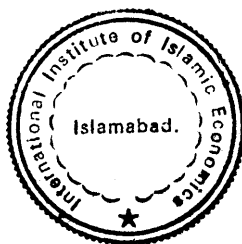


FISCAL POLICY AND RESOURCE ALLOCATION IN ISLAM

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A Theory of Fiscal Policy in an Islamic State

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INTRODUCTION

The present study attempts a theoretical exposition of the fiscal dynamics of an Islamic economy. In view of the absence of any empirical base in the modern world, the exposition relies heavily on the following techniques of analysis:

1. The norms and values that are relevant to and direct the economic aspect of individual and collective behaviour in an Islamic society have been spelt out in terms of their likely impact on the allocation, distribution and stabilization branches of public economics.

2. The behaviour of an Islamic economic system in the past has been taken as the datum for theoretical projection in future. In other words, the total absence of any empirical base in the modern Muslim societies has been partly compensated for by a selective adoption of the past Islamic societies, as the sample.

The use of latter technique could render the whole analysis anachronistic. But this has been avoided through the complex device of introducing the significant elements of current economic systems and integrating them, as far as possible, with an Islamic economy. This has helped us to visualise the future working of an Islamic economic system.

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The main elements of this theory may be summarised as follows:

1. Islamic economy has been characterised as a three-sector economy, namely, the private sector, the voluntary sector, and the public sector. The three sectors working in conjunction, furnish the institutional framework of an Islamic economy.

2. Zakah provides the base of the fiscal system and defines its scope of operation within the general institutional framework of the Islamic economy.

✓ 3. The allocation, distribution and stabilization functions of an Islamic economy are processed and implemented through all these sectors jointly.

4. Public sector's role is minimal but crucial in so far as it operates continuously to ensure an optimal allocation of community's resources, rectifies sub-optimal distribution of income, and introduces an element of stability.

Is a Fiscal Policy Possible in an Islamic State?

It has been argued in certain knowledgeable quarters of Islamic theorists that a fiscal system beyond what is defined by *Zakah* is un-Islamic. The argument relies on the sanctity of private property recognized by Islamic *Shari'ah* and contends that any compulsory government charge on it is patently unjust. Since taxes constitute the core of modern fiscal policies, an Islamic fiscal policy is contradiction in terms. A refutation of this assertion may be briefly stated in few paragraphs.

The socio-economic policy goals of an Islamic state are as follows:

1. Justice and equity.
2. Provision of the socio-economic needs of the community or socio-economic welfare.
3. Enhancement of the community's economic resources or economic growth.
4. Improvement in the cultural milieu of the community.

These policy goals have been derived from the Quran and *Sunnah* and implemented in the simple socio-economic system prevalent during the Prophet's (peace be upon him) lifetime and the Caliphate. Later, as the Islamic society became more complex, Islamic thinkers such as Al-Ghazzali,¹ Abu Ubaid,² Imam Yusuf,³ Ibne Taymiah,⁴ Al-Shaatbe,⁵ and others dealt with these policy goals and their implications and also

¹Abu Hamid al-Ghazzali: *Al-Mustasfa fi ilm al-usul* (Cairo: Maktabah al-Tijariah al-Kubra, 1937).

suggested appropriate devices for their attainment. Recent additions to this literature are extremely valuable in view of their contemporary relevance and modern exposition.⁶ We can take them as given and envisage the path along which the fiscal mechanism in an Islamic state is likely to operate.

It may be correctly argued that *Zakah* is the most important fiscal and distributive mechanism of an Islamic economy. But as pointed out subsequently, *Zakah* may generate certain incidental effects on the economy, which can be redressed only by an appropriate mechanism of secular levies. For instance, a situation may arise where *Zakah* levies may lead to such a diversion of resources that is not desirable from the point of view of general socio-economic goals of the society. To prevent this, an appropriate fiscal device may be required. Moreover, the policy goal of an Islamic society to alleviate poverty, may in certain situations, necessitate the imposition of subsidiary welfare levies. Later in this paper we have specified such situations.

The argument that *Zakah* receipt may sometimes fall short of resource requirements for welfare expenditure, has been recognized by the Quran itself inasmuch as it has exhorted the Muslims to expend voluntarily a part of their resources. Many Islamic thinkers have also taken note of it, as discussed in the following paragraphs. Although such situations may not ordinarily arise, they are nevertheless important in the context of many Islamic countries of today, where the phenomenon of mass poverty co-existing with a relatively small member of wealthy people may call for additional mobilization of resources. Moreover, equitable distribution of income in a situation where exogenous developments have led to an unprecedented rapid accumulation of personal incomes, may not be wholly attainable through *Zakah* levies alone. In such a situation *Zakah* may be interpreted as the

— Continued from page 28

²Abu Ubaid Qasim ibn Sallam: *Kitab al-Amwal* (Cairo: Al-Maktabah al-Tijariah al-Kubra, A. H. 1353).

³Abu Yusuf: *Al-Kharaj*, Al-Matba al-Salafiya.

⁴Abd al-Salam ibn Taymiah: *Al-Siyasah al-Shariah fi Islah al-Rai wa al-Raiyah* (Beirut — 1961) and *Al-Hisbah fi al-Islam* and *Al-Mawardi, al-Ahkam al-Sultaniah* (Cairo, 1960).

⁵Abu Ishaq Ibrahim al-Shatibi: *Al-Muwafiqah fi usul al-Shari'ah* (Cairo: Maktabah al-Tijariah al-Kubra).

⁶See for instance, Al-Qardhawi: *Fiqh al-Zakah* (Beirut—1969); Abu Said Mahmud: *Khutut Raisia fi al-Iqtasad al-Islami* (Beirut—1965); *Mustafa al-Sabi: Ishirakatul Islam* (Damascus — 1960); Syed Qutub: *al-Adalah al-Ijtimaiah fi al-Islam* (VII ed.) 1968; M. N. Siddiqi: *Islam ka Naziriya Milkiyat* (Urdu), (Lahore, 1968).

minimum rather than the maximum effort to alter the situation. But it seems probable on the basis of evidence recorded in early Islamic literature that a compulsory additional charge on such extraordinary income is permissible under Islamic law.⁷

The allocation function of the Islamic economy may also require an appropriately devised tax system. An optimal allocation of community's resources between different sectors of the economy and within each sector is likely to call for a tax policy geared to this need. Similarly, the allocation of resources along the time and spatial scale requires a judicious use of tax policy together with monetary policy and other regulatory measures. Economic welfare of the Islamic community may involve a more appropriate time and spatial allocation of its resources. The intertemporal allocation of scarce resources or their conservation in the interest of the Islamic collectivity through state conscription or public management has been alluded to in the Quran itself in the *Surah Yusuf*.⁸

The verses regarding *Fay* have specifically laid down an equitable intertemporal allocation of the *Fay* proceeds. Although initially all such proceeds were distributed without regard for the succeeding generations, Hazrat Umar changed this policy in respect of the distribution of the conquered lands of Iraq and Egypt.⁹ These lands were retained by the state not only to prevent concentration of wealth but also in the interest of future generations as the argument of Mawaz reveals.

⁷See, for instance, Ibn Taymiah *op. cit.* and Abu Yusuf: *Al-Kharaj*. Also see Abu Yusuf Yaqub ibn Ibrahim: *Kitab Al-Kharaj* (Cairo: Matba al-Salafiyah A.H. 1352) and also Abu Ubaid: *Kitab al-Awwal*.

⁸Al-Quran XII.

'And the harvest that ye reap, ye shall leave them in the ear except a little, of which ye shall eat.

Then will come after that (period) seven dreadful (years) which will devour what ye shall have laid by in advance of them — (All) except a little which ye shall have (specially) guarded.

Then will come after that (period) in which people will have abundant water, in which they will press' (wine and oil). (47, 48, 49).

⁹See for a brilliant exposition of the entire gamut of this issue: Siddiqi M.N., *Islam Ka Naziriya Milkiyat* (Urdu) (Lahore, Islamic Publications 1968). Also see Mohammad Baqar al-Sadr *Iqtisaduna* (Arabic) (Beirut; Dar al-Fikr, 1968).

An Islamic state may require additional mobilization of tax resources to: (a) regulate price movements; general concern of *Shari'ah* in this respect is reflected in its prohibition of speculative hoarding of essential goods, although specific instructions in regard to control of prices are absent for obvious reasons; and (b) to provide such goods as are imperative for the welfare of the society and cannot be left to the private enterprise. That the Islamic state is entitled to additional mobilization of resources, through *ad hoc* levies or other methods when and if the conventional resources of the state exchequers are not able to meet emergency requirements, has been ably argued by classical Islamic thinkers. During the *Aam-E-Al-Rimiadah*; Hazrat Umar is reported to have underlined the fiscal power of an Islamic state clearly.¹⁰

In a different context Ibne Hazam has also recognized the compulsive economic power of the Islamic state in extraordinary situations.¹¹

System Constraints on Taxation

The above analysis highlights the usefulness and necessity of a tax system to serve the socio-economic objectives of an Islamic state. An attempt has also been made to prove that it is permissible for the Islamic state to conscript resources to meet its ordinary and welfare expenditure. It will be argued, however, in the succeeding paragraphs that there are certain inbuilt constraints in the Islamic socio-political organization that prescribe the permissibility frontiers of taxation by the Islamic state. The limitation lies in the ideological-cum-moral parameters of an Islamic society and applicable to normal conditions only. It is these which point to an optimum level of taxation which, if exceeded, results in the diminution of aggregate socio-economic welfare of an Islamic society.

The permissibility frontiers of taxation, envisaged here are not quantifiable. Nor the optimum level translatable in terms of certain universally valid magnitudes. Abstracted from its quantitative implications the optimum level may be derived from two characteristically unique inbuilt system constraints of the Islamic economy. In the first place, the Islamic taxation policy will be so designed as to compensate or supplement the "resources gap" arising out of or incidental to *Zakah* and *Sadaqat*. It will not be an independent variable but a derived one.

¹⁰ Abu Ubaid: *Kitab al-Amwal*, p. 59. Mawaz is reported to have argued thus: "Then will come after them people who will defend Islam (to the best of their ability) and will find nothing. So consider the stand that suits the first and the last of them."

¹¹ See Ibne Hazam: *Al-Muhalla*, Vol. VI, p. 156.

Its dynamics will operate within the outer limits set by *Zakah* and voluntary contributions to the aggregate socio-economic welfare of the community. The Islamic taxation system will be an adjustment to the resource flow originating in these sources. An assessment of the "resource gap" thus left uncovered compared to the overall fiscal needs of the public authorities, given the socio-economic goals of the community and its stage of economic development will determine the quantitative aspect of the tax effort, and as a corollary thereof, its structure and rates. It will define the assessment base of direct taxation in so far as the equity and ability to pay considerations intrinsic to *Zakah* levies are not negated through a thoughtlessly conceived system of secular levies.

In the second place, Islamic tax system will be so structured as to fill in the 'objectives gaps' indicated by, or incidental to *Zakah*. It will serve to promote primarily the same ends for which *Zakah* has been levied. If certain aspects of the economic impact of *Zakah* tend to frustrate the general design of the *Shari'ah* and act to the detriment of economic growth, Islamic tax policy will be accordingly adjusted. For instance, if in full employment, or in comparatively rigid supply conditions, the transfer of resources exerts an upward pressure on the price level, taxation policy will be suitably adjusted to arrest the price spiral. Or if *Zakah* levies cause a sudden diversion of resources from savings to overspending, or from investment in *Zakah*-able to *Zakah*-free economic activities whose overall impact on the economy is likely to be detrimental to general welfare of the Islamic community, tax policy will have to be readjusted. Similarly, any difference in the burden of *Zakah* incidental to the rates applicable on varying forms of wealth-saving may result in an unbalanced intersectoral allocation of community's resources, say, between agriculture and manufacturing, the tax policy will have to take due account of it in so far as this unbalancing effect runs counter to the overall objectives of an Islamic society. On the other hand, if certain developments in the economy tend to frustrate the ultimate objectives of *Zakah*, taxes will be used to arrest or control them. A general inflationary rise in prices may be the case in point, as it releases forces that tend to increase the income disparities and distort the flow of resources.

This analysis, however, does not make the assertion that Islamic taxation policy will be a 'residual' exercise only. It does maintain, however, that it will be primarily a 'compensatory' policy or one that is complementary to *Zakah*. It will be clear as we proceed through this analysis that the Islamic taxation policy will nevertheless be

an effective allocative and distributive device pivoted to the central Islamic levy — *Zakah*. Somewhere it will appear to enjoy a comparatively freer hand. Even so, the general system constraint can never be lost sight of.

It may be argued, however, that 'resource gap' concept is inadequate for the dynamics of modern economy that involves a much wider scale of governmental economic activities which need financing on such a large-scale that render the 'resource gap' formula derived from *Zakah* impracticable. But this objection is not so formidable as it appears to be. In the first place, development finance depends only partly on taxation. Bulk of finance for public investment has traditionally come from non-fiscal sources of budgetary receipts, such as public borrowing, both internal and external, money creation, and income from economic activities of the state. In the second place, aggregate public expenditure in an Islamic society will necessarily tend to decline for many reasons. For one thing, an Islamic administration will be a less-expensive one in view of its distinctive cultural milieu. Secondly, it will depend, to a large extent, on private initiative for development. Thirdly, a sizable part of its welfare expenditure, will be met out of *Zakah*. Thus taxation will surely decline in importance, as a means of public budgeting.

Another significant system constraint taxation policy derives from the distinctive nature of the Islamic economy. Islamic fiscal policy conceived in the terminology currently in vogue, and with reference to modern fiscal theory, will be a fruitless and self-defeating exercise. It is imperative to have a clear vision of not only the value base of an Islamic economy but also to spell out its *modus operandi*. Without such an effort, we are likely to fall in line with other economists and paint the economic landscape of an Islamic society largely similar to that of a value-less and profit-based society.

Elements of an Islamic Fiscal Theory

An economy has to deal with four basic problems. The limited supply of productive resources leads to the problem of scarcity which involves a specific decision as regards the allocation of the available productive resources and the institutional means through which the desired allocation is to take effect. Closely linked to it is the problem of distribution which relates to the manner in which the 'real output' is divided among the various individuals and family spending units of a society. The attempt to increase the productive base of the society to bring about an improvement in the societal welfare over time, creates

the problem of economic growth and the institutional means through which it has to be vigorously pursued.

Contingent upon the devices chosen to tackle all these problems, economic disturbances of varying intensities occur, which require a set of measures, conveniently summed up as stabilization policies.

The nature of decisions taken by a particular society to effectively tackle one or all of these problems, and the institutional means already in existence or freshly designed for that purpose do not depend on only economic considerations of cost and benefit. Nor is there any degree of specificity associated with the economic targets or institutional means such that defy their total or partial substitution. A particular decision as regards the allocation of productive resources which determines both the volume and composition of real output to be produced and its division between the market or government sectors arises out of the preferences, values, and the political influence of various sections of a society. Similarly the distribution of effective demand between the various spending units of a society is vitally linked with a given state of income and wealth distribution and desire of the society to alter it.

It will be wrong to assume, therefore, that the superficial similarity of tools of economic policy used in different societies prove the "means specificity" of the economic issues stated above.

ISLAMIC ECONOMY : A THREE-SECTOR MODEL

✓ Modern economies offer two institutions to tackle the allocation and distribution problems, namely the market and the government. Alternatively, the two may be referred to as the private and the public sectors. Private sector is characterised by the forces of demand and supply, price and profit motive. The public sector acts not in defiance of the forces of demand and supply as reflected in the price phenomenon but as a corrective mechanism and as a supplement to it. In this sector profit motive is substituted by social welfare. In the so-called free enterprise economies, private sector is the prime allocative and distributive mechanism whose excesses, lapses and distortions are corrected by the public sector. The socialist economies reverse this role. Public sector is the prime allocative and distributive mechanism while the private sector acts as the minor partner in the process. However, an Islamic economy may be characterized as a three-sector economy. It will comprise of the private sector motivated by profit, the private sector free of any profit motive (the voluntary sector)

and the public sector. Alternatively, we may describe the three institutions as the market, voluntary economic institutions, and the government. The three-sectoral characterization of the Islamic economy derives from the value premise of an Islamic society which involves the voluntary flow of a sizable part of its total resources in such activities as are considered to attain the welfare of *Al-Akhira* but have significant economic implications for the society.

✓ To avoid confusion, it may be appropriate, at the very outset, to define the third sector. It encompasses all such individual and social activities, which are not by intent or design, undertaken to attain any economic or material benefit for the doer or doers, but generate wide ranging economic repercussions. Thus though some of these operations may appear outwardly similar to the private sector but are essentially different in object and conduct. For instance, the cash disbursement of *Sadaqat*, creation of *Auqaf*, organization of education and health services for the poor, contribution (voluntary) to state's defence needs, construction and maintenance of mosques, provision of shelter and meals to the way-farers and various forms of charitable activities fall within this sector. To this, we may add that part of *Zakah*, which may be left for assessment and distribution to the individual assessee — we mean *Zakah* on *Amwal-Batinah* (as specified, for instance, in recent Pakistan legislation). Empirical and historical evidence suggests that substantial economic and financial resources have passed through this sector in Muslim countries.¹² The volume of the economic resources flowing through the third sector will be a function of the state of *Taqwa* of an Islamic community. It will be, so to say, a barometer of the state of moral health of the *Ummah*. It will be distinct from the public sector inasmuch as it will be totally free from any element of compulsion. Even in an Islamic society state operation will in effect be compulsive in nature even if overall design may be decisively moral and religious. Moreover, there is nothing wrong if the public sector is actuated by economic benefit and aims at maximization of profit or of eventual social good. But the third sector will lose all, if it aims at economic benefits.

✓ The Allocation Function

The allocation function in an Islamic economy will be performed through each one of these institutions separately as well as jointly with each institution working complementarily to the other. But each sector

¹²See, for instance, Mustafa al-Sabi: *Min Rawa-e-Hadharatna*.

will operate in its own characteristic way. The market mechanism, however, will not be the only institution in the allocation branch. Its allocative function will be implemented through the price mechanism acting in conjunction with the profit motive. The pattern emerging out of the market mechanism will, however, be modified by the voluntary institutions operating through *Sadaqat* and non-profit economic activities of the economy. This modification may basically alter certain economic magnitudes and flows.

In the first place the allocation of sizable monetary resources through the voluntary institutions may increase private expenditure in some crucial avenues of productive activity where the market fails to operate. For instance, it is likely to increase private expenditure on the production of goods and services beyond the equilibrium indicated via the equality of marginal revenue and marginal cost. In modern market based economies such a shortfall in production is compensated by supplementary public expenditure. It may also channelize privately-owned savings in such avenues that do not indicate a reasonable rate of return to private investment. As an illustration, we may cite the production of coarse textile fabrics. The profit motive of the private businessman prevents him to expand his supplies to meet the full societal requirements. For such an expansion is likely to exercise a downward pressure on prices, thereby reducing the reasonable rate of marginal return, a calculation not wholly based on objective cost assessments but partly derived from subjective evaluation of what constitutes a reasonable rate and the expected rate of return in alternative investment. The second case may be illustrated through the provision of rent-free schools, development of shrines etc. Thus voluntary institutions may do two specific things. They may make-up the shortage of output of goods and services which the market fails to do, and secondly invest in such avenues as do not attract private capital motivated by profit.

Public and Quasi-Public Goods

Modern economists usually classify goods into two separate categories, namely, private goods and public/social goods. The latter defined as those economic goods which the entire community consumes, and in whose respect cost and revenue calculations are not possible on account of the indivisibility of benefit derived therefrom. For instance, defence is a public good. Radio and T.V. networks are other examples. It will be more appropriate, however, to define public goods not on the basis of the indivisibility of the benefit derived there-

from but on the basis of their being non-profit goods, that is to say, goods required by the society whose benefit is not translatable in terms of economic revenues. For example, investment in education, science research, health, certain items of social overheads etc. In all modern economies production of public goods is usually reserved for the state. The state ensures allocation of a part of the community's resources to the production of public goods, usually through conscription, or borrowing. In an Islamic economy, however, the voluntary institutions will play a significant role in certain areas of public and quasi-public goods. Private resources may be passed to the state for some activities, or may be directly expended on their production. For instance, education is one important area where considerable private resources may flow without the scantiest regard for a reasonable rate of return. In this respect it may be pointed out that religious, general and scientific or technical education are all treated at par insofar as they jointly improve the quality of a Muslim community and its prowess. That is the reason why all knowledge has been strongly recommended by the Prophet's tradition as the goal of the *Muslims*. Next is the provision of health. The care of the diseased, incapacitated, weak and poor is necessary. Thirdly, defence may also claim sizable part of resources channelized through the voluntary institution. We may, therefore, envisage that in an Islamic economy voluntary institutions will provide not an inconsiderable part of the resources required for the production of public and quasi-public goods and services.

Gross National Output and its Composition

The voluntary institutions will exert a direct influence on consumption and national output. The disbursement of accruals from *Auqaf*, *Zakah* and *Sadaqat* to those who do not have financial resources to buy certain goods/services in desired quantities are likely to enter the market and thus raise the money demand. With higher marginal propensity to consume, the receivers of these funds are likely to spend proportionately greater part of their income on consumption. Given excess capacity and unemployed resources, this phenomenon may release forces that increase output of such consumption goods as enter the poor man's budget. That may result in a different pattern of intersectoral and intrasectoral allocation of resources and alter the composition of society's output. It is obvious that the resultant change in the composition of output will be in favour of poor man's goods and services. This will be an indirect allocative impact of the voluntary institutions which will express itself through the market.

Optimum Allocation

An optimum intersectoral and intrasectoral allocation of resources is a desirable objective of every economy. The market mechanism fails to bring about a desirable pattern of intersectoral allocation of community's resources for the obvious reason that it acts on the basis of profit – the only relevant factor in its behaviour. Its decision as regards the priority of investment in different sectors may not coincide with the optimum required by the sum total of socio-economic benefits or costs. Any deviation from this optimum is corrected by the state both through regulatory techniques and direct participation in the economic process. In the three-sector model we have presented above the distortions emerging out of the market mechanism will be rectified by the voluntary institutions as well as the government. We have already indicated above that an allocation pattern weighted in favour of luxury goods/or comforts will be suitably altered by the activities of the voluntary institutions. Thus within the industrial sector (intrasectoral) itself an altered allocation of resources may be brought about. As between industry, agriculture and services, the allocation emerging out of the market will be similarly modified. We have already discussed above, the way in which social services will attract not an inconsiderable part of resources flowing through voluntary institutions.

Role of the State

It may be safely asserted that a significant part of the role associated with government in correcting distortions or deviations from the socially optimum allocation of resources will be taken over by the voluntary institutions. Even though minimal, the government's role will not be in any way less important. First, the government may alter the pattern of voluntary institutions' expenditure through its educative effort. It may provide the necessary information in respect of the needs of the poorer classes, expend a part of the resources handed over to the public sector in accordance with its own assessment of priorities, alter the time and spatial distribution of *Zakah* and *Sadaqat* resources, use or cause to be used a part of these resources in directions where the play of market forces has resulted in supply deficiencies. As indicated above the voluntary institutions' economic behaviour is likely to change the market allocation of resources through its impact on consumption demand. But the government sector's allocative function will not be limited to indirect or complementary/supplementary measures. Its allocative function will also relate to direct public expenditure in those avenues where neither of the two sectors, jointly or separately, are able

to enter, or where supply deficiencies require a larger share of community's resources than that allocated otherwise. It may also involve the removal of sectoral disparities generated through the economic activities of the two sectors.

Deviations from, or failure to attain, the socially optimum allocation of resources will, therefore, be corrected by the government sector. Although such a failure of the market mechanism may be partly compensated by the voluntary institutions in an Islamic economy, gaps are still likely to remain for the reason that this sector too, by reason of its individualistic approach, will fail to take a total view of society's economic and social needs. Although proceeding from different value premises, and working under different assumptions, both the market and voluntary institutions may result in socially sub-optimal allocation of resources. An example may help in understanding this situation better. Roads connecting the market with the production point may be translatable in terms of cost/revenue calculation of an entrepreneur. But roads connecting far off villages to the town are most likely to be excluded from the list of profitable investment of the private sector as well as the voluntary institutions evaluation of what is useful for the under-privileged in the society. Similarly industrial projects with long gestation periods are likely to attract much less capital than necessary. Hence, the government sector will be required to step in.

Given its concept of social welfare, and given its value premise the Islamic economy will decide the mix of its resource allocation between the three sectors. Where and if, the actual and optimum intersectoral allocation of resources do not coincide, the government will strive to correct the intersectoral imbalance of resource allocation through the devices indicated above as well as taxes. Contemporary discussions of optimal intersectoral allocation of resources, may be traced back to Hansen and Galbraith.¹³ Hansen contends that public sector should be used to promote the educational and cultural development of Americans, the "submerged tenth". He believes that economics in a mature society should emphasize social priorities rather than goal of maximum national output. Galbraith asserts that due to traditional bias against public sector spending and what he calls a "dependence effect" there has been an under-allocation of resources to the public sector. This discussion, however, does not indicate a theoretical principle which

¹³See Alvin H. Hansen: *The American Society* (N. Y. McGraw Hill Book Co., 1957); and John K. Galbraith: *The Affluent Society* (London: Andre' Dentsch 1977).

may guide an optimal allocation of resources, except that of relevance of social objectives. The attempt made by some economists to work out a precise formula of resource allocation through the indifference curve technique is at best arbitrary. The production potential of the society, as determined by its resources and technology is brought into a relevant relationship to society's preference for public and private goods, as made effective by the state of income, wealth and political choice and shown through an indifference map. But that is an effort which proves conclusively that no criterion based on "value free" marginal analysis of a universally valid optimum intersectoral allocation of resources is possible. The Islamic economy will determine the optimal allocation of resources between three sectors with reference to its social norms and value premises. Its guiding principle will be the maximization of aggregate social welfare which has both a material as well as spiritual dimension.

An optimum allocation of resources in an Islamic economy may be defined as the one that establishes an equilibrium between the moral and economic imperatives of the society, given its income, and the state of technology. As indicated above moral imperatives will be primarily taken care of through the voluntary institutions, while the institution of market will reflect its economic imperatives. The public sector will not only supplement the economic activities of the two but will also act in a way calculated to ensure a better performance by both. In addition to this aspect of the government's economic activities, the allocation function of the public sector will also involve direct public expenditure to help the economy reach the equilibrium indicated above.

Figure 1 shows an optimal allocation of resources between the private sector and voluntary sector. The public sector has been shown on Y axis together with voluntary sector. S_1 , S_2 , S_3 are social indifference curves. The point where S_2 is tangential to production possibility curve AB is that of optimal allocation. The distribution of resources shown in Figure 1 has only an illustrative significance. It is subject to change in response to the general economic and technological requirements on the one hand, and the state of moral consciousness of the Islamic society on the other.

The Distribution Branch and Islamic Economy

Although in an Islamic economy the distribution function will be performed through the activities of the voluntary sector aided and sup-

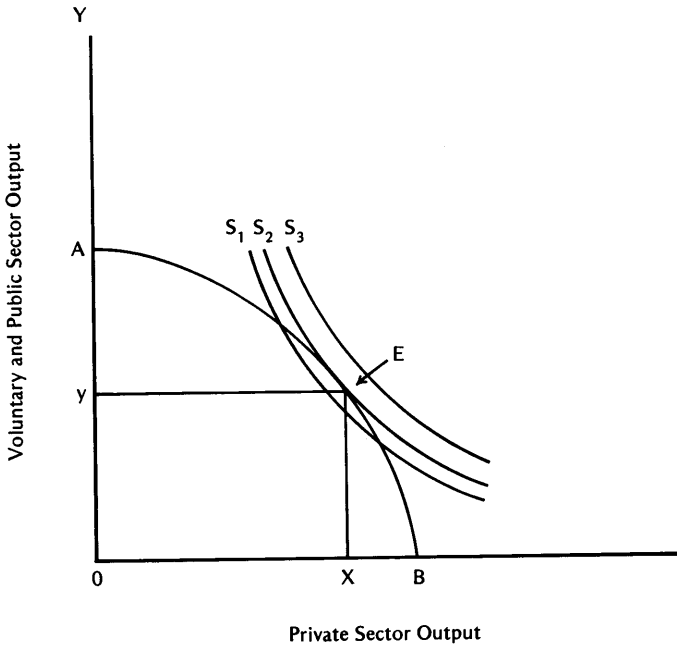


Figure 1: Optimal Intersectoral Allocation of Resources in an Islamic Economy

plemented by government operations but for purposes of the present analysis, let us assume that most part of *Zakah* resources – the chief distributive device – are imbursed through the state. Thus distribution function may be initiated through any facet of the government budget ranging from expenditure policies to various forms of government revenue-gathering activities.

The main objective of distribution function may be achieved through either an exhaustive public expenditure programme or a scheme of negative taxes and/or transfer payments or other secular taxes on income and wealth. Since *Zakah* proceeds are envisaged as the principal redistribution mechanism in an Islamic economy and since it is traditionally a form of transfer payment let us start with it.

Zakah as Negative Tax

The transfer of funds between individuals through *Zakah* disbursements or other taxes may redistribute real income amongst the members of the society via the redistribution of purchasing power. *Zakah* payment may be conceived of in terms of what is described as

a "negative tax". Under the concept an individual is considered to be capable of making a positive tax contribution to the government if his personal income exceeds poverty level but is considered eligible to receive the negative transfer of funds from the government if his personal income is below a designated poverty level of income. Under *Zakah*/transfer payment the government may similarly designate a poverty line based on current living standards and make payment to those individuals whose income falls below the poverty line so designated. But the calculation of such eligibility will be more complex in an Islamic scheme of things. Any poverty line designated with reference to current standards of living will have to be adjusted in the light of *Zakah Nisab*. *Nisab* allows for a dynamic interpretation in terms of cost of living index and reasonably defined current standards of living.¹⁴ But sometimes there is a loose link between current incomes which fall short of needs and one's saving in terms of gold/jewellery, which exceed *Zakah Nisab*. Hence, the disbursement of transfer payments, will have to take into account both of these aspects of the situation.

A 100 per cent payment* of transfer/*Zakah* funds to bring individuals above the poverty line may have to be revised for its likely disincentive effect on work effort. Thus a trade-off may necessarily arise between the goal of alleviation of poverty and protection of work efforts. In case 100 per cent transfer/*Zakah* payment conceived as negative income-tax to bring individual above the designated poverty line involved an expenditure in excess of *Zakah* proceeds, a trade-off may inevitably arise between the goal of mitigation of poverty, preservation of labour incentive and loss of revenue. In that situation a 40 per cent or 50 per cent payment may be considered as sufficient.

Exhaustive Public Expenditure and Redistribution Function

Modern governments have the option to redistribute real incomes either through transfer payments or direct availability of certain important quasi-public goods to the poor. A mix of both the approaches, however, is a realistic policy goal. There are some pertinent questions that arise in this respect when we proceed to analyse the approach of an Islamic state to its distributive function. As we have seen above *Zakah* disbursements in the form of transfer payments/or negative

¹⁴ See al-Qardhawi, *op. cit.*

*A 100 per cent payments means payment to the full extent of the difference between one's income and the poverty-line level (Editors).

income-tax have traditionally been considered valid. But the formulation of an exhaustive public expenditure programme intended to make available to the poor certain important public or quasi-public goods financed out of *Zakah* revenues is received with mixed feelings by Muslim scholars. At any rate, two forms of public expenditure programmes for the poor are universally approved. These are education and health programmes. Educational programmes not only improve the ideological and cultural receptivity of the poor but enhance their income-earning capacity as well. Empirical studies have conclusively proved a positive functional relationship between human resource development and aggregate economic performance of a nation/community/group of people. The tendency of the market to under supply education stems from its nature of being a quasi-public good, that is to say, a good whose benefits defy easy quantification or pricing. But increase in the supply of education to the poor has a redistributive role as well. If free of charge, it confers direct financial benefit on the recipient and ensures future financial returns in terms of increased earnings. In this regard technical education is of greater importance. It benefits the poor more by increasing their skill and income earning capacity.

An Islamic state's distribution function may, therefore, be performed through an expenditure programme of education, medicare, medicare facilities. These items belong to allocation as well as distribution branch of fiscal economics. But direct provision of a number of private goods, such as textiles, shoes, medicinal drugs, etc., free of cost or at cheap rates to the poor, and financed out of *Zakah* funds are also permissible from the *Shari'ah* point of view.

✓ Stabilization Function and Islamic Fiscal Policy

If we assume that Islamic economies are expected to belong to that part of the present world which is characterized as underdeveloped, many of the destabilization problems, such as the deflationary or inflationary gaps of the intensities experienced by advanced economies will not be relevant. Still some such problems as monetary inflation, temporary recession may be experienced depending upon the financial organization of the Islamic economy.

If the Islamic economies opt for a fractional reserve monetary system, where banks have the power and ability to create bank money, excess credit situations may occur. The substitution of interest by *mudarabah* or profit-sharing and consequent restructuring of the capital market, are expected to establish a direct link between bank money and

productive investment. But the urge of the banker to seek more and more avenues of investment will still be there, with the significant difference that he will be directly exposed to losses, if the investment is not profitable in the strictly economic (not financial) sense. It is sometimes argued that such a direct involvement is most likely to dissuade the banker from excess credit creation since marginal investment may be highly risky. But the fact that bank portfolio may be quite wide ranging and that losses in some investments may be absorbed partly by the cushion provided for this purpose, and the specific provision in terms of reserves may insulate the shareholders from shock of losses, may still encourage the banker to create excess credit. Any amount of credit that does not correspond to the real resources elsewhere in the economy may generate inflationary pressure. To this urge we may add differing interpretations of what is an economically profitable investment. The banker, intent upon maximizing the earnings of his shareholders, may include not only productive investments in his list of sound investment projects but quite an impressive schedule of commercial transactions as well, which do not add an iota to GNP. In the absence of speculative transactions involving bonds and stocks, wide fluctuations in market conditions are not feasible. Hence such investments will continue to be attractive. Thus bankers in an Islamic state may also be prone to excess credit creation. Financing of public expenditure through the printing press, or bank borrowing (free of interest) may accentuate the inflationary gap.

Zakah collection and its disbursement may act as effective stabilizing agents against such a situation. *Zakah* levies even though not directly connected with current income will, in effect, constitute a charge on it. With fixed rates, *Zakah* levies will, therefore, constitute an inbuilt fiscal stabilizer. *Zakah* disbursements, however, may work as discretionary fiscal stabilizers as well, with the government managing it as it does the transfer payments, or exhaustive government expenditure programme.

It may, however, be pointed out that because of the *Zakah* rate and base being given, it may not be adequate to the needs of the situation in some periods. In that situations, other taxes, whose rate may be varied, and transfer expenditure, which are not financed out of *Zakah* may be used to that effect.

A comprehensive set of fiscal measures appropriate to an Islamic economy may be designed to remedy such a situation. The elimination of modern varieties of purely financial papers and speculative trading in them, will exercise a restraining influence on excess money supply. In addition, the state may devise discriminatory penal taxes on some

investments and business that exert relatively higher destabilizing effect on the economy. Moreover, it may decrease/increase public expenditure depending upon the needs of situation.

Comments

Dr. Muhammad Uzair

The paper by Dr. F. R. Faridi is an excellent attempt to present the fiscal policy of an Islamic state in a scientific manner. In the very beginning the learned author summarises the basic elements of his theory, namely: (a) the three-sector economy, i.e. public sector, private sector and voluntary sector; (b) *Zakah* as the basis of Islamic fiscal system; and (c) the functions of Islamic economy defined in terms of allocation, distribution and stabilization. In connection with methodology he explains that the source of guidance is the experience of the early stages of the Islamic state and the writings of the jurists. Later in the paper he develops his three-sector model. While elaborating the three sectors he also mentions the motivations of the respective sectors. The motivation of the private sector is *profit*, while the motivation of voluntary sector is the fear of Allah Almighty (*Taqwa*) and reward in the life-hereinafter (*Al-Akhira*). However, he does not clearly specify the motivation of public sector and its implications. It would seem to include the 'compensatory' or 'balancing' role. It may be pointed out that the public sector, as it is prevalent in the modern times, would also have an angle of 'welfare' besides regulation as its motivation.

With regard to the fiscal functions of an Islamic economy, the learned author confines his treatment to allocation, distribution, and stabilization functions. Stabilization function has been taken to include the problem of inflation. However, sufficient justice to the problem of inflation has not been done, while the more recent phenomenon of 'stagflation' has not been touched. Perhaps he does not deal with inflation because the problem was not there in the early period of Islamic stage from which he derives his theory. However, the demands of the present day are such that the problem of inflation is going to be with us for quite sometime. Another important omission with regard to the functions of Islamic economy, is the problem of 'growth'. The learned author has not given due place to the problem. It has been accepted as an important objective of fiscal policy and a function of the present day states. Moreover, unlike inflation, there does exist the importance of this objective in the Islamic literature as well as in the early days of Islamic history. In fact, the term *Zakah* itself includes the connotation of growth to which the author has not paid much attention. Moreover, the objective of economic growth and betterment has been recognised as a proper desire and need of indivi-

duals. The motivation of betterment has been mentioned in the Holy Quran in terms of endeavour to seek the bounty from the Allah Almighty (*Ibtigha Min Fadlillah*). This occurs in several places in the Holy Quran. Moreover, there are some *Ahadith* of the Holy Prophet (peace be upon him) wherein people have been advised and encouraged to use the funds and assets for income generation so that these are not exhausted and depleted through the process of *Zakah*.

While enunciating the principles of fiscal policy and its tools, there is a mention of taxation. However, problems of public borrowing, programmes of public expenditure etc., have become an integral part of fiscal policy today, and cannot be brushed aside. The learned author has not devoted much attention and space to these problems. The author has paid some attention to permissibility of taxation other than of *Zakah*. This was not really needed because there is not much dispute left now with regard to permissibility of taxation other than *Zakah*. Later he mentions that *ad hoc* levies or imposts for supplementing welfare expenditure for defence purposes are administratively difficult to operate and also uneconomic. This can be questioned. There are precedents of special donations demanded by the Prophet (peace be upon him) for the purpose of defence. However, in more recent history we have examples of special levies and imposts, by secular governments, during and immediately after war — the World War II. These were not only operationally successful in raising funds but also economically helpful in mopping out excess liquidity with the trade community because of inflation. He maintains that taxes other than *Zakah* would not be 'residual' but 'compensatory' in terms of Islamic economics. In this regard he indicates the resource gap as a basis for taxes other than *Zakah*.

Dr. Faridi has casually mentioned a possibility that *Zakah* levies may mean a sudden diversion of resources from saving to spending or from investment in *Zakah*-able uses of funds to non-*Zakah*-able uses of funds. However, due attention has not been paid to the problem of "capital formation" in an Islamic economy, especially as a result of imposition of *Zakah*, *Ushr* etc. It is well known that even in non-Muslim economies fiscal administration faces a paradox in terms of fiscal objectives pursued. The objective of improvement in distribution would suggest some transfer of resources from relatively higher income groups — possessing higher marginal propensity to save — to relatively lower income groups — having lower marginal propensity to save or higher marginal propensity to consume. Moreover, promotion of capital formation is an important and necessary, though not sufficient, condi-

tion for the process of economic growth, the importance of which can hardly be minimised in today's world. Growth and development implies not only increase in per capita income and GNP — usually taken as a measure of growth — but also development taken in a wider sense including growth of technology besides capital formation. Every country today aims at growth and development as an important objective. This is especially true because an overall economic growth now-a-days is a symbol of 'strength' of Muslim countries viz-a-viz non-Muslim countries. The learned author has not tackled this problem of 'paradox' in the objectives of fiscal policy.

The learned author has devoted quite a bit of effort and space to develop his three-sector model. In doing so public sector and government have in some places been taken as synonymous. The two terms have been used interchangeably. In fact there is a difference between the government and public sector as we understand them today, both in respect of legal and administrative entities and in respect of functions and objectives pursued by both. The author gives an impression that 'profit' is the motive force for private sector alone, while the public sector has only regulatory and a balancing role to perform. In many muslim countries of today and even in some non-Muslim countries public sector is reasonably large, comprising a large number of public enterprises producing a variety of commodities and services. Being business units, these public enterprises also have a 'profit' motive besides other objectives and goals of public sector. In fact some Muslim countries have their entire industrial activity in the public sector, and these enterprises inevitably try to operate with a profit motive. Thus, the balancing role and profit motive are not necessarily mutually exclusive. The fact that the author has taken government and public sector as one entity is also evident from the fact that he assigns the allocative role to the public sector. In reality allocative role is a function of the government, which is performed partly through government policy measures, and partly through instrumentality of the public sector, which is legally and operationally an independent wing under the government.

The concept of voluntary sector as the third sector of his model seems to be the major element of the theory of fiscal policy as presented by the author. In this connection two points need to be mentioned. In the first place, voluntary sector is not the characteristic of an Islamic system alone. Even in capitalistic system there is a reasonably large sized voluntary sector, or subsector of the private sector. In case of U.S.A., for example, there is an institution of 'non-profit'

corporations and organizations in different fields of life. Most of the hospitals and the universities in the United States constitute part of this voluntary subsector of private sector. This vast field is not motivated by profit but by social, moral, and spiritual considerations. Moreover, even in case of primary and secondary education, the Catholics and the Jews have their own private network of higher and primary schools because the sponsors do not like their children to go to the government-sponsored schools where 'secular' education is given. Similarly, there are certain small television and radio networks sponsored by religious groups and motivated by moral and spiritual considerations. Then, of course, there are huge foundations for social and welfare purposes such as Ford Foundation and Rockefeller Foundation, to name just two of them. The budgets of some of these foundations are larger than the total budgets of certain Muslim countries. Thus, voluntary sector is not a unique or distinctive feature of an Islamic economy.

The second point, in connection with voluntary sector, is that the learned author has built his framework of voluntary sector on the basis of 'voluntary' payment of *Zakah* and *Sadaqat* in a Muslim country. However, if a Muslim country wants to enforce *Zakah* and *Ushr* etc. as part of Islamic system as a whole, collection of *Zakah* would have to be on a compulsory basis and at the state level. This would mean that much of what Dr. Faridi has put in voluntary sector, would in fact be a part of *Baitul Mal* or state treasury, and thus constitute an activity of the government or public sector as he prefers to describe it. When Islamic system is enforced the collection of *Zakah* would not be confined to *Alamwal ul Batinah* (invisible or non-apparent assets), alone, but would also include *Alamwal uz Zahirah* (visible or apparent assets). Collection of *Zakah* from *Alamwal uz Zahirah* would be much larger than the collection of *Zakah* from *Alamwal ul Batinah*, because we are living today in a monetised economy where financial assets, investments, bank deposits, insurance policies, provident funds, and many similar assets have become very important, and certainly larger in value on a collective basis than the *Alamwal ul Batinah*. Naturally, when the Islamic economic system is sought to be enforced, as a beginning has been made in Pakistan for example, the collection of *Zakah* can hardly be included as an exclusive part of voluntary sector. This will have to be a different subsector of public sector or an independent wing of the government machinery. Moreover, any country which decides to enforce Islamic economic system must also introduce collection of *Ushr* through the government. In Muslim countries with agricultural orientation, the collection of *Ushr* would be substantial, and in some cases

may exceed the collection of *Zakah* from *Alamwal ul Batinah*. If we add up *Zakah* on *Alamwal uz Zahirah*, collection of *Ushr* and *Khums*, the sum total would be several times larger than the collection of *Zakah* on *Alamwal ul Batinah*. Thus linking *Zakah* and *Ushr* with the voluntary sector, does not hold good on either a conceptual basis or an operational level. Whether or not there is a voluntary sector in the sense and form presented by Dr. Faridi, his point that motivation for *Zakah* and allied activities is fear of Allah, or *Taqwa* and *Al-Akhira* is well taken. This is what distinguishes *Zakah* and *Ushr* from taxes.

Dr. Faridi has given a detailed treatment of allocation and distribution functions of fiscal policy. Although a good part of the discussion is based on the usual discussion of fiscal policy in the standard Western literature, some interesting additions have been made. He maintains, for example, that an optimum allocation of resources in an Islamic economy is the one that establishes an equilibrium between the moral and economic imperatives of the society given its income and the state of technology. As we have mentioned earlier we may not agree that income and technology be taken as given. In our view, growth as a symbol of strength is in itself an important objective of fiscal policy. However, the concept of equilibrium between moral and economic imperatives is a sound policy guide. We wish this were dealt with more clearly and elaborately inasmuch as this mix or blend is the characteristic of an Islamic society. The discussion on moral imperatives not nearly as adequate as one would wish it to be.

In connection with distributive function, he uses the concept of Poverty Line. However, income tax exemption is not a very valid criterion for its determination. Empirical research alone can determine a sound and acceptable Poverty Line. Income tax exemption limit varies from country to country, as the author admits later. Then, there are certain Muslim countries where income tax just does not exist. Income tax exemption limit, or existence of income tax itself, are all policy variables constituting in themselves the parts of fiscal policy mix of a particular state or government. Although the author has gone in great length to discuss allocative and distributive functions of fiscal policy, he does not discuss much about fiscal operations. In fact the two go together. Perhaps, this is why much attention has not been paid to guidelines for public expenditure programme and the question of public borrowing — as mentioned earlier — which constitute an important part of fiscal system in any type of economy. Anyhow the learned author has done some good groundwork for the theory of fiscal policy in an Islamic society. Others can later take up some of the issues which have received insufficient attention of Dr. Faridi.

Dr. Anas Zarqa

The author maintains "that the distribution function of an Islamic economy may be discharged largely by *Zakah*".* I do not think that this is strictly correct to say that *Zakah* is the major tool of redistribution in an Islamic economy. It will be a very big omission not to point out that there are other major devices for redistribution in the Islamic economic system. They may not have as large an influence as *Zakah*, but they are very significant and they should be pointed out. One of them is *Nafaqat-ul-Wajiba* which is an obligatory family support, not only for one's own immediate family members but also for relatives. In *Maliki Fiqh*, a support for poor relatives can be imposed by state. Another is the law of inheritance, which hardly needs any elaboration. Then comes the Islamic rules of ownership and of the use of natural resources. Islamic laws about mineral wealth on or below the ground and such other compulsory injunctions also fall into this category. It is provided in Islamic injunctions, that certain natural resources must be reserved for the whole community. Finally, there is the prohibition of interest. This also has a positive effect on income distribution. All these tools tend to make income more equally distributed. Keeping in view all these measures we can not say that the income distribution function in an Islamic economy is *largely* discharged by *Zakah*.

There is also a confusion about the intended functions of *Zakah* and the functions of taxes. Dr. Faridi has mentioned that in the provision of public or quasi-public goods by the state, the disbursement of *Zakah* can be used.† This may sound on the surface to be acceptable but, in fact, it is not. *Zakah* cannot be spent to produce public or quasi-public goods. There are strong indications in Quran that *Zakah* is essentially for the poor. Almost all sects of Muslims prohibit expenditure of *Zakah* on building a mosque because it is used by both rich and poor. Thus we should not say that *Zakah* would help produce public and quasi-public goods. No! It can be transferred to the poor only. Some may interpret the spending on welfare goods as *Fi Sabilillah* but the most authoritative interpretation would not allow this.

Dr. Faridi maintains that the tax system in Islam will serve to meet primarily the same needs for which *Zakah* has been levied. I do not think this is an accurate statement. The tax system in Islam, to the extent it is permissible, is to produce public and quasi-public goods and

*In the revised draft this statement has been replaced by the statement that "the *Zakah* is the most important fiscal and distributive mechanism of an Islamic economy". (Editors)

†The author has dropped this assertion in the revised paper. (Editors)

has nothing to do with what *Zakah* was meant to do. The idea to harmonise the tax system with *Zakah*, on the face of it, may seem to be very innocent but it is a complicated issue.

Three-sector model (the third sector) is very significant and deserves a separate paper.

It is good idea to use negative income tax concept to analyse the concept of *Zakah*. We, however, should be careful in applying the concept of negative income tax to *Zakah* in view of the fact that negative income tax has been found to work as a disincentive to work. This will not be so in case of *Zakah* because *Zakah* is *Haram* for those who can work. There is a moral stigma in case of *Zakah*.

Mohammad Ahmed Sakr

I should first congratulate Dr. Faridi in the beginning for presenting a lucid and imaginative paper. He tackles his topic with depth and clarity and without repeating earlier rudimentary approaches to fiscal policy in Islam.

However, paper can be improved in style if it can get rid of some repetitions while dealing with such problems, as allocation, distribution, stabilization and more precisely when dealing with what he calls the third (voluntary) sector.

I fully agree with Dr. Zarqa that there are devices other than *Zakah* in the Islamic system which will improve income distribution. It is well known that *Zakah* is primarily meant for meeting the economic needs of needy persons. Eliminating poverty is its prime objective. It is true that *Zakah* will transfer income or wealth from those who have to those who have not. But it was never designed to achieve full equitable distribution of income in the Islamic society.

Dr. Faridi is of the opinion that other taxes and fiscal measures are needed to attain the socio-economic goals of society. I agree with him. But he fails to show his preference whether he is largely for direct or indirect taxes. Perhaps direct taxes (on income and wealth) are more equitable and more in conformity with Islamic norms. It is true that Muslim countries of today are developing and the general practice is to depend heavily on indirect taxes. There is a difficulty in the assessment of income and wealth and in the prevalence of tax evasion. But we expect that the introduction of *Zakah* coupled with the introduction of fully integrated Islamic policy in all spheres of social life, will improve greatly the fiscal apparatus. Income and wealth can be assessed more correctly. *Zakah*-payers will feel when they are assessing their *Zakah* that they are discharging a religious duty. Hence more use can be made

of direct taxes, which is almost impossible in the present secular state of mind and policy. Direct taxes can hit the right source and thus decrease the sufferings of low income groups or rather increase the net gains from new taxes.

There is a discussion about *Nisab* where it seems that there exists some misunderstanding about it, when Dr. Faridi makes the point that *Zakah* should be paid only to those who fall below *Nisab* and those who have the requisite *Nisab* but still fall below poverty line may receive non-*Zakah* transfer payment.

Here we have to be clear about the real meaning of *Nisab*. *Nisab* means that minimum level of income (or savings) which is left over after meeting all necessary living costs of the Muslim. Some jurists made long list of these costs to include such things as expenditure on food, rents, working tools, house furniture, servant salary, means of transportations, debts and expenditure on education and buying books of knowledge (See Qardhawi, vol 1, pp. 151–153).

كُلُّ مَا يَدْفَعُ الْهَلَاكُ وَالْوَسْوَسُ الْإِنْسَانَ

This list has been derived from the saying of the Prophet (peace be upon him) (No *Zakah* or *Sadaqah* is due except out of abundance).

لَا مَسَدَ قَدَّ إِلَّاهُ عَنْ ظَهْرِي غَنَى .

The relevant point in this regard is that those who possess the *Nisab* are not poor and definitely they are above the poverty line*.

Dr. Faridi rightly points out that the government should formulate an expenditure programme in the field of education and health to help the poor. He seems reluctant to advise that government can indulge in long-term projects from *Zakah*. Islamic government can embark on a range of productive projects in industry and agriculture which will provide permanent employment for the poor and as such will create continuous flow of income. Such projects will be financed out of *Zakah* proceeds. Supplying the poor with food, clothing and the like is just one form but it is not the only permissible and accurate form. (See Qardhawi, *Islamic Economics*, p. 247).

We come now to the role of the voluntary sector. Although we are all in agreement about its importance, yet it seems that this role is

*The author has revised the relevant portion of the paper. He now seems to point out the possibility of current income falling short of current needs in spite of the fact that one may possess some assets e.g. gold/jewellery worth the amount of *Nisab*. However, no clear-cut recommendation is made as to whether such persons should receive transfer payments or not. (Editors)

highly exaggerated, to the extent that the government role is left completely outside its social responsibility. The role of the public sector in developing economy is vital in the allocation of resources to the infra-structure facilities, to the heavy industry to revolutionize agricultural methods and to train the workers and the like. His contention that public expenditure in an Islamic society will necessarily tend to decline and Islamic administration will be less-expensive seems strange. On the contrary the economic and social responsibility of the government will increase in the Muslim society and in regard to the outside world.

Dr. Faridi does not mention any fiscal tool other than taxation to cope with public expenditure. There is a limit for taxation. Why not suggest public borrowing? That raises many questions. Should the borrowing voluntary or compulsory? How such sources can be tapped in an economy with no interest rate? The paper should have taken up such important issues.

Fiscal policy cannot be drawn in a vacuum. Dr. Faridi could have served the purpose better if he had given us the overall policies of an Islamic government with specific concentration on Islamic economic policy as a whole. Integration of economic policies is very crucial for the success of fiscal policy or any other policy. Monetary policy and fiscal policy are perhaps more related, the paper deprived us from seeing how this link can be worked out.

Discussion

M. Akram

This is not correct to say that *Zakah* cannot be used for the public and quasi-public goods. This is based on orthodox interpretation of the use of *Zakah*. There is a liberal interpretation of *Zakah* expenditure and people have been contending that *Zakah* can be spent on such projects as roads or hospitals or such industries where people can be provided employment opportunities.

My second point is that though non-profit institutions exist in non-Muslim countries also (as Dr. Uzair pointed out) the difference is that such non-profit activities in Islamic societies are done for the sake of reward in *Akhira*.

Mrs. Rehana Islam

I have to disagree on the point that *Zakah* can be spent on public or quasi-public goods. This is a general misunderstanding. I think it cannot be spent on general welfare projects like constructing bridges, roads and for the provision of education and health facilities etc. I would like to refer to *Surah Taubah* in support of my contention, wherein the categories, for which *Zakah* can be used, are explicitly mentioned.

It is very important for us to note that whereas the rate of *Zakah* has not been specifically mentioned in the Quran, the eight categories of expenditure have been specified by God Almighty. If you try to extend the list of beneficiaries of *Zakah*, it will never reach to those who are in real need. The other point is that *Zakah* has been levied in a way that it least impairs the growth of wealth. It is levied in a way that encourages the circulation of wealth in the economy and also lead to further production of wealth. That is why we have to follow the path laid down in the Holy Quran with lot of care when spending *Zakah*. My last point is that *Zakah* is compulsory. Sustenance of those who are in need cannot be left to the voluntary actions.

تَأْخُذُ مِنْ أَمْوَالِ الصَّدَقَاتِ

تَأْخُذُ means take and, therefore, it cannot be considered voluntary.

Dr. Omar Zubair

We should not call *Zakah* a tax. Tax is something which is paid with discomfort. It is a burden; that is why we calculate tax-burden. *Zakah*

is an obligation that has to be paid with pleasure. The other point which Prof. Faridi has mentioned is about the poverty line. He seems to be engaged in finding another tax so that those who fall above the *Nisab* but are considered to be poor, may be paid by that tax. Poverty line is a relative concept. We do not have an absolute poverty line. It depends upon the state of the economy and the relative position of the people. An other point in this regard is that there may not be any need of this extra tax. In the *Fiqh* of Abdul Malik you can pay from the *Zakah* even to those people who are paying *Zakah* and we have many examples. Hazrat Umar paid *Zakah* to such people, who were above the *Nisab* level. I do not agree with Dr. Zarqa that the able bodied people should not be paid *Zakah*. One person came to our Holy Prophet (peace be upon him). He was healthy and sound but was poor. He gave him certain means of production, e.g., tools of construction. So those people who are able to work but do not have the means of production should be paid from *Zakah*.

Prof. Rafiq Ahmed

I should not be misunderstood if I say that if you want to make *Zakah* really a powerful fiscal tool, then following four points will have to be kept in mind: Firstly, the basic rate of 2½ per cent and other rates will have to be manipulated. Secondly, the scope might have to be enlarged. Thirdly, the base might also have to be enlarged. Fourthly, for the *Nisab* we will also have to do a little rethinking.

Since this is impossible, because they are based on devine message, *Zakah* is not really a powerful tool to serve all the objectives of fiscal policy. It will not be able to play a powerful role unless it is complemented by other taxes. Take the example of Pakitan where *Zakah* legislation has been able to generate a total of Rs. 480 million. This amount has been spent on roughly 2 to 3 per cent of the total population about which records are available. Nobody knows accurately, but roughly the number of persons needing support range from 15 to 20 per cent of the population. So *Zakah* really cannot play a powerful fiscal role in developing countries like Pakistan unless it is supported by other taxes.

Prof. Syed Nawab Haider Naqvi

I think most of the problems have arisen from the title of the paper wherein he says a theory of fiscal policy. So far he has been talking of practice of fiscal policy. In actual practice I think what he is saying makes sense. But I think a paper on the theory is expected to cover

ideal situations. From this point of view, Dr. Faridi's paper cannot be accepted as a paper on the theory of fiscal policy.

Secondly, I would like Dr. Faridi to work out the equilibrium conditions for his model. I think the third sector will not exist under equilibrium.

Dr. Mohamed Ariff

There is a tendency to regard *Zakah* as a tax in the modern terminology and that is why people come up with all types of suggestions. *Zakah* is an *Ibadah* and not a tax. Moreover, it is a divine commandment and we should not entertain the ideas of broadening the base and uses of *Zakah*.

Dr. Sultan Abu Ali

The author has defined the optimum allocation of resources with respect to given income and technology. I think this is a rather static definition. The optimum allocation of resources should aim at maximising income and other objectives. Dr. Faridi's paper also lacks the discussion on the trade-offs between growth and equity objectives of fiscal policy.

Dr. F. R. Faridi

I agree that it was probably a mistake on my part not to recognise the role of other measures in the distribution of income and wealth as pointed out by Dr. Zarqa. The second point that I would like to make is that there is a misunderstanding about what I have said about the use of *Zakah* on public and quasi-public goods. I have not made a general statement that all kinds of welfare activities would be financed out of *Zakah*. I think I have only stipulated that some public and quasi-public goods which cater to the needs of the poor may be financed out of *Zakah*.

It is logically wrong to compare the Ford Foundation and such other institutions with the poor developing countries. What would be logically right, is to try to compare the budget of these voluntary institutions in the United States with the budget of the private, profit motivated sector there and then compare this with the same in Muslim countries. That would be a correct comparison. The voluntary sector is an integral part of the entire economic operation of an Islamic society. It is not grafted. It is something which is inherent in the Islamic economy. Whether you like it or not, it will be there. Even today some of the Islamic countries are maintaining *Auqaf*. Can you

imagine that in a non-Islamic society *Auqaf* had been created for maintaining the horses and cattle and for dogs and for a lot of other activities and some of these "Auqafs" still exist.

I have not said that the role of public sector should be minimised. I have also not said that there will be no government sector or that it will stand in the corner. If my statements can be interpreted like that I do not know how else it can be expressed.

I do not agree that the equilibrium in my paper is a static equilibrium. It is a dynamic equilibrium.