

# **ECONOMIC RATIONALE FOR THE STATE COLLECTION OF ZAKAH**

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*This article advances arguments in favour of the state collection of zakah by elucidating the public good character of the rationale for redistribution. It then explores the potential of zakah as poor due in comparison to that component of the state income transfers in the U.S. that are targeted specifically at the poor. The data for 1990 exhibit that means-tested payments are around 2.5% of the US national income that equals to the lower bound of the zakah rate. One can safely infer that the potential of zakah is not that limited as some critics have been suggesting in the past.*

## **1. Introduction**

The collection, disbursement, and potential of *zakah* as an instrument for poverty alleviation has over the years received considerable attention in literature on Islamic economics. In fact, *zakah* was one of the earliest instruments to be explored by Muslim development and public finance specialists. Ziauddin Ahmad *et al* (1983) include papers discussing and analysing *zakah* as an instrument of fiscal policy. Munawar Iqbal's (see bibliography) selection of papers presented before the Second International Conference on Islamic Economics held at Islamabad in March 1983 contains detailed description and examination of the scope and place of *zakah* in an economy administered on Islamic ethical principles. Ziauddin Ahmad (1991) presents *zakah* as a social security instrument that is part of a broader and integrated Islamic system for poverty alleviation and income distribution. Sadeq (1994) provides an overview of the economic, juristic, and administrative dimensions of the instrument of *zakah*. Shirazi (1996) undertakes an intensive economic analysis of the contribution of *zakah* system in Pakistan in poverty alleviation. He also makes a critical assessment of the *zakah* collection and disbursement mechanisms in Pakistan. Umar M. Chapra's (2000, 1993, 1985) exquisite contributions to Islamic economics contain numerous entries on the subject of *zakah*. Nejatullah Siddiqi (1996) likewise attributes a prominent role to *zakah* in the context of the state obligation to provide for the fulfilment of basic needs in an Islamic economy.

One would think that after the above mentioned extensive analysis and coverage of the various dimensions of the *zakah* issue, there is little scope for raising basic questions such as the advisability of the state collection of *zakah*. However, this issue re-surfaces from time to time and prominent experts on Islamic jurisprudence defend state collection on religious grounds. This paper explores secular rationale for the state collection of *zakah*. In doing so, it employs economic reasoning advanced in defence of redistribution in a liberal democratic society and the public good character of such rationale that makes state intervention necessary.

## **2. Economic Rationale for Redistribution**

Usher (p.335-346) discusses five motives for including redistribution among the minimum functions of government in a liberal society. The two principal motives are taking and giving. Taking refers to the use of voting power to modify the privileges of the rich. Giving refers to the willingness of the rich to share a portion of their income or wealth with the poor. Giving could be agreeable on account of altruism, insurance, prevention of crime, and/or preservation of a liberal society. Below, we provide an overview of Usher's research on each of the four motives for giving. The stress is not on the details of economic modelling but the wisdom that trickles

from such modelling.

## **2.1 Altruism**

Altruism embraces genuine concern of the prosperous for the welfare of the less well off. In a technical sense, the form of the utility function of an altruist has a significant impact on his choice between an act of private charity and using state as an intermediary for the purpose. If giving away a specific amount in charity provides utility to an altruist, then private charity would suffice for him. However, if what provides utility to an altruist is the average income of a class of poor people, then he will prefer that the state uses its powers to tax to raise funds for assisting the poor. Accordingly, such an altruist is expected to vote in favour of state administered redistribution.

## **2.2 Insurance**

The insurance motive for redistribution stems from inherent uncertainty about the initial or continuing ability of a person to sustain better living conditions. Such an uncertainty may stem from multiple causes. Part of the risk owes to the random chance of being born retarded, or being born in a less well-off household that is unable to support appropriate child education. Some risk comes from the very nature of the market economy itself such as the possibility of the obsolescence of earning skills, business failures, and default of investment assets or savings etc. Yet another class of risk stems from natural causes such as fires, floods and tornadoes. Finally, uncertainty may originate from the likelihood of accidents.

Some risks mentioned above, like the risk of car accident or house fire, can be insured through the private market. Other risks, such as the risk of poverty for a handicap or a child born in a poor household, can not be insured. Market failure to provide this kind of insurance can be attributed to two factors. First, insurers know in advance the adverse prospects for earnings for the handicap and the children coming from poor households. Second, any private insurance program against poverty faces the problem of adverse selection, i.e. attracting too many poor and too less rich rendering pooling of risks unfeasible.

The failure of private markets to insure against certain kinds of risks, in particular poverty, provides one motive for voters to look towards the public sector to seek such insurance. However, full insurance against such risks is likely to have adverse impact on incentives to work one's way out of a dismal situation. Accordingly, insurance argument provides scope for only partial pooling of risks and hence some form of redistribution through the public sector.

## **2.3 Deterrence of Crime**

This argument rests on the assumption that poverty can potentially draw some people to banditry whilst having modest means can prevent such behaviour. Under these assumptions, if there is no redistribution, increased banditry will sap resources of the rich in the form of increased protection costs and costs of hunting and punishing the criminals. It may be advantageous for the rich to channel such potential costs toward redistribution expecting a decrease in crime.

## **2.4 Preservation of the Liberal Society**

The political argument for redistribution in a liberal society rests on grounds similar to those that underlie behaviour of the ruling class in a despotic society. Just as fear of rebellion causes despots to moderate exploitation of the ruled, fear of the disenfranchised poor voters considering sweeping termination of the liberal political framework through one last vote in favour of revolutionaries could cause rich to moderate their privileges through redistribution.

Usher argues that the motives elucidated above are operative to a lesser or greater degree in every state redistributive program in the West, from old age pension to unemployment benefits, although one or the other motive may be more prominent in specific programs.

### **3. The Public Good Aspect of the Economic Rationale for Redistribution**

Three - insurance, crime deterrence, and preservation of societal structure - of the above mentioned arguments in favour of giving have a public good character. Paul Samuelson (1954, p.387) defines collective consumption goods (public goods) as those 'which all enjoy in common in the sense that each individual's consumption of such a good leads to no subtraction from any other individual's consumption of that good'. Paul Samuelson (1954, 1955) provides formal foundations for analysing public goods.

The standard economic literature presents public goods as a potential obstacle to the attainment of allocative efficiency even in a perfectly competitive market system. This is because public goods enter in a person's utility function in a special way. Compared to a private good for which only that portion of the total supply enters a person's utility function that he exclusively utilises or consumes, for a public good, the total supply enters simultaneously into every person's utility function since all persons can simultaneously consume a level of the public good equal to its supply (Dan Usher, p.329).

Research on public goods points to an acute problem, that of accurate revelation of individual preferences that can serve as a basis both for finding out the aggregate level of public good demand as well as allocation of its costs across individual consumers. If it were possible to ration the provision of public goods through the price system, then different households may decide to consume varying levels of public goods. The unfeasibility of using price system to ration public goods means that there is incompatibility of incentives for rational consumers to pay for the services, on a voluntary basis, in accordance with their true preferences for public goods. Each consumer has an incentive to shift the burden of supplying public goods on to the others by declaring less than his real demand for the good. The reluctance of individuals to contribute voluntarily to the provision of public goods and instead look for the opportunity to share the benefits of such goods free of cost is referred to as the free rider problem (Stiglitz, 1988, p.120-121).

The free rider behaviour causes at least two inefficiencies. First, left on market, public goods will be under-supplied as the market fails to strike a harmony between private and social interests. Second, similar conclusions may follow in case voting is used to reveal preferences for the payment of taxation for the funding of public goods. Politicians may be expected to 'buying' votes by restraining taxes and democracies may be under supplying public goods compared to the actual demand for such services (Stretton, p.55).

The public choice perspective provides a challenge to the above orthodox conclusions in two ways. First, it draws attention to the possibility that organised interest shift tax burden such that they pay less than their due share of tax burden in contribution for the provision of public goods. Thus, there is an opportunity for rent seeking and plunder in a political context (Jha, p.136). Second, pure public goods are scarce. For most impure (congestion prone) goods exclusion mechanisms can be designed so as to reduce the role of government and mimic market efficiency in their provision.

The gist of the orthodox public good arguments applied to the rationale for redistribution is that left to the private sector, too little charity will come forth owing to tendencies for free riding. Consequently, it is necessary to harness the coercive power of the state to collect reasonable amounts for redistribution through taxation in order to make the effort worthwhile for reasons (for giving) elucidated above. Public choice contends the orthodox position by underlining the possibility of over-provision as special interest groups manipulate the political process by shifting tax burden to others and benefits to themselves.

### **4. Zakah, Redistribution Rationale, and State Collection**

In Islam altruism comes at the top of the list as the rationale for charity. Altruism, in Islam, simultaneously symbolises an act of submission to the commandments of Allah. It is reasonable to assume that the genuine concern of a Muslim for the poor will not culminate in deriving satisfaction from paying one's own due share of *zakah* alone. Instead, in line with the true ethos of the Islamic call, a Muslim's utility function in all likelihood

will include as an argument, concern for the average welfare of the poor as a group. In such a case, as argued by Dan Usher, state collection of charity becomes preferred course of action from a giver's perspective.

Coming to the rationale beyond altruism, there is scope for entertaining such modelling and reasoning as advanced by Usher in light of the Prophetic statement meaning that poverty can lead to the act of denial or infidelity (*kufur*). Denial, in this sense, can be interpreted as accommodating a wide array of actions that may include crime, child slavery, pornography, and prostitution - acts that have become a frequent manifestation of poverty in modern world. In all such cases, the public good argument provides a rationale for the state collection of *zakah*.

As regards the public choice argument for occasions of rent seeking through shifting of tax burdens, at least in case of *zakah*, the possibility is averted on the collection side as the charge applicable on different kinds of wealth is pre-specified. With improved administrative design and some *ijtihad* on expenditure prioritisation, public choice concerns on the distribution side could be taken care of since *zakah* spending heads are specified as well. In summary, the specification of *zakah* rate and its expenditure heads is a distinguishing feature of the Islamic poverty alleviation program that if operationalised through appropriate administrative mechanisms can prove a powerful in-built mechanism against political rent seeking.

Finally, there are powerful non-economic reasons for state collection of *zakah*. In some Islamic countries with low literacy rates, factional allegiances prevent a degree of coherence that is necessary for internal security and national consensus. Allowance for private collection and distribution of *zakah*, under such circumstances could lead to increased polarisation of the society as factional leaders struggle to maintain or increase their *zakah* dividends by inspiring strong rivalry on inconsequential matters. For similar reasons, spending of *zakah* could entail strong discriminatory bias. State collection alleviates the potential for such perverse factional interests and incentives. A counter argument is that the state collection can become a means for achieving supra-Islamic objectives in the Islamic garb. Jamal Malik (1995) can be referred as an example of such debate that falls outside the scope of this article.

## **5. An Aside on *Zakah* Potential vis a vis Poor Targeted State Transfers in the US**

It is sometimes argued that compared to the size of income transfers in the Western economies, the potential for *zakah* is very limited. This argument needs to be put in a proper perspective. First, it should be kept in mind that a significant proportion of income transfers in the West is not targeted at the poor. As Gwartney and Stroup (1992, p.770) point out, in the US 'means-tested transfers, those directed toward the poor, constitute only about one-sixth of all income transfers. No income test is applied to the other five sixths and they are generally directed toward groups that are either well organised or easily identifiable. The recipients of these transfers have incomes well above average. This suggests that the rent-seeking model of government plays an important role in the allocation of income transfers.' For example, around two-thirds of the \$15 billion in direct crop subsidies to farmers in the US in 1989 went to those having annual sales in excess of \$100,000.

We may like to contend that agricultural subsidies in particular may have an international dimension and 'capture' or 'dependency' of the third world economies as an implicit political motive could not be ruled out although further research needs to be done on this aspect. Coming back to the main issue, given the total size of all income transfers as a percentage of national income was 15.2% in the US in 1990 and given further that only one sixth was targeted at the poor (Gwartney and Stroup, 1992, p.770), the ratio of poor transfers to national income comes to 2.5%, the lower bound of the *zakah* rate. Gordon Tullock (1997, p.98) using a different database comes to the conclusion that 'the welfare state is an immense apparatus for transferring income but that the bulk of it is not devoted to aiding the very poor'. There is little scope for entertaining doubts about the *zakah* rate on the basis of such empirical evidence.

The second point worthy of consideration in this regard is that the structure and modus operandi of the banking and monetary system plays an important background role in choosing winners and losers in a private economy. It is now a well-researched argument that the prevailing financial system has a systematic bias against small players and in favour of big business. Such a system may very well need sizeable transfers to ward off 'peasant revolts'. When we benchmark potential for *zakah* with reference to the Western welfare system, we are presumably not comparing like with like. There is a need to intensify research on developing alternative models of monetary and banking system that do not entertain the artificially induced bias in favour of the prosperous inherent in the presently prevailing financial architecture.

## **7. Exemptions Undermining *Zakah***

Shirazi (1996) notes that a prominent problem with regard to *zakah* collection in Pakistan has been the exemptions allowed by the government that limit full exploitation of the potential of *zakah* as poverty alleviation instrument. It can be argued that insofar as such exemptions are given to specific groups, they undermine the non-economic rationale for the state collection of *zakah*. However, the solution to such problem is quite simple. In the interest of improved collection and wider base, a complementary secular poverty alleviation tax - assessed in the same manner as *zakah* - can be levied on all those who are exempt from paying *zakah* including non-Muslims. This is not only in harmony with the well-known taxation principle of horizontal equity but also saves government from indulging in complicated *fiqhi* and political quagmires.

## **8. Conclusion**

This paper has presented arguments from economic theory favouring centralised *zakah* collection. The economic rationale is supplemented with non-economic reasons for the state collection of *zakah*. It is presumed that the arguments advanced here provide the microeconomic foundations for the religious (*fiqhi*) preference of entrusting the responsibility of *zakah* collection to the state. As a side issue, some empirical evidence is presented to demonstrate that the critique on the potential of *zakah* is misplaced. It needs to be assessed in relation to the bigger picture mechanics of the prevailing political, economic and financial system.

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