longer-term, and can be used for economic growth and income generation. Generally, waqf involves donating a plot of land, building or other assets for religious or charitable purposes, with no intention of reclaiming these assets. This land can be used to develop the local economy, such as through farming. Waqf has huge untapped productive potential in Indonesia, comprising land five times the size of Singapore (4,300 sq.km.), in 435,768 locations, and with a value of US$27 billion (Rp370 trillion).

At the same time, cash waqf is also growing. A key outcome from a recent panel discussion at a UNDP innovative financing event was that there is scope to consider using waqf as a social impact financing tool. Already, Badan Wakaf Indonesia (BWI), the Indonesian Waqf Board, has cooperated with various parties in managing waqf land productively. Among these are uses for plantations, livestock, hospitals and mining.

A good example of waqf land being used productively is Rumah Sehat Terpadu hospital. The hospital pioneered free healthcare for the less fortunate when it was established in 2012. Managed by Dompet Dhuafa, a humanitarian NGO, the hospital provides free healthcare for the needy and less fortunate, and has capacity to support 10,000 patients monthly. The hospital is built on waqf land and its operational costs are covered from zakat, infaq, sadaqa and waqf endowments. Opposite the hospital is Smart Ekselensia Indonesia, a secondary boarding school for less fortunate children from all over Indonesia, also funded through religious contributions. Similarly, Ahmad Wardi eye hospital in Serang, Banten, the westernmost province of Java, established by BWI and Dompet Dhuafa provides free of charge services to the poor.

UNDP Indonesia is working with BWI to develop a waqf digital platform to encourage waqf contribution for SDGs, raise awareness on the importance of giving waqf and promote trust in waqf management institutions. Since the Indonesian demographic composition is dominated by tech-savvy youth, waqf crowdfunding is expected to be a significant breakthrough, leveraging and scaling up cash waqf.

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38 Badan Wakaf Indonesia, 2016.
7. Beyond Zakat: 
Investment in Infrastructure with Sukuk

While zakat, Islamic microfinance and waqf are largely charitable forms of funding, sukuk (Islamic bonds) are a commercial instrument to attract financing. Unlike conventional bonds which are a debt obligation, the presence of underlying assets in sukuk is compulsory for it to be compliant with sharia. As sukuk grant partial ownership in the underlying assets, investors have the right to receive profits, meaning that selling sukuk is selling ownership of the assets. The value of assets determines the sukuk price, while conventional bonds pricing is based on a credit rating and the profits correspond to the fixed interest (riba) which is prohibited in Islam. Sukuk can capture both sharia and conventional consumers.

The issuance of sukuk is usually intended for general funding purposes or for financing infrastructure projects, such as dam construction, power plants, ports, airports, hospitals and toll roads. Indonesia is one of the few countries that regularly issues sukuk in the domestic market through a scheduled auction. Sukuk can leverage private finance for investment in infrastructure in areas where SME development is taking place thereby providing a local economic environment where SMEs are more likely to thrive.

The Government has issued retail sukuk at affordable prices to encourage financial inclusion. Central Bank of Indonesia, BWI, and Ministry of Finance are planning a waqf-based sukuk. It could be implemented under the scheme in which waqf lands are used for underlying sukuk issuance. In addition, the return of the sukuk could also be utilised for financing MSMEs through Islamic microfinance.

UNDP Indonesia supported the Ministry of Finance prepare to issue its first sovereign Green Sukuk in February 2018. This is the first sovereign green sukuk issued in dollars anywhere in the world. It followed a UNDP project to support the Ministry of Finance’s performance-based budgeting to integrate climate change mitigation and adaption within the Government’s planning and budgeting processes. This project helped identify the projects within the Government budget that could become part of the sukuk.

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Different forms of Islamic giving and commercial financing, while separate and with different rules governing their use, can complement each other when viewed holistically. After receiving an initial lift from zakat, other forms of finance, such as Islamic microfinance, can help people move beyond survival to grow their livelihoods and businesses. Cash waqf can be used to invest in micro and small economic activities through revolving funds for micro-enterprises as long as the initial value of the assets is retained. Moreover, financing instruments, such as sukuk can encourage investment to promote inclusive, sustainable economic growth. In this way, different Islamic funding and financing instruments can play an important role in poverty elimination and achievement of the SDGs.

As part of the move from funding toward financing for development, UNDP Indonesia has acquired much rich, in-depth knowledge and experience on different forms of innovative financing. Its new Innovative Financing Lab, conceptualised with Baznas and other partners in 2017, focuses on how to unlock and leverage new finance, including Islamic finance, to close the SDG funding gap. The Lab will design and test new financing instruments and help enhance investments for higher SDG returns, measure progress as well as evaluate impact. It also seeks to convene through a platform the different forms of Islamic finance and funds to support the achievement of the SDGs.

Overall, UNDP Indonesia can help zakat and other religious funding and financing organizations address poverty, inequality, and other areas of common interest that are outlined in the Maqasid al Shariah and SDGs. UNDP can assist with identifying the communities and households in greatest need, identifying key vulnerabilities, and how to overcome them in a sustainable manner. As waqf and zakat organisations seek to move to more productive approaches to poverty alleviation, UNDP can help identifying sustainable and inclusive interventions that promote entrepreneurship and local economic development.

8. How UNDP Can Contribute

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UNDP Indonesia seeks to extend its partnerships with Islamic finance organisations to design more impactful projects for which zakat, waqf and other religious funds and financing could be deployed. Further, the zakat funding can be used to attract additional financing, both from philanthropy and investment financing.

There is also scope to support religious organizations improve the governance and management of funds, which in turn improves trust and generates increased contributions through these formal channels. Technology, including digital and online technologies, can for example, play an important role in improving outreach as well as the collection and distribution of funds.


----- (2018). First in Indonesia: Zakat Financing Gives ‘Rays of Hope’ to Four Villages in Jambi. Available at: <URL:


