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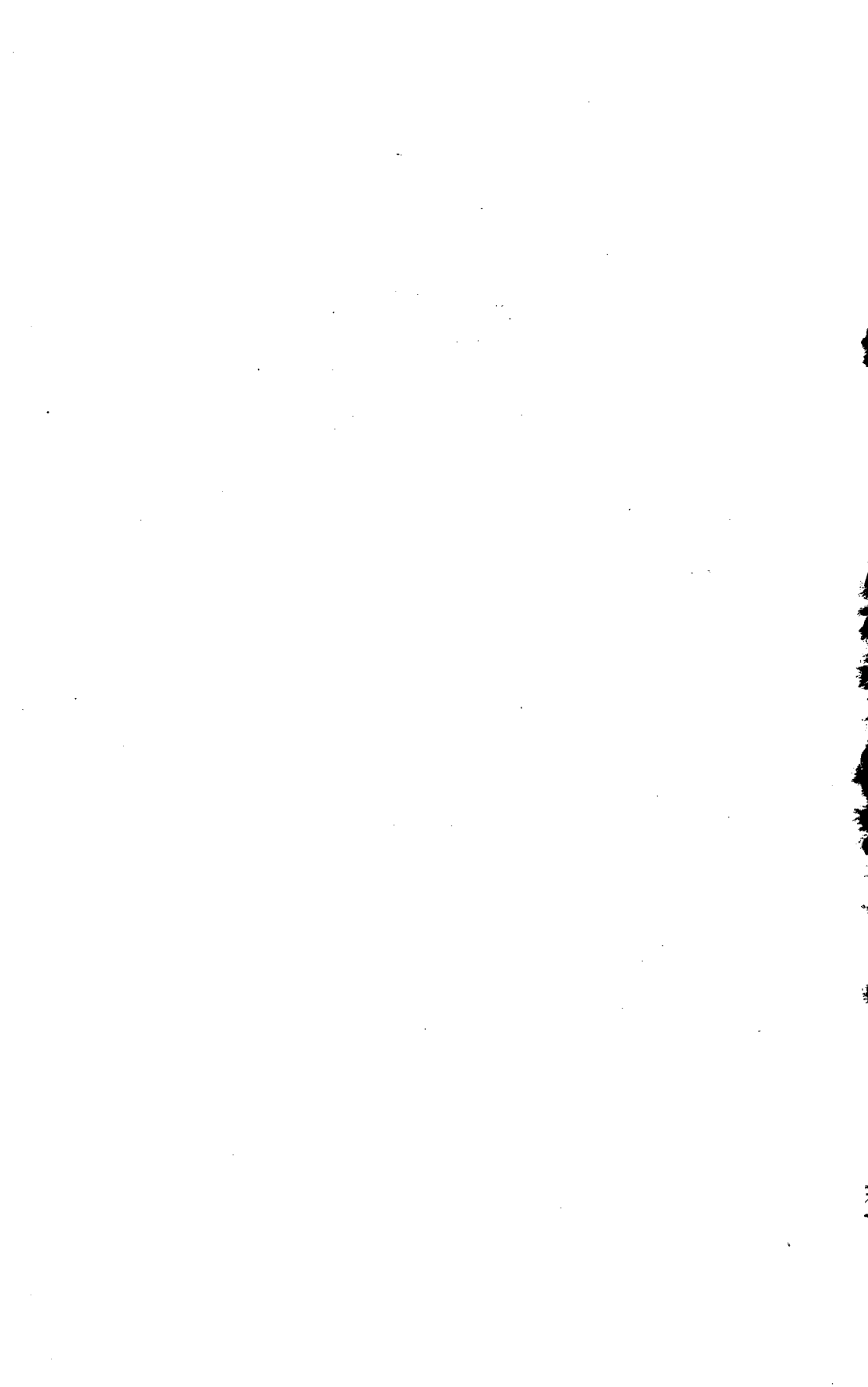
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DEPARTMENT OF ECONOMICS
GOVERNMENT COLLEGE LAHORE • PAKISTAN



Introduction

During the past decade there has been a growing interest among the muslim countries to reshape the various facets of their societies in accordance with the tenets of Islam.

With a view to replace the existing economic order with an Islamic one, it became imperative to explain and critically examine the known economic hypotheses from the Islamic point of view. This has resulted in the emergence of a new academic discipline of Islamic Economics. A number of institutions of higher learning and research in many muslim countries have been established for the teaching of Islamic Economics and undertaking theoretical research in this discipline. International Institute of Islamic Economics, International Islamic University, Islamabad holds a position of eminence amongst such Institutions.

The Institute besides performing its Teaching and Research activities, also occasionally arranges Seminars and workshops to discuss practical ways and means to Islamise the economy.

In 1984, the Institute held an International Seminar on "Islamic Financing Techniques" and we were proud to publish three papers read at that Seminar in our 1985 Issue—Vol. XVIII, Nos. 1 & 2—with the courtesy of the Institute. These papers were greatly appreciated by our readers.

In July 1986 the Institute held another International Seminar on "Fiscal Policy and Development Planning in an Islamic State" at which Papers on the role of Fiscal Policy and the methodology of Development planning in the perspective of the over all objectives of an Islamic State were presented.

In view of the importance of Fiscal Policy and Planning, for Stabilization and development of an economy, we are publishing three papers read at that Seminar with the kind permission of the International Institute of Islamic Economics, Islamabad.

The proceedings of the Seminar shall be published by the Institute in due course of time.

Editor

Towards a Theory of Taxation in Islamic Economics

MONZER KAHF*

Introduction

Once more it seems necessary to come to the discussion of taxation in Islamic economics in an attempt to settle an issue that is long in need to be formulated in a comprehensive theory. Taxation in Islam seems to be as misunderstood and mishandled by Muslim writers as one can imagine. It still falls in the lap of the generalities of "the functions of the Islamic state" and "the objectives of its economic policy"! It appears that many writers on this issue still insist on building their visualization of the Islamic state's economic role on the foundation of a western economic system. It is already past due that we examine the ever repeated (and sometimes dull) presentations of the objectives of Islamic policy with a close eye on the purely Islamic principles and question the precision of any term used in such presentations.

Obviously, therefore, the objective of this paper is to endeavor this undertaking, knowing that it is huge and that the abilities of the writer may fall short of it.

This paper consists of three parts : part one surveys the present state of art on the issue of taxation in Islamic economics, in part two, the critique of part one will be expanded into a formulation of the economic role of the Islamic state with a focus on taxation. This part has three sections that deal consecutively with the functions of the Islamic state, its obligations and the theoretical basis of these obligations. Lastly, part three attempts to formulate a proposed theory of taxation in Islamic economics and the related issue of

* The writer is a research economist at the Islamic Research and Training Institute, the Islamic Development Bank, Jeddah. Both IRTI and IDB bear no responsibility with regard to this paper or any of its contents. He likes to express his appreciation to Dr. M.N. Siddiqi whose paper "Public Expenditure in an Islamic State" which is repeatedly referred to in the present study, was a great incentive and challenge to the author in writing this paper.

budget deficit and balance. This theory is derived from the functions of the Islamic state and the practice of the early Islamic society led by the Prophet (P) and the four caliphs without neglecting the rich experience of later Islamic states until our times. Part three consists of two sections devoted to the theory of taxation and budget deficit respectively.

Throughout the paper, the terms taxation or taxes are used in such a way that include all mandatory levies by the Islamic state on people or things, wealth or income except *Zakah* as it is imposed by God.

PART ONE

Taxation and Functions of Islamic State as Seen by Modern Muslim Writers.

In one of his most recent works, Abidin Ahmad Salama counts the objectives of fiscal and monetary policy as :

- resource allocation
- economic stability
- acceptable growth rate
- just distribution of income and wealth.¹

Talking about the objectives of monetary system, M. Umar Chapra repeats the same with the addition of “full employment” and “broad based economic wellbeing”². F.R. Faridi puts the objectives of the socio-economic policy as :

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1. Abidin Ahmad Salama, “*Ahdāf al Siyāsah al Māliyyah Wa al Naqdiyyah fi al Dawlah al Islāmiyyah wa Kayfiyyat Tahqiquha*” [Objectives of fiscal and monetary policy and how to realize them], paper presented at the seminar on Islamic Economics and Developmental Integration in Arab Countries held in Tunis under the sponsorship of the Arab states League, Nov. 18-21, 1985, P. 1.
 2. M. Umar Chapra, *Towards a Just Monetary System*, (the Islamic Foundation, Leicester, U.K., 1985), P. 34.

- "1. Justice and equity"
- "2. Provision of 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,"³

M.M. Metwally talks about the objectives of equilibrium, curbing unemployment and inflation, and accelerating economic growth as objectives for which "economic dues are imposed and manipulated in an Islamic economy"⁴. Lastly, in an earlier paper I showed that very often Muslim writers assign the functions of growth, welfare and equilibrium to fiscal policy⁵.

In fact, western literature on fiscal policy always assigns it distributive, allocative, stabilizing, and growth functions⁶.

Muslim writers, very often, tend to make generalizations about economic goals of the Islamic state on the basis of general hints and indications in the *Qur'an* and *Sunnah*. Such generalizations do not distinguish between what is desired and what is necessary. All economic systems in the world, including the Islamic one, share a common desire to solve the economic problem of man. They are all alike as far as their appetite to improve the allocation of resources, the implementation of justice and the well-being of people. Every

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3. F.R. Faridi, "A theory of Fiscal Policy in an Islamic State" in Z. Ahmad, M. Iqbal and M.F. Khan, ed., *Fiscal Policy and Resource Allocation in Islam* (ICRIE, King Abdul Aziz University, Jeddah, 1983), P. 28.
 4. M.M. Metwally, "Fiscal Policy in an Islamic Economy" in Z. Ahmad, *ibid.*, pp. 59-75.
 5. M. Kahf, "Taxation Policy in an Islamic Economy" in Z. Ahmad, *ibid.*, pp. 131-153.
 6. See for example : R.A. Musgrave and P.B. *Musgrave Public Finance in Theory and Practice*, 4th ed. (Mc Graw-Hill, New York, 1984) ch. one.

economic system includes in the list of its objectives everything that is acclaimed by the Muslim writers as objectives of the Islamic economic system. Therefore, nothing is unique about a statement of objectives in such general terms. And if we are all alike, then what matters is to talk about what specifically characterizes the Islamic economic system.

In regards to the fiscal system in Islam, founding the case of "Policy recommendations" on the basis of such generalizations about what is desired is hard to support by the rules of shari'ah because whenever it comes to taxation and expenditure, a question of how far the state, in the Islamic system, can go must be answered first. The attempt of deriving a fiscal system from the broad goals may be frustrated by several constraints imposed by the balance between individualism and collectivism in Islam. Thus what is required is a statement of the obligations of the Islamic state or its duties that must be performed even at the expense of the interests of individuals.

Unfortunately, Muslim writers do not give, usually sufficient attention to such distinction between the ought and the desire. A perfect example is the approach of Prof. F.R. Faridi in the article mentioned above. He states that "socio-economic welfare" (p. 28) and allocation of resource (p. 30) are among the goals of fiscal policy and moves swiftly to designing a "taxation" system to fill in the "resources gap" and the "objectives gap" that are created by the fact that *Zakah* and "voluntary contributions" [sadaqat] may fall short of the resources required to achieve the objectives.⁷ Salama (op. cit) shares the same lack of rigor in deriving taxation implica-

7. "Resources gap" is caused by insufficiency of *Zakah* and voluntary contributions to achieve the goals of economic policy, while the "objectives gap" filling aims primarily at promoting "the same ends for which *Zakah* has been levied (Faridi : p.p, 29-31). Apart from the fact that these really are only one gap as it is apparent, one may incidentally argue whether the approach of roving around *Zakah* is the best way for formulating a proposed fiscal system for the Islamic state ?

tions from the general objectives without distinguishing between what the states must do and what it is desirable to be done. Other writers who emphasized the welfare, development and equilibrium aspects did not put the issue of taxation under their prime focus, so their propositions for financing the achievement of those objectives were but general and crude.

One important, and sometimes predominant, reason for the failure to observe such a distinction can be derived from Prof. M. M. Sakr's note on an earlier paper of mine, he say: "'Umar, the second caliph, used to give aid to all children, this is a welfare spending"⁸. The fact that 'Umar did that is not disputed but equally must be recognized the fact that he did not finance it from taxes. In *Sunnah*, we have a hint to this distinction. The Prophet (P) is reported to have taken responsibility of debts on deceased persons who left no sufficient bequest to take care of the payment of their debts. This is obviously a welfare spending. But the Companion who narrates this saying adds an explanation that it happened only after a flow of war booties started coming to the Prophet (P)'s treasury, continuing that before that he used to abstain from making the funeral prayer [Salat of janazah] on the corp unless the deceased person had left sufficient wealth to pay back the debts.⁹ Apparent enough, the state of the Prophet (P) did not impose any tax to finance this kind of welfare spending.

Kahf (op. cit) pointed out to this distinction and attempted to list the theoretical cases that call for tax lavying. Recently Prof. M. N. Siddiqi followed a similar approach by departing from the conventional fiscal theories that focus on the social welfare function to a proposition of considering the "ought to" as a base for legitimizing any heads of expenditures.¹⁰ While Faridi and Salama

8. Discussion notes ; M. M. Sakr, in Z. Ahmad, *Op. cit*, p. 159.

9. The full text of this saying is on p.p. 24-25 of this paper.

10. M. N. Siddiqi, "Public Expenditure in an Islamic State" paper presented at the International Seminar on Fiscal Policy and Development Planning in an Islamic State, Islamabad, Pakistan, July 1986, p. 24.

consider the provision of public goods the basis for government spending and consequently the legitimizer of taxes, and Chapra (and other writers mentioned in my earlier paper on taxation policy) implicitly considers the social welfare function as justification for taxation, Siddiqi refers to the role of state with regards to public expenditures in terms of fulfilling the "social obligatory duties" or *fard al kifayah*.¹¹

In part two, I shall attempt to show that the concept of *fard al kifayah* modified into a 'public ordinance of what is viewed as good and forbiddance of what is viewed as bad', serves as a better foundation for tax financed public expenditures. This will be done without sacrificing the non-assignment characteristic of taxation (except in *Zakah* naturally).

PART TWO

The Economic Role of the Islamic State¹²

In this part, the functions of the Islamic state and its financial implications will be discussed. Section one attempts to state these functions under the assumption of no resource restriction, section two will be more realistic by relaxing this assumption, and section three is devoted to the attempt of discovering a theoretical basis for these functions :

Section one :

Objectives of the Islamic State.

Naturally, the economic objectives of the Islamic state are dervi-

11. *Ibid.*, p. 8.

12. In previous two papers, the same writer discussed the nature of the Islamic state as distinct from the welfare state. So there is no need for repeating the definition and characteristics of the Islamic state. See M. Kahf, "The Islamic State and the welfare State: Similarities and Differences" in M. Tariq Quraishi, ed. *Islam: A way of Life and a Movement*, (American Trust Publication. Indianapolis, IN., USA, 1984) p.p. 135-148, and M. Kahf "Taxation Policy" *op. cit.*

ed from the role of the state in Islam based on the definition of the *khilafah*, this role can be summarized in the following points :

- protecting religion, defending its land and people, and promoting the Word of Allah,
- public administration, maintaining law and order and the judiciary,
- providing adequate means of living for people, promoting their welfare, and improving the economic well being of individuals and the society as a whole including issues of economic equilibrium, development, stability, and distribution,
- managing the public property to the benefit of the whole society,
- ordaining what is known as good and forbidding what is known as bad, on individual level as well as on collective level.¹³

Obviously many sub-objectives fall under these headlines, such as promoting the values and practices of justice and righteousness among all mankind, helping all human beings receive the Word of Allah, providing guidance and support to Muslim minorities, increasing capital formation, enhancing scientific research, protecting the environment, etc.

It is noticed that these objectives are broad and inclusive, after all the reason d'etre of *Khilafah* is to serve people and not to exercise authority on them.¹⁴ All of these objectives can easily be supported

13. See Monzer Kahf, "Daur al Qita'al 'Am fi Taulid Iradat li al Tanmiyah fi al Nizam al Iqtisadi al Islami" [Role of Public Sector in providing Resources for Development in the Islamic Economic System], paper presented at the Seminar on Financial Resources in the Islamic State, organized by the Islamic Research and Training Institute of the IDB, Jeddah, in Cairo, April 12-19, 1986, P. 99 See also, M. N. Siddiqi, *Op. cit*, p. 8.

14. Shawqi A. Dunia, *al Islam wa al Sanmiyah al Iqtisadiyyah*, [Islam and Economic Development] (Dar al Fikr al 'Arabi, Cairo, 1979), P.P. 113-116.

by the general guidelines in the *Qur'an* the *Sunnah* and the general principles and axioms of *Shari'ah*. From these general objectives, specific economic aims are derived for the Islamic state as follows :

1. the allocation of public property and the maximization of its utilization for the purpose of producing the highest level of benefits to Muslims.
2. the provision of financial resources sufficient to maintain the general administration, defence, and law and order, and to promote the Islamic faith.
3. the fulfilment of adequate level of living to all its people and the improvement of their material and cultural welfare, individually and collectively.
4. the maintenance of socio-economic balance in the society, and the achievement of equitable distribution of income and wealth.
5. the realization of economic and price stability and the carrying out of policies aimed at achieving an acceptable growth rate.
6. the protection of the socio-moral values and their observance in economic transactions,
7. the ordinance of what is known as good and the forbiddance of what is known as bad, especially in matters related to public.

Remarkably, there is no disagreement on the above goals among Muslim writers¹⁵. The Islamic economic system is structured around them. Its built in mechanism and essential pillars such as *Zakah* and the prohibition of *riba* are geared towards achieving these goals. Needless to say that working toward these goals and the implementation of the Islamic system itself requires that the Islamic state be free

15. For a discussion of the objectives of price stability, full employment, economic equilibrium and development, see M. Kahf, "Role of Public Sector", *op. cit.*, pp. 17-22.

of foreign powers and have full control of own country. Thus political and economic independence and its solidification are prerequisites for adopting the above goals as objectives of the economic policy¹⁶.

Section Two :

Economic obligations of the Islamic State

The expose of section one, though old, is necessary to introduce the analysis of this section. The obligations of the Islamic state deal with what is a must and necessity. The state is required to dispose of its responsibilities even if this requires the use of unusual means including expropriation and confiscation in order to finance them. Thus, this section intends to deal with the minimum of the state functions, without their achievement, the state's performance is considered below standard from the Islamic point of view, or the duties for whose fulfilment the state must recruit sufficient resources by any means.

Obviously doing as much as possible of the above mentioned functions is not a sufficient answer since it does not deal with the issue of how far can the state go in enlisting and appropriating economic and financial resources.

Individual's actions are usually classified into desired مستحب premissible مباح, obligatory فرض, and forbidden محرم, so are the state's action¹⁷. Therefore it is important to analyze the obligations of the state and distinguish them from what is desired. Naturally

16. Muhammad A. Sakr, "al Khutut al 'Aridah li al Nizam al Iqtisadi al Islami" [Broadlines of Islamic Economic System], paper presented at the Seminar on Islamic Economics and Developmental Integration in the Arab World, Tunis, Nov. 18-21, 1985. pp. 13-14.

17. It is evident from jurist's writings that actions, whether done by individuals or the state, are subject to the same classification. So we always read that such an action is desired, obligatory or forbidden to the state, the same way we read about individuals.

the concept of obligation is itself relative because it depends on circumstances and available resources. It is at this relativity that the answer in the preceding paragraph applies, but that does not frustrate the query of minimum obligations. Thus let us relax the assumption of availability of resources and means, and assume, instead, that, for each and every activity carried on, the state has to expropriate resources from individuals or to impose on them restrictions that are not in *Shari'ah* such as confiscation or diversion of labor and/or capital to certain economic activities by force or by illusive persuasion. Under such situations the indispensable obligations of the state become those matters that are bare requirements **فرائض**. These can be stated in the following :

1. Maximizing the Muslims' benefits of public property such as minerals, water and energy resources, and publicly owned land.
2. Financing the indispensable needs of general administration, defence of religion, people and land, and law and order.
3. Fulfilling the basic livelihood needs of all individuals in the Muslim society such as minimum housing, food, clothing and education.
4. Maintaining a socio-economic balance and realising just distribution of income and wealth within the limits of *Shari'ah*.
5. Maintaining a macro economic viability sufficient to protect the freedom of choice vis a vis the foreign market and to preserve its internal integrity.
6. Supervising the observance of social ethics and moral values in economic transactions and relationships.
7. Ordaining what is known as good and forbidding what is known as bad in all matters related to public interests and actions.¹⁸

18. Needless to say that these minimum functions of the Islamic state can be disposed of by means of monetary and credit policy, regulations and licencing system, pricing, appropriation and allocation of public property as well as fiscal policy. The choice of policy and the selection of fiscal instruments is left to part three.

Some of these functions are self explanatory, while some call for further notes. In function No. 3, for example, the basic needs of living are socially determined and not merely physical, since basic needs differ according to the mode of living as they are not the same for nomadic beduins, village dwellers, and metropolitan population. However there is a vast difference between "basic livelihood needs" and "adequate level of living". The latter is an objective that can be pursued, given available resources, while the former is a must that the Islamic state should provide at any cost because it relates to survival itself. Consequently all quotations, that are usually cited about the "adequate level of living" from the grants the Prophet (P) or any of his Wise Successors made or from giving *Zakah* to the poor, apply only to the case of resource availability. None of them, exclusively, apply to a case when the Prophet (P) or any of his Wise Successors had to expropriate private property for financing such givings. And there is no person in sanity, let alone Muslim scholars who may call for providing a poor an adequacy of living out of *Zakah*, while there is still another poor, equally deserving, who lacks basic food or clothing.¹⁹

Furthermore, the concept of basic needs includes the religious requirement and not only the physical necessities for survival, Here comes an amount of education that is required for every Muslim or the provision of clothing for covering what must be covered of the body although this may not be needed on physical grounds under certain climatic conditions.

In regard to socio-economic balance and distributive justice, the Islamic state is required to collect and distribute *Zakah*. This is the major means of redistribution of wealth and income. The state is

19. For such quotations see, among others, 'Ali 'Ali Mansur, "*Nuzum al Hukm wa al Idarah fi al Shari'ah al Islamiyyah wa al Qawanin al wad 'iyyah* [Government and Administration Systems in Islamic Shari'ah and Man-made Laws] 2nd ed. (Dar Al Fath, Beirut, 1971) pp. 110-114, Shawqi A. Dunia, *Op. cit.* pp. 380-384, M. Sakr's Comment on Kahf's Taxation Policy, *Op. cit.*, and Yusuf al Oardawi, *Fiqh al Zakah*, 2nd ed. (Dar Al Risalah, Beirut, 1973), Vol. 2, pp. 566-578.

also required to forbid *riba* [interest] since it is an unjust arrangement and a flaw in the distribution theory. Besides, the Islamic state is required to protect the Islamic society from being reduced to a caste society because of high income and wealth differences and to protect its social harmony that is based on brotherhood and caring.

The Islamic state is further required to preserve the freedom of choice of its society in the economic arena and to avoid any submittance to alien economies, it is also required to protect its internal integrity against devastating destabilizers such as rates of inflation that disturb the distribution of income and wealth to the disfavour of the poor.

Finally, the ordaining of good and forbidding of bad in public matters refers to three categories of things. Firstly, things mentioned in *Shari'ah* without being declared as clear obligations such as construction of collective prayer's facilities (Mosque, open prayer fields, ablution fountains, etc.), secondly, things not mentioned in *Shari'ah* but essential to the basic interests of Muslims such as bridges, river banks, and thirdly, things that are implied in *Shari'ah* as a duty of the society because they relate to basic obligations such as constructing of a fortress or a wall around the city to improve its essential defence or guarding the borders against drugs or alcoholics' smuggling. The next section will go into the analysis of this principle of ordaining the good and preventing the bad.

Section Three :

Theoretical Basis of State Functions.

Two ideas are presented in this regard by Muslim economists : Public goods and social obligations. This section will discuss these two ideas and show their deficiency in explaining the theoretical basic for the Islamic state's functions, it will propose an alternative in the form of ordaining what is good and forbidding what is wrong.

A. Public goods :

The concept of public goods is usually offered by Muslims writers in theorizing the Islamic state's functions, i.e., the Islamic state is required, to provide public goods such as "public health, education,

provision of accommodation as well as other services.”²⁰ Faridi takes the effort of defining public goods “on the basis of their being non-profit goods” so that public goods are “goods required by the society whose benefit is not translatable in terms of economic revenues.”²¹ He further speaks of quasi public goods as those “whose benefits defy easy quantification or pricing.”²² According to Faridi, the provision of public goods and quasi public goods is done by the Islamic state as well as the voluntary sector which includes *Awqaf* and other “voluntary institutions operating through *sadaqat* [charities] and non-profit economic activities.”²³ He believes that the Islamic state takes the responsibility of supplementing (and correcting) the voluntary sector’s provision of public and quasi-public goods and of providing these goods directly whenever such doing server the allocation, distribution and stabilization objectives of the state.²⁴

Musgrave and Musgrave define “social goods”²⁵ as those on whom the market mechanism fails to function either because of the inability (or undesirability) to apply the exclusion principle, or of the non-rivalry of consumption or because of both together.²⁶ Market provides an efficient mechanism for individuals to reveal their preferences through price bidding. But since this applies only to private

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20. Abidin A. Salama, “Fiscal Policy of an Islamic State”, in Z. Ahmad, *Op. cit.*, p. 115.
21. F. R. Faridi, *op. cit.*, p. 37. Ironically he gave as an example of public goods “radio and T. V. networks” (p. 36), disregarding that they are run on profit motive by the private sector in many countries. Thus what we have on hand is either a case of public good (indivisible) produced and marketed by profit seekers or a case of private goods (profitable) that tolerate “free riders”.
22. *Ibid*, p. 23.
23. *Ibid*, p. 36.
24. *Ibid*, p.p. 38-43.
25. Musgrave and Musgrave use the term “social goods” in the same meaning as “public goods” used by Salama and Faridi.
26. Musgrave and Musgrave, *op. cit.*, p.p. 48-51,

goods, individuals find it to their benefit to hide their preferences in the case of social goods in order to take the advantage of riding free. Consequently, an alternate mechanism of preference revealing is needed in order to know what social goods to produce and pay for their cost of production. This approach is, by nature, a political one,²⁷ i.e., voting or any substitute of voting in political decision making.

In spite of the seemingly attractive glamour of the concept of public goods, it is unlikely that it passes the tests of Islamizability and adequacy as a theoretical interpretation of the state functions in the Islamic system because of the following reasons :

1. its indeterminate nature : the principles of exclusion, non rivalry in consumption of Musgrave and non profitability of Faridi do not provide exclusive criteria of classification of goods into social and private, and leave the door wide open to the political process to determine what goods are to be considered public (or social) and what private. Thus while Salama speaks of "education", Faridi talks of "education to the poor" as public goods.²⁸

And the actual application in the world varies so much that goods provided for by a tax/expenditure process range from security to networks, to health care to roads and bridges, whereby all these can be "public goods" in certain countries and "private goods" in

27. *Ibid.*, p. 54.

28. The example of "education to the poor" is somehow ambiguous. Education is a private good like food and clothing. If we define a good by its user instead of by its own inherent characteristics, then any good is not given to the poor through the market mechanism and market is bound to fail in supplying the poor with anything simply because the latter's demand is not supported by a purchasing power, it is only a notional demand. Thus the provision of consumption (or productive) goods to the poor cannot be a case of market failure, and it therefore cannot be a public good. This is rather an issue of distribution for which Islam enacts *Zakah* and other legal devices.

others.²⁹ Especially if we agree to apply the non-profitability principle of Faridi, everything can become a "public good" because every good can take the non-profitable character by certain social rearrangement. The examples of providing health care and education to the poor are typical.

Thus unless in extreme cases where a given good is at the same time non rival in consumption, subject to exclusion, and its externalities are difficult to internalize such as street lighting, that one needs to call for fiscal process of providing such goods.

2. The concept of "public goods", because it leaves too much of a say to political processes, is not sufficient to explain the role of the Islamic state. The social organization in Islam assigns certain functions to the state without letting the existence of these functions be subject to political decision, they are simply part of this religion as prescribed in *Shari'ah*. An example in ordaining what is good and forbidding what is wrong or supervising the observance of ethics and values in transactions. Functions of this sort are mandatory on the Islamic state because they are derived from its very nature and people cannot vote them out by any political process. The services themselves can hardly be said exclusive or non-rival so they can not be described as public goods.
3. Lastly, the concept of "public goods" falls short of reflecting the depth and importance of certain state's functions such as defence. In Islam, defence is not merely a public good, it is also a sacred *personal*, as well as collective obligation which extends to persons and wealth together. Similarly, fulfilling the livelihood needs of the poor is a religious obligation whether it is done by means of the religious duties of *Zakah* and obligatory spending on relatives *التقاة الواجبة*

29. Networks can be run on profit basis in all cases where their services can be divided into units subject to cost internalization such as advertisement time, programs, and closed circuit viewing.

للاقتراب or by means of additional levies in case the former is insufficient or not inclusive. Goods provided this way are neither exclusive nor non-rival, and their provision has a religious dimension that makes it stronger and deeper than public goods.

Lastly, it should be emphasized that the concept of public goods remains useful in the area where internalization of cost is not possible.

Finally, before we move to discussing *fard al kifayah*, a mention of the "merit goods" is felt necessary.³⁰ Certain private goods, such as public transportation or education, may be considered of certain merits that the state takes the responsibility of their provision. Siddiqi implicitly refers to this concept when he mentioned "assignment by the people" as a "rationale" for public expenditures,³¹ since the assignment by people means nothing except considering a "good" of such "merits" that it should be provided by the state. Merit goods make a good case for desired functions of the state, but unless they fulfill the criteria for "tax financeable", they do not provide sufficient rationale for taxation. Additionally public decision making must also be guided by the principles of *Shari'ah* and not left to mere value judgement.

B. *Fard al kifayah* فرض الكفاية (Obligation on everyone with a sparing mandate) :

Apparently not satisfied with the concept of public goods,³² M. N. Siddiqi used the concept of *fard al kifayah* to explain the func-

30. This is brought to my attention by Dr. Ausaf Ahmad of the Islamic Research and Training Institute.

31. Siddiqi, *op. cit.*, p. 28.

32. This dissatisfaction is shown in such statement as "The *fard al kifayah* rationale justifies public expenditure relating not only to supply of "public goods" or all goods whose supply is characterized by market failures, but it also justifies supply of private goods in certain circumstance". *Op. cit.*, p. 27.

tions of the Islamic state.³³ *Fard ai kifayah* is an obligation on every individual but it is characterized by the condition that if it is done by someone, then all others are spared, and if it is not done at all, then every one is held responsible for failing to do it³⁴

The *Qur'an* addresses its order regarding this obligation sometime to the whole community as in the verse : *ولتكن منكم ائمة يدعون الى الخير*

“Let there arise out of you a band of people inviting to all that is good” (3 : 104) and sometimes to an undetermined segment of it as in verse “If party out of every group should go forth to study religion” “فلولا نفر من كل فرقة منهم طائفة ليتفقهوا في الدين” (9 : 122).³⁵

But *fard al kifayah*, as defined above does not serve as a satisfactory explanation of the functions of the state in the Islamic system because of the following reasons :

1. *Fard al kifayah* is in principle and by definition a matter of individual action backed by individual responsibility, and not a matter of collective action backed by collective responsibility. This is clear in the examples usually given as well as in the definition itself. See the two verses mentioned above or the example given by Siddiqi, i.e., burial of the deceased. The required action is something to be done by certain individual(s). It is true that some socio-economic or technological circumstances may render it inefficient and sometimes impossible for individuals to perform *fard al kifayah* without state's coordination and support. Under such circumstances, the state takes up necessary support and coordination as one of its functions. Example of such cases are defence and specialized professions such as medicine, carpentry and midwifery. Al Khudari describes *fard al kifayah* as things “whose fulfilment is necessary regardless

33. M. N. Siddiqi, *Op. cit.*, p.p. 8-10 and 23-29.

34. Muhammad al Khudari, *Usul al fiqh* (axioms and rules of jurisprudence), 6th ed. (al Maktababah al tijariyyah al kubra, Egypt, 1969), p. 42.

35. *Ibid.*, p. 43.

of who does them"³⁶ and adds "and when any of them is demanded by the Legislator, the demand applies to those who have the capability to do it, and if they fail, the rest of the community is required to have them do what is demanded. Thus those who are capable are obligated to undertake the task, while others are obligated to get them to do so. If there were no capabilities, the whole community is required to take what is necessary to acquire them...This is the meaning of solidarity insparing-mandate interests المصالح الكفائية."³⁷

This individuality nature of *fard al kifayah* excludes from its realm major functions of the Islamic state such as the administration of state owned property, collection of *kharaj* and maintenance of law and order. These are known in Islamic literature as the responsibilities of the "khalifah" or the state per se. Moreover, it gives strength and personalizations to duties that are in the public interests, so that defence, for example, is an individual obligation backed by personal responsibility and not merely a function of the state and that is all.

2. *Fard al kifayah* derives its legitimacy from *Shari'ah*, it thus requires hard evidence, e.g., a text or a proof of its being essentially necessary, which is very difficult to obtain in most issues of state functions that are usually controversial. It is therefore too strong to be manageable in theorizing state's functions. Take the case of air pollution, no one disputes it is harmful. But what limit of it is tolerable? And what devices keep it under control? And how much of their cost can be internalised? All are questions which make air purification very controversial that a consensus about its imposition as *fard al kifayah* is unlikely.

Additionally, the society (and the state) may desire to undertake certain functions in the area of improving the

36. *Ibid.*, p. 41.

37. *Ibid.*, p. 44.

quality of life. In fact, some of these functions become obligatory on the Islamic state who have sufficient non-tax financial resources. The concept of *fard al kifayah* is inadequate to cover such cases.³⁸

C. Ordaining what is known as good and forbidding what is known as bad in public matters الامر العام بالمعروف والنهي عن المنكر

What is known as good المعروف covers every good, whether it is obligatory in *Shari'ah* or only desired and encouraged as well as what is known as good by *consencious* and convention of the Muslim community as long as it does not violate any of the *Shari'ah* principles and rulings. What is known as bad is the opposite. Consequently, "ordaining the good and forbidding the bad" is inclusive to all the objectives of *Shari'ah* in individual life as well as in social life.

Ibn Taymiyyah writes "the summing up of religion and all authorities is ordaining and forbidding. The ordaining with which God sent His messenger is ordaining what is known as good, and the forbidding with which He sent him is forbidding what is known as bad. Doing so is characteristic of the Prophet (P) and the believers. God (ta'ala) says "The believers, men and women, are protectors, one of another, they enjoin what is good and forbid what is evil." المؤمنون والمؤمنات بعضهم اولياء بعض يامرون بالمعروف وينهون عن المنكر (9 ; 71)³⁹. Then He goes on to say that "ordaining what is good and forbidding what is bad" is the ultimate objective of the Islamic state in all its functions, be they military, political, financial or related to

38. Probably, sensing this inadequacy urged Siddiqi to write "to complete the picture, a third rationale, assignment by people, should be added to these bases of public expenditure" *Op. cit.*, P.P. 28-29. These bases are "*fard al kifayah*" and "public goods". Ironically public goods can only be supplied by public vote (see Mususgrave and Musgrave, P. 54) which is no more than public assignment. This reduces the rationales back to two only.

39. Ibn Taymiyyah, *Al Hisbah fi al Islam*, ed. by Muhammad al Mubarak, (Dar al Kutub al Arabiyyah, Damascus, 1967), p. 6.

law and order, especially since the state has more power and capability in performing this task than individuals.⁴⁰

Consequently, "ordaining what is good and forbidding what is bad" explains the role of the Islamic state and provides a comprehensive rationale or base for all of its functions. It can be practiced by individuals as well as the state, and it covers issues of private interests as well as of public interests. The state supervision of the observance by individuals of the ethics and moralities in transactions is "ordaining.....and forbidding" in the private arena. Same thing can be done by individuals.

Talking about "ordaining what is good and forbidding what is bad" in public matter, al Mawardi says "it is like, when, in a village, the water fountain gets broken, the protection wall gets ruined, as wayfarers pass through and no one provides them with needed help."⁴¹

Thus "ordaining what is good and forbidding what is bad" serves as a rationale for the functions of the Islamic state, and it was used as such by Ibn Taymiyyah. It goes beyond a basic skeleton of state function, i.e., the necessities or obligations; to include the area of the desired. Its scope is wider than *fard al kifayah* on yet another scale since it also covers what people view as good (or bad) as long as it is within the limits of *Shari'ah*.

Lastly it must be noted that this principle is not restricted to having others do what is good and abstain from what is bad. It rather includes taking up things in the form of direct implementation. This is clearly implied in the statement quoted above from Ibn Taymiyyah, it is explicitly mentioned by al Mawardi who writes immediately after "ordaining what is good in public matters" if there were funds in the treasury...[the state must] order the repair of the fountain, reconstruct the wall, and help the wayfarers who pass through

40. *Ibid.*

41. Abu al Hasan al Mawardi (died 450H), *al Ahkams al Sultaniyyah*, 3rd ed. (al Halabi Printers, Cairo, 1973), P. 245. The full text is attached as appendix because of its relevance to this part as well as to all of part three. Notice that he considers mosques of the same category.

since these are duties obligated on the treasury and not on people"⁴² As a matter of fact, the concept that "ordaining and forbidding" includes taking action of doing the good and removing the bad is established by several sayings, we only quote two of them. The Prophet (P) is reported to have said :

He, among you, who sees an evil	من رأى منكم منكراً
he must change it by his own hand,	فليغيره بيده
if he could not, then by his tongue.	فإن لم يستطع فلسانه
and if he could not then by his heart...	فإن لم يستطع فبقلبه

Reported by Muslim.⁴³ رواه مسلم

and :

The example of him who takes action	مثل القائم
on the ordenances of God, and of him who	في حدود الله
violates them is like the example of a	والواقع فيها كمثل قوم
group [of people].	

who divided shares in a boat among themselves .. استهموا في سفينة ..
those [who were in the bottom section] said :

"why don't we make a hole in our section"	لوانا خرقتنا في نصيبنا خرقتنا
...If they left them do what	فإن تركوهم وما
they wanted, they would expire,	ارادوا هلكوا
all of them, and if they took over their	جميعا وان اخذوا على
hands [prevented them forcibly],	ايديهم
they would be saved, and all of them	نجوا ولجوا
would be saved"	جميعاً

Reported by al Bukhari.⁴⁴ رواه البخاري

PART THREE

A Theory of Taxation in Islam

No matter how it is discussed, or by adherents of what isms, the issue of taxation boils down to a discussion of individuals vis a vis

42. *Ibid.*

43. Al Nawawi (d. 671), *Riyad al Salihin*, (Dar al Kitab al 'Arabi, Beirut, 1973), p. 100.

44. *Ibid.*, p. 101.

the state, Thus personal freedom and private property are central to any taxation analysis. So F. R. Faridi was quite right in stating that the core of issue is the "sanctity of private property" in *Shari'ah*.⁴⁵

Moreover, taxation in Islam is, first of all, an issue of *Shari'ah* that deals with the ought, the permissible, and the prohibited as Siddiqi rightly puts it with respect to expenditure. Consequently, and objection to resorting to jurists' views is disregarded and needs not to be given an ear.⁴⁶

Since the protection of private property and personal freedom vis a vis the state is well established in the literature,⁴⁷ and its relevance to taxation was stressed in my previous paper, there is no need to repeat it in the present study. Consequently, this part consists of two sections. Section one is devoted to deriving a position on the issue of taxation, and section two is devoted to the deficit/surplus in the budget.

Section One :

A Proposed Theory of Taxation in Islam

The distinction made in part two of this study, between objectives and obligations of the Islamic state is very important to the theory of taxation in Islam. Such a distinction provides the base for

45. Faridi. *op. cit.*, p. 28.

46. See Anwar Siddiqi's comments on Kahf's "Taxation Policy" in Ziauddin Ahmad, *op. cit.*, p.p. 154-157.

47. It is worth our attention, however, to notice that the Islamic system assigns a sizable chunk of productive resources to the public sector such as minerals, land not owned privately, water resources, major energy sources, etc. This may characterise the Islamic economic system as a dual property system (i.e., the coexistence of private and public property) rather than a private property system especially with the fact that the surplus of the public economic enterprises can be used to expand its productive base. See M. Kahf "The Role of Public Sector". *Op. cit.*

tax legitimacy in the Islamic system because it points out the needs for tax proceeds which will be shown as the reason d'être of levying the tax. This distinction is, further necessary to invalidate the functional approach to the argument for taxation. Faridi, Salama and others argue that since the state functions include distributive, allocative, stabilizing and welfare measures, then taxes can be imposed to achieve these objectives. The argument of this paper centers on the point that only obligations of the state justify taxes, otherwise attainment of the objectives must not be achieved by means of restrictions on personal freedom and property.

1. The Early Islamic State : The Prophet's (P) Period :

To examine the issue of taxation in Islam, one should refer to the early Islamic state. At the time of the Prophet (P), there were no taxes at all until *Zakah* was imposed. The functions of the state were all financed by voluntary contributions. We, even, have numerous reports about physical needs of the hungry, including, at times, the Prophet (P) himself, that reached striking level such as falling unconscious, or tying a stone to stomach in order to press it to reduce the pain of hunger or not being able to sleep at night out of hunger, etc.⁴⁸ Also we have many reports of the Prophet (P) calling for contributions or asking for volunteers to feed new comers to the city or to bring food into the mosque to feed the tens of people who lived by the mosque devoting all their time to the service of the state and religion (known as *Ahl al Suffah* أهل الصفة).

After the first battle, Badr, acquisition of property from the enemy in war started. And a few years later, a permanent income to the state was established by the Prophet (P), in terms of assigning the yield of part of the conquered land of Khaybar خيبر and Fadak فدك to the state. But the state became rich only at the end of the life of the Prophet (P), and more specifically during the reign of the second *Khalifah*, Umar.

Two incidences speak for the position of the Prophet (P) on issues of how far the state goes in regards to the welfare and develop-

48. Several authentic sayings refer to these cases that I feel no need to mention any of them.

ment objectives. First, a report by al Bukhari and Muslim from Abu Hurairah :

That the Prophet (Peace and prayer be upon him)	ان النبي صلى الله عليه وسلم
used to be brought a deceased man with debts on him, he asks : did he leave for his debt	كان يؤتى بالرجل عليه الدين فيسأل هل ترك لدينه
[any thing sufficient] for [its] payment back ?	من قضاء
If he were told that [the man] left what fulfills [the debt]	فان حدث انه ترك وقاء
he would pray [the prayer on the dead] on him, and if not, he would have said : "pray on your friend"	صلى عليه والا قال صلوا على صاحبكم
But when God opened for him the openings [gave	فلما فتح الله عليه الفتوح
him conquers], he said :	قال :
I, am more of a supporter to believers [even] of their own selves, he who dies with debt on him, it is on me, [the responsibility of] its payment back." ⁴⁹	انا اولى بالمؤمنين من انفسهم ، فمن توفى وعليه دين ، فعلى قضاءه
And second, a report by the Four (Abu Dawud, al Tirmidhi, and Nasa'i) and Ibn (Majah) from Anas :	
that a man from <i>al Ansar</i> came to Prophet (Peace and Prayer be on him) asking him : [for financial help.], [the Prophet] said : don't you have any thing at home	ان رجلا من الانصار اتى النبي صلى الله عليه وسلم يساله فقال اما فى بيتك شى
[the man] said : yes a piece of cloth, we wear part of it, and lay on the floor its other part and a jug, with which we drink water.	قال بلى حلس نلبس بعضه ويبسط بعضه وقعب نشرب فيه الماء

49. See Yusuf al Qardawi, *Fiqh al aakah*, Op. cit., VII, P.P. 627-628.

[The Prophet] said : bring them to me.	فقال ائتني بهما
He brought them in. The Messenger of God	فأتاه بهما فآخذهما
(Ppbuh) took them and said : who buys	رسول الله صلى الله عليه وسلم
these two [things] ? A man said :	وقال من يشتري
I buy them	هذين ؟ فقال رجل انا آخذهما
for one <i>dirham</i> . (The Prophet) said :	بدرهم. قال من يزيد
who offers	
more than a <i>dirham</i> ? twice or three times.	على درهم ؟ مرتين او ثلاثا
[Another] man said : I take for	قال رجل انا آخذهما بدرهمين
two <i>dirham</i>	
[the Prophet] gave them to him,	فأعطاهما اياه
took the two <i>dirham</i> and gave them	واخذ الدرهمين واعطاهما
to the man from <i>al Ansar</i> , and said :	الانصاري وقال :
buy food, with one, and send it to	اشترى بهما طعاما وانبذه
your family,	الى اهلك
and buy an axe, with the other, and	واشترى بالآخر قدوما
bring it to me	وائتني به
the Messenger of God (Ppbuh) tied to it a	فشد رسول الله (صلى الله
piece of wood	عودا
[handle] with his own hand, and told	بيده ثم قال له :
[the man] :	
go and cut [fire] wood and sell it, let me	اذهب فاحتطب وبع ولا
not see you for fifteen days.	ارينك خمسته عشر يوما,
The man went cutting wood and	فذهب الرجل يكتطب ويبيع
selling, then	
he came with the <i>dirhams</i> he gained,	فجاء وقد اصاب عشرة دراهم
with some, he bought a piece a cloth	فاشترى ببعضها ثوبا
and, with some food... The Messenger of	وبعضها طعاما... قال رسول
God (Ppbuh) said : This is better for	الله صلى الله عليه وسلم
you than begging coming [as] a dark spot	هذا خير لك
	من ان تجي المسالة نكتة

on your face on the Day of Resurrection...⁵⁰ في وجهك يوم القيامة

These two incidences indicate that the Prophet (P) did not take any tax measures to finance guaranteeing debts of the deceased or even providing a gainful jobs to the unemployed. In fact, for the debt guarantee, which is a pure welfare matter, he did not take any action at all before having non-tax resources of finance. As for the job supply, which is at the same time developmental, he took the role of a capitalist that enhances and improves the allocation of private material and human resources.

But a conclusive case against taxation from the experience of the Islamic state during the life of the Prophet (P) is hard to make, because we do not have a case when the idea of imposing taxes was proposed and rejected. And a question remained unanswered, what would the Prophet (P) have done had he not received sufficient voluntary contributions for say building the mosque or feeding the hungry?

2. The Period of Four Wise Khulafa

Unfortunately, our experience in regard to taxation during the state of four Wise *Khulafa* is not must better since non-tax income was abundant. The exception of *al ushr* on trade is imposition perhaps the only clue to taxation. 'Umar imposed *ushr* on trade between cities at the rate of 2.5% on Muslims, 5% on *Ahl al Dhimmah* (people of the Book who reside in the Muslim land) and 10% on foreign traders. Apparently, several quotations on *al ushr* indicate that it was the *zakah* on trade's merchandize for Muslims, dues contracted in the surrender agreement for *Ahl al Dhimmah*, and dues necessitated by reciprocal treatment of Muslim traders in foreign land.⁵¹

Abu 'Ubaid clearly argues that 'Umar did not impose this *ushr* on Muslims. He gives this kind of opinion immediately after quoting

50. Yusuf al Qardawi, *Ibid.*, P. 895.

51. See the appendix for such quotations from Abu 'Ubaid.

several sayings and narrations against *max* مكس and *ushr* عشر, both taxes were imposed by ancient Arab and non-Arab kings.⁵²

On the other hand, 'Umar's famous action regarding captured land is a milestone in establishing permanent sources of income which not only takes into consideration the interest of future generations, but is also flexible in both its size and allocation. The rates of this income, *al kharaj* الخراج, may be changed at the discretion of the Islamic state, and its proceeds can be used for any policy objectives.⁵³

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52. Abu 'Ubaid, *al Amwal*, p. 529. Ironically *max* and '*ushr*' were taxes imposed by virtue of sovereignty of the state and its authority. Thus the rationalization of modern taxes on grounds of sovereignty and authority seems to violate the principle of the prohibition of *max* and '*ushr*'.
53. It is amazing that this action of 'Umar, which gained the unanimous approval of the Companions, did not yet receive sufficient analytical study. The following points are worth consideration :
1. Although the controversy between 'Umar and his opponents was focused on to whom the land must belong ; the fighters or all generations. 'Umar, after convincing his opponents, did not restrict the use of the return of the land to distribution to persons, as the rule of distribution of *ghanimah* may imply. He rather treated the return as a revenue to the state and used it to financing all of its functions. Jursits, later, followed this tradition.
 2. This is supported by the fact that, in his argument, Umar used the verses of Surah al Hashr. Those verses deal with the cuse of *fay*', i.e., booties from conquer without fight. These verses give the state more flexibility in use of funds, especially after the death of the Prophet (P), than the verses in Surah al Anfal which deal with *ghanimah*.
 3. More emphasis needs to be put on the dimension of permanency to state revenue which was introduced by the Second *Khalifah* and its amenability to changes as a result to changes in financial needs and productivities.

3. Elements of Islamic Theory of Taxation :

One may hardly find any reference to taxes by early jurists, there was simply no need for taxes at times of abundant non-tax sources.

But, later on, when traditional resources started to dry out, while the need for funds increased especially in areas of the Muslim land that experienced more defence expenditures, jurists discussed imposing taxes as a means of financing the state's function. It is no surprise, therefore, to find most early jurists silent on taxation while they all preserve the general blanket assertion against levies done by pre-Islamic rules under the name of *ushr* or *max*, the same way Abu 'Ubaid did.

Consequently, one had to work through the juristic opinions keeping in mind the analysis of part two of this paper and the practice of the Prophet (P) and the four Wise *Khulafa'*. Without feeling a need to repeat previous research,⁵⁴ the following three points lay the ground for understanding the elements of taxation theory in Islam :

- a. *Zakah* is the only financial obligation that is due on a person because he/she has wealth/income i.e., *because of owning 'mal* مال. All other financial duties obligated in *Shari'ah* (such as supporting relatives or providing hospitality to guests) are caused by some other factors, but being financially able is a condition for their obligation.⁵⁵ This means that taxes meant for mere purpose of reducing the payee's wealth or purchasing power are not likely to have Islamic backing.
- b. *Taxes can be imposed with binding conditions*. In other words, taxes cannot be imposed without the fulfilment of these conditions.

54. See ; Monzer Kahf "Taxation Policy", *Op. cit.*, Yusuf al Qardawi, *Fiqh al Zakah*, p.p. 1072-1105, and Abd al Salam al 'Abbadi, *Al Milkiyyah fi al Shari'ah al Islamiyyah*, V. 2 (Maktabat al Aqsa, Amman, Jordan, 1975), p.p. 288-301.

55. al Qardawi *Fiqh al Zakah*, V. 2, p.p. 991-992.

- c. The Islamic system of ownership, based on the *coexistence of public and private ownership*, provides the Islamic state with a sizable, permanent and flexible source of income that is amenable to policy objectives.

Now the elements of a taxation theory in Islam can be put forward :

- I. Taxes are *tightly linked to the need for expenditure* :

This means that, first and foremost, taxes can only be justified by the use of their proceeds. It does not require expenditure appropriation of taxes.

Taxes derive their justifications from the obligatory functions of the Islamic state, i.e., anything which is required to be done, such as fulfilling the essential needs of the poor, can be financed by taxes if other resources are not sufficient. The obligatory functions, as explained in part two of this paper, are distinct from the desired functions. The latter can only be undertaken if there are sufficient non-tax resources available to the state. It must be realized that the details of obligatory functions of the state are socially determined in such a way that it is left to the political decision making to draw the lines and determine the specifics. But important enough is to recognize the fact that the legitimizer, from the Islamic point of view, of taxes is ; the use of their proceeds falls within the obligatory functions of the Islamic state. Consequently, a case can be made against any tax levy, if it can be shown that its proceeds are not used for a necessary function. Al Ghazali, for example, although he approves of imposing taxes to finance defence, made a case against taxes of his time that are imposed to finance the military activity because what is given to "few [top ranking] soldiers, if it is distributed to all [soldiers], it would be sufficient for them for a long time, ... They (top officers) are very high in their luxuries, and enjoyment of high living, and extravagant in spending on [big] buildings and aspects of beautifications on a tradition similar to that of ancient persian kings. How can we appreciate their need for tax to

be imposed on people in order to supply them [with more funds] while, compared to them, wealthy persons of all time look like poor".⁵⁶

Consequently, improvements in quality of life, and all things that can be classified as improvements in al Shatibi's classification of necessities, conveniences and improvements, do not make good cases for taxation, although the state can undertake them, and sometimes it may be obliged to do so, given availability of non-tax resources such as yield of public property.

Moreover, the function of ordaining what is good and forbidding what is bad provides a ground for taxations to finance a wide area of the socially important public goods such as building and maintaining mosques, water fountains, street lights, flood protection networks, to promote Islamic way of life and similar activities, when non-tax resources are not available. As was shown earlier, ordaining good and forbidding bad is more flexible and more inclusive than *fard al kifayah*. It is noteworthy, however, to see that the examples given by al Mawardi (see the appendix) relate to public goods on which user's fees can not be applied because of the nature of the good (e.g., wall protecting the city from enemy), religious reason (e.g., mosques) or socio-economic considerations including cost of collecting fees, social stability, caring and solidarity (e.g., water fountain and helping wayfares).

II. Taxes are the last resort :

Taxes can be imposed only after exhausting all other resources. There is no single Muslim scholar, past or present, who says that taxes can be imposed before exhausting all other resources. Al Mawardi, for example, insists that resorting to taxing the financially able can only be done if the treasury does not have sufficient funds. Al 'Abbadī

56. al 'Abbadī, *Op. cit.*, p. 289.

and al Qardawi quote al Ghazali, al Shatibi, al Mawawi, Abu al Walid al Baji, Abu 'Abd Allah al Farra', 'Izz al Din bin 'Abd al Salam, al Maliqi, al Qadi Ahmad al 'Anasi (Zardi) and others on the issue of allowing taxation provided there are no other resources.

Non-tax resources in the Islamic state must not be underestimated. *Zakah* provides for 2%—8% of GDP generated in the private sector.⁵⁷ *Zakah* is principally used as a means of redistribution of income and wealth. One can hardly suggest any faster redistribution without risking the stability of the economy. Additionally, *Zakah* can be collected in advance for a year to come or more.⁵⁸ The Prophet (P) is reported to have needed funds and collected one year *Zakah* in advance from al 'Abbas.⁵⁹ Practically, all that is usually hoped for by writers like Faridi and Salama with regards to education, health services, transport, housing, subsidies, and even welfare projects addressed to the poor is covered by *Zakah*, even provision of certain public goods can be done by use of *Zakah* as long as any service can be restricted to categories included among the *Zakah* recipients mentioned in the *Qur'an*. Furthermore, *Zakah* proceeds (and advanced collection) can be used for capital goods to build productive capacity owned by the poor, in this way recipients are enriched via the distribution of equities as well as job opportunities created by proper allocation of *Zakah* proceeds. Especially that the essential objective of *Zakah* institution is not to merely provide minimum consumption needs to the poor but also to enrich the poor and remove him from the list of future recipients.

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57. Monzer Kahf 'Zakah' Estimation in Selected Muslim Countries study in progress, expected to be finished in mid 1986.
58. Al Qardawi, *op. cit.*, p.p. 825-827.
59. The story is reported by al Baihaqi, and versions of it are in Abu Dawud al Tayalsi and Muslim. See al Qardawi, *ibid.*, p. 825.

Additionally, the economic public sector in the Islamic economy is expected to be relatively big because of its system of ownership. Moreover, as was seen earlier in this paper, the Prophet (P), and 'Umar after him, inculcated the tradition of establishing permanent non-tax rent-yielding resources to the state. The income of such public property, including the public economic enterprises, can be used for all policy objectives whether they are necessities or not, according to an established socio-political preference (not forgetting that necessities come always first). Here too, the size of the public sector should not be under-estimated. A rough estimation shows that between 20% and 86% of GDP, generated in the production and distribution activities of eight Muslim countries of different natural endowment and economic systems, come from the public sector enterprises.⁶⁰

Moreover, before thinking of taxes as a legitimate device in the Islamic state, four measures must be done with completely and fairly. These are expenditure trimming, financing development undertakings by means of private participations, selling public goods for fare prices or fees, and voluntary and forced public borrowing. It is not easy, at all, to defend the pattern of expenditure that prevails in budgets of many Muslim countries on grounds of efficiency and socio-economic priorities, and unless public expenditure is re-evaluated, any proposal to justify taxes on Islamic basis may not be relevant, since the most important variable in such a justification is the need for funds.

On the other hand, public financing of government activities by non-tax means must be explored. The public can participate in financing many public goods such as large portion of infrastructure including investment in human resources on the basis of user's fees.⁶¹ Also many develop-

60. Monzer Kahf "Role of Public Sector", p. 46.

61. Knowing that the poor's fees can be carried out by *Zakah* fund,

mental projects as well as many infrastructure and construction works for the public sector can be designed on profit basis, and financed by private, profit oriented savings.⁶²

Lastly, voluntary and forced public borrowing is a source of financing public expenditures, especially at extraordinary and emergency situations, that must be resorted to before taxes in many occasions. This is left to section two of this part.

III. Whenever they are imposed, taxes must be just :

Justice in the distribution of tax burden is an essential condition mentioned by many great scholars such as al Ghazali, Ibn Taymiyyah, al Mawardi, and others. In fact imposing taxes on the poor contradicts the principle of *Zakah* itself as well as guaranteeing a minimum standard of living. Jurists, persistently, use the term "those who are able *ذوى المكينه*" in the distribution of tax burden.⁶³ This term implies that tax burden should be proportional to the ability of the payees and exemptions should be based on allowing tax-free adequate level of living. It accommodates progressive taxation whenever it is feasible as a major form

62. Such as building roads, schools, dams, etc. and renting them to the public sector, or on the basis of *mudarabah* bonds similar to the *Muqaradah* Bonds for which a special act was lately adopted in Jordan. See Monzer Kahf "Sanadat al Qirad wa daman al Fariq al thalith wa Tatbiaquhuma fi Tamwil al Tanmiyah fi al Buldan al Islamiyyah [Qirad Bonds, third party guarantee and their application in financing development in Muslim countries] unpublished paper, Jan. 1986.

It seems that several countries, lately, started to appreciate the merit of the public participation—on profit basis in financing the public economic enterprises to the extent that some of these countries decided to sell shares in public corporations to the private sector. See the case of Pakistan in *Pakistan and Gulf Economist*, Feb. 1-7, 1986, cover story "Public Sector Shares for Sale".

63. See Al Mawardi in the appendix.

of taxation in the Islamic system. al Qardawi clarifies "since equating [in tax burden] the unequals is injustice".⁶⁴

This condition makes a strong case against most indirect tax whose final incidence is the poor and middle class masses in as much as it supports taxes on luxury goods. It also runs opposite to the capitalist development propositions of taxing the consumption of masses and subsidizing the investments of the business community. This condition does not seem to accept any compromise with distributive justice under developmental or allocative pressures.

On the other hand, preference of direct and progressive taxes, implied by the condition of justice, does not require the suggestion of a one tax system. Al Ghazali believes that it is left to the state to decide the variety of taxable wealth and income as long as taxes are not levied on some of the able individuals while some others are not taxed.⁶⁵

Section Two :

Budget Balance and Deficit Financing :

The issue of deficit financing and budget surplus or deficit is tightly related to taxation because all Muslim scholars do not seem to even imagine tolerating the idea of taxes while there is a budget surplus or budget balance without the tax revenue. Consequently in this section, I shall discuss two points : deficit financing of government activities and revenues-clearing expenditure.

1. Deficit Financing :

Holding to deriving our theory from a deliberate analysis of the practice of the Prophet (P), one may detect the origins of a fiscal policy that can be characteristic to the Islamic economic system. As it was shown in this paper, the activities of the Islamic state at the time of the Prophet (P) was financed by two major sources : the first is voluntary contributions which made up the major source of financ-

64. al Qardawi, *op. cit.*, p. 1081.

65. Al 'Abbadi, *op. cit.*, p. 290.

ing until the second source, war booties, started its inflow. This second source became overwhelming as the expansion of the Islamic state continued until the time of the Omayyads. Noticeably, in this period, the Prophet (P) and his second Successor, 'Umar, established properties to the state yield a permanent stream of revenue.

A closer examination of voluntary contributions as a means of financing state's activities reveals that it is in fact a form of deficit financing. The way it worked was as follows : An expenditure is decided, say, financing the battle of Tabuk, the prophet (p) stands and calls for contribution until the need is satisfied.

In contemporary context, budget deficit is financed by international borrowing, borrowing from the central bank or voluntary and involuntary financing from the private sector. Evidently, in a state based on ideology, voluntary private financing adds a dimension that cannot be neglected and must be included in our consideration. Voluntary private financing may take one of three forms: donations, loans, or profit-motivated sharing.

Voluntary private donations and loans may not be very important in relieving chronic budget deficit in normal cases,⁶⁶ but this source of deficit financing may be responsive in cases of emergencies. On the other hand, as mentioned earlier, a good deal of Government deficit could be financed by profit-seeking private savings if the authorities were able to reformulate its developmental projects to suit the profit motivation such as :

66. Faridi, *op.cit.*, p.p. 34-35, plays high the role of voluntary sector. Although a voluntary sector, called often the "third sector", is not negligible in some western economies today, I do not think that it could make important contribution to regular or normal conduct of the economic units in an Islamic economy for two reasons: first once *zakah* is removed from the voluntary sector to government, the remaining contributions will not most likely be sizeable, and second, in most cases the third sector's administrator behave, in production, on motivation very similar to the profit motivation of the private sector, especially if the comparison is done with corporate businesses,

1. Financing development projects through negotiable *qirad* bonds. These bonds are based on the concept of *mudarabah*. They can be issued for one specific project or a group of well identified projects. Certain form of Government guarantee can be provided for such bonds.⁶⁷
2. Financing infrastructure projects by means of creating development finance corporations that float shares. The role of such DFC will be to contract infrastructure projects with the state at staggered payments and at prices that allow for a profit margin, and build contracted projects, via sub-contractors. The finance comes from floated shares sold to the public. Assets of such DFC, at each moment of time, will be IOU's issued by the state for finished and delivered projects, projects in process (these are owned by the DFC) material and administrative facilities, and advances to contractors and liquid cash. Shares issued by such multiprojects DFC may be negotiable.
3. DFC may be created for one single project with negotiable or non-negotiable shares,⁶⁸ with the purpose of providing a variety suitable to different categories of investment preferences.

As for involuntary borrowing from the private sector, it is restricted, in this paper, to direct interest-free loans taken from the rich.

67. See, for details, Monzer Kahf *Qirad Bonds*'', *op.cit.*

68. Dr. Anas Zarqa, in a private discussion, brought to my attention that once the assets of such DFC take the form of a debt on the state after the delivery of the project, negotiation of its shares for other than the face value of what they represent of the debt may run in *fiqhi* difficulties, which may render it impractical to permit transfer of shares at such stage. He added that he is working on developing a scheme that may remove any *fiqhi* objection to transfer of ownership of shares at market values. This is mainly based on preserving the projects ownership in the hands of the single project DFC until complete payment of its value is paid by the state, and in the meanwhile collecting rental income from the state. I look forward to seeing this proposal completed.

Apparently, Muslim scholars who approve of taxation in order to fulfill the obligatory duties of the Islamic state would consider forced direct borrowing from the rich as a better alternative to taxation. Al Mawardi, for example, does not approve of public borrowing for improvements while he approves for it or expenditure which is obligatory on the state if not paying (or delaying) it may cause any damage.⁶⁹ As quoted by al Mawardi, al Shafii seems to have accepted the idea of public borrowing too, since he approved of putting aside certain provision for debt payment in case of budget surplus.⁷⁰

On the other hand, one must distinguish between borrowing for public consumption and for yield-generating development projects. Al Imam al Shatibi (d 790 H/1388 A.D). makes a similar distinction between the case of expecting future revenues sufficient to pay the loan back (this may be generated from yield or future regular revenues) and the case of not expecting such an income. He argues that in the latter case a tax is preferred to borrowing.⁷¹

Al Shatibi's argument, which came several centuries ago, makes a strong case against the contemporary lavish public borrowing for consumption purposes, which is a hot spot in the current dilemma of international public borrowing. In fact, al Ghazali (d 505H/1102 A.D.) preceded al Shatibi in making such an argument against borrowing for public consumption. Al Ghazali's example may shed more light on his opinion of resorting to taxation instead of public borrowing in case of fulfilment of required state activities, he says "if Muslims are hit by a famine or shortage [of crops], and some people were near ruined, wealthy persons are obliged to fill their needs. This is a *fard kifayah*. It cannot be financed by way of lending, since the *poor ones are dependent on the rich ones*, they are to them like children to fathers. It is not permitted that an [obligated] relative spends on his [dependent] relative by way of lending except when the latter has non-present

69. Al Mawardi, *op. cit.*, p. 215,

70. *Ibid.*

71. See Muhammad Abu Zahrah, *Al Imam Malik*, 2nd ed. (Dar al Fikr al 'Arabi, Cairo, 1952) p. 337.

wealth.⁷² Interestingly Al Qadi Ahmad al 'Anasi (a Zaidi) suggests that there should be no guarantee of any form if the state could not pay back loans from the private sector, i.e., such loans become like taxes.⁷³

Lastly, borrowing from the central bank is looked at with skepticism because of its destabilizing effect. Also international borrowing without interest is very unlikely, and recently we hear many experts voicing the call of substituting it by international equity participation.⁷⁴

2. Balancing the Budget.

There are several hints in the practices of the prophet (p), his four wise successors, and 'Umar bin 'Abd al 'Aziz' to the effect of not leaving any surplus in the budget. Abu 'Ubaid reports that the prophet (p) used not to let any amount of money stay over night in his treasury. Abu 'Ubaid explains, "this means if money comes in the morning, the mid day is not reached but with all the money distributed, and if it comes in the evening, he would not go to sleep until it is all distributed".⁷⁵ Abu Ubaid also reports the Prophet (p) to have said "If I had [as much as the mount of] Uhud of gold, I would be pleased that no third [night] passes and I still have any bit of it, except something I put aside for a debt [due] on me".⁷⁶

It is obvious that 'Umar, the Second Khalifah and 'Umar bin 'Abd al 'Aziz extended the services of the state and beefed up the cash and food distribution in order to get rid of any surplus they had in their treasury. Abu'Ubaid reports 'Umar bin al Khattab and 'Umar bin 'Abd al 'Aziz both, added several items of welfare nature to the ex-

72. See al 'Abbadī' *op.cit.*, p. 292.

73. *Ibid.*, p. 296.

73. See for detail Tariquillah Khan "The Role of National Development Financing Institutions in promoting Joint Ventures in OIC Countries" paper in progress, expected in mid 1986.

75. Abu 'Ubaid, *al Amwal, o. p. cit.*, p, 248.

76. *Ibid* , p. 249.

penditure headings in order to use up the budget surplus.⁷⁷ Specifically ‘Umar bin ‘Abd al ‘Aziz wrote to his [commissioner] ‘Abd al Hamid bin ‘Abd al Rahman – then in Iraq – ‘to distribute to people their [regular grants], the latter wrote him back. ‘I have distributed to people their grants, and there is still a [surplus of] fund in the treasury’. He wrote him ‘see every one who had borrowed [money] with no recklessness or extravagance and pays one’s loan on one’s behalf’. He wrote him back [here] I have done that and there is still surplus in the treasury of Muslim’. He wrote him again ‘see any bachelor who has no wealth and accepts that you help him get married, marry him and pay the dowery on his behalf’. He wrote him back ‘I helped marrying everyone I found and there is still fund in the treasury of Muslim’. Finally, ‘Umar wrote [to his commissioner] after all this was done ‘See those on whom there is *jiziah*, but they become [financially] weak that they could not take care of [farming] their lands, give them advance sufficient to make them able to work on their lands, we do not require them [to pay back] for a year or two’.⁷⁸

Additionally, a look at the special case of *zakah* also tells that the principle is, general, to distribute all the proceeds during a very short period. As for *zakah* of al *fitr*, this period is made even shorter, i.e., not more than last few days of the month of Raman in normal cases.

From the above, it may seem sound to formulate the first axiom of budget balancing as :

In principle, while the Islamic system of public finance does not tolerate the imposition of taxes if the budget is at least balanced, it does not feel at ease with a surplus of non-tax revenues over expenditures. Furthermore, in any such case, it call for expenditure expansion.

This axiom, naturally, call for a time horizon and a provision for emergencies and unexpected events. Al Shāfi’ī believes that such a provision is not needed except for payments of loans since expenditure necessitated by emergencies, when they happen, must be financed

77. *Ibid.*, p.p. 250-251.

78. *Ibid.*, p. 251.

by all able Muslims.⁷⁹ On the other hand, according to al Mawardi Abu Hanifa is a believer in making certain provision for emergency expenditure.⁸⁰ The later's position might be enhanced by the tradition that whenever he was able the Prophet (p) used to save food sufficient for one year's consumption of his household, and by the lesson derived from the story of the Prophet Yusuf (p) and his seven years of good harvest and seven years of drought. Thus, a medium and long term balancing of the budget is not alien to the jurists' thinking. Moreover, the use of short term source of revenue, war booties, to establish permanent sources of income that take into consideration the future needs of the state as well as the interests of forthcoming generations was practiced by the Prophet (p) and his Second Successor with the approval of Companions. All this allows to formulate the second axiom of budget balancing as :

Whenever, it is possible, budget balancing should take into account the interests of future generation even if this may imply using current non-tax revenues for creating long term service and/or revenue-yielding sources that serve the best interests of all Muslims in the present and in the future.

CONCLUSION

The crux of this paper is not a denial of the possibility of the presence of taxes in Islamic context, but a call for coherence with the well founded tradition of Muslim scholars of standing against unnecessary taxes and attempt to discover the rationale of taxation in Islamic economics so that any proposition to use taxation policy, for any purpose, recognizes how far it can go. Additionally, this paper tries to put an end to vagueness, looseness and lack of rigor in the conceptualization of fiscal policy in Islamic framework.

In brief, taxation is not the general case in the Islamic economic model. Especially that the Islamic organization of the economy appeals for permanent and mostly enormous sources of public non-tax revenues.

79. al Mawardi, *ibid*, p. 215.

80. *Ibid*.

The proposition, that *zakah* may effect, sometimes, results undesirable from the point of view of the economic objectives, the thing which calls for remedial taxes, is baseless according to the present writer, because *zakah* is a pillar of this religion and its economic system. Its results are desirable by God, His Prophet (P) and all believers, What is wrong is the "economic objectives" in the mind of the beholder's conception of *zakah*, or his estimation of those effects.

An objectives' approach to the analysis of taxation may not be undesirable but it comes only at a second stage after the principle of taxation is put in its right place and given its proper weight in the thinking of contemporary Muslim economists, and naturally such an approach must distinguish between the necessary and the desirable.

Lastly, this paper attempts to put the question of deficit financing with in the perspectives of taxation since deficit financing is a manifestation of insufficiency of normal current revenues to bear current burdens of the Islamic state. In an Islamic society that lives upto its name public deficit calls for private contribution on the basis of social solidarity and mutual cooperation, voluntarily whenever it may be, and involuntary when need arises.

APPENDIX I

الماوردي ، ص ٢٣٥ - ٢٥٦

(فصل) فأما الامر بالمعروف في حقوق الادميين فضربان : عام و خاص -
فأما العام فكليلد اذا تعطل شربه أو استهدم سوره أو كان يطرقة بنو السبيل
من ذوى الحاجات فكفوا عن معونتهم ، فان كان فى بيت المال مال لم يتوجه
عليهم فيه ضرر أمر يا صلاح شربهم و بنا سورهم و بمعونة بنى السبيل فى الاجتياز
بهم ، لانها حقوق تلزم بيت المال دو نهم ، و كذلك لو استهدمت مساجدهم
وجوامعهم ، فأما اذا أعوز بيت المال كان الامر يناء سورهم و اصلاح شربهم و
عمارة مساجدهم و جوامعهم و مراعاة بنى السبيل فيهم متوجها الى كافة ذوى المكنة
منهم ولا يتعين أحدهم فى الامر به ، و ان شرخ ذوو المكنة فى عملهم و فى
مراعاة بنى السبيل و باشر و القيام به سقط عن المحتسب حق الامر به و لم

يلزمهم الاستئذان في مراعاة بنى السبيل و لا فى بناء ما كان مهدوما ، ولكن لو أرادوا هدم ما يعيدون بناء من المسترم والمستهدم لم يكن لهم الاقدام على هدمه فيما عم أهل البلد من سوره و جامعهم الا باستئذان و لى الامر دون المحتسب ليأذن لهم فى هدمه بعد تضمينه القيام بعماته و جاز فيما خص من المساجد فى العشائر ألا يستأذنوه ، و على المحتسب أن يأخذهم بناء ما هدموه و ليس له أن يأخذهم باتعام ما استأنفوه ، فأما اذا كف ذو و المكنة عن بناء ما استهدم و عمارة ما استرم ، فان كان لمقام فى البلد ممكنا و كان الشرب و ان قل مقتعا تاركهم و اياه - و ان تعذر المقام فى البلد لتعطيل شربه و اندحاض سوره نظر ، فان كان البلد ثغرا يضر بدار الاسلام تعطيله لم يجوز لولى الامر أن يفسح فى الانتقال عنه و كان حكمه حكم النوازل اذا حدثت فى قيام كافة ذوى المكنة به و كان تأثير المحتسب فى مثل هذا اعلام السلطان به و ترغيب أهل المكنة فى عمله ، و ان لم يكن هذا البلد ثغرا مضرا بدار الاسلام كان أمره أيسر و حكمه أخف و لم يكن للمحتسب أن يأخذ اهله جبرا بعمارتها: لان السلطان أحق أن يقوم به ، ولو أعوزه المال فيستجده فيقول لهم المحتسب ما استخدام عجز السلطان عنه أنتم مخيران بين الانتقال عنه أو التزام ما يصرف فى مصالحه للتي يمكن معها دوام استيطانه ، فان أجابوه الى التزام ذلك كلف جماعتهم ما تسمح به نفوسهم و لم يجوز أن يأخذ كل واحد منهم فى عينه أن يلتزم جبرا مالا تسمح به نفسه من قليل و لا كثير و يقول ليخرج كل واحد منكم ما سهل عليه و طاب نفسا به و من أعوزه المال أعان بالعسل حتى اذا اجتمعت كفاية المصلحة أو بلوح اجتماعها لضمان كل واحد من أهل المكنة قدزا طاب به نفسا شرع حينئذ فى عمل المصلحة و أخذ كل ضامن من الجماعة بالتزام ماضمه ، و ان كان مثل هذا الضمان لا يلزم فى المعاملات الخاصة ، لان حكم ماعم من المصالح موسع فكان حكم الضمان فيه أوسع -

APPENDIX I

From al Mawardi, p.p., 245-246

(chapter), ordining the good with regard to human beings' rights is two kinds : public and private.

The public one is as in [the case of] a city, whose drinking [fountain] becomes out of function or surrounding wall is wrecked,

or if the city is crossed through by wayfares, who are in need [for help] but people ceased extending that [financial] help to them.

If Bait al Mal has funds, which [if used] do not cause harm, [the state] orders the fountain repaired, the wall reconstructed, and crossing wayfares helped, since these are obligations due on Bait al Mal and not on people. The same is when their mosques and prayer areas get ruined. But if Bait al Mal lacks funds, the order to get the wall rebuilt, the fountain repaired, the mosques and prayer areas reconstructed and wayfares taken care of is addressed to all those who are capable among them, no specific one is assigned that responsibility.

If those who are capable abstain from building what was wrecked or reconstructing what was ruined, [one should look]. If living in [that] city remains possible [such as] if the drinking [fountain], though reduced, is still barely sufficient, [the state] should leave them [free] with respect to it [i.e., the fountain]. But if living in the city becomes impossible because of the non functioning of its drinking [fountain] or the destruction of its wall, [the state must look again]. If the city is a border [settlement] whose idling brings damage to the land of Islam, the state is not permitted to allow [people] to move away from it. It is then considered as [the case of] catastrophees, when they happen, with regard to [the obligation of] all those who are capable to take care of..... . But if the city were not a border point whose [elimination] brings damage to the land of Islam, its question becomes more relaxed and the ruling about it more simple. The state has no right to force people to rebuild it since it [the state] is more responsible to do that [from its own resources and if it lacks funds, it must find a way to get them..... .

APPENDIX II

الماوردي ، ص ٢١٣ - ٢١٥

وأما المستحق على بيت المال فضربان : أحدهما ما كان بيت المال فيه حرزا فاستحقاقه معتبر بالوجود ، لأن كان المال موجودا فيه كان صرفه في جهاته مستحقا

و عدمه مسقط لاستحقاقه - والضرب الثاني أن يكون بيت المال له مستحقا فهو على ضربين : أحد هما أن يكون مصرفه مستحقا على وجه البديل كرزاق الجند و أثمان الكراخ والسلاح فاستحقاقه غير معتبر بالوجود و هو من الحقوق اللازمة مع الوجود و العدم ، فان كان موجودا عجل دفعه كالديون مع اليسار ، و ان كان معدوما و جب فيه على الانظار كالديون مع الاعسار - والضرب الثاني أن يكون مصرفه مستحقا على وجه المصلحة والارفاق دون البديل فاستحقاقه معتبر بالوجود دون العدم ، فان كان موجودا في بيت المال و جب فيه و سقط غرضه عن المسلمين ، و ان كان معدوما سقط وجوبه عن بيت المال و كان ان عم ضرره من فروض الكفاية على كافة المسلمين حتى يقوم به منهم من فيه كفاية كالجهاد ، و ان كان مما لا يعم ضرره كوعور طربق قريب يجد الناس طريقا غيره بعيدا أو انقطاع شرب يجد الناس غيره شربا ، فاذا سقط وجوبه عن بيت المال با لعدم سقط وجوبه عن الكافة لوجود البديل فلو اجتمع على بيت المال حقا ضايقا عنهما واتسع لا حد هما صرف فيما يصبر منهما ديننا فيه ، فلو ضايق عن كل واحد منهما جاز لوالى الامر اذا خاف الفساد أن يقترض على بيت المال ما يصرفه في الديون دون دون الارتفاق و كان من حدث بعده من الولاة مأخوذا بقضائه اذا تسع له بيت المال -

و اذا فضلت حقوق بيت المال عن مصرفها ، فقد اختلف الفقهاء في فاضله ، فذهب أبو حنيفة الى أنه يدخر في بيت المال لما يتوب المسلمين من حادث - و ذهب الشافعي الى أنه يقبض على أموال من يعم به صلاح المسلمين ولا يدخر لان النوائب تعين فرضها عليهم اذا حدثت فهذه الاقسام الاربعة التي وضعت عليها قواعد الديوان -

APPENDIX II

From al-Mawardi, p.p. 214-215

As for what is due on *Bait al Mal*, it is two kinds: the first is that for which *Bait al Mal* is only a depository. Its obligation is based on the [funds] existence. If funds exist, expending it becomes due. and if they do not, there is no obligation. The second is that which is obligation on *Bait al Mal* itself, this is also two categories. First category [consists of] that which is due on exchange basis such as salaries of soldiers, value of weaponry and arms, its obligation is not related to existence [of funds]. This is among dues obligated in case of presence [of funds] as well as in case of [their] non-existence.

If there are [funds], payments [of such obligations must be made on time, the same as in the case of [due] debts while having [sufficient] means [for their payment]. But if there are no funds, delay of payment becomes a must also as in the case of [due] debts while having no means [for their payment]. As for the second [category], it [consists of that whose expending is due on grounds of [public] interests and benefits without exchange. The [latter's] obligation depends on presence [of funds] but not on [their] absence. If *Bait al Mal* has funds, it becomes due on it, and nothing is obligated on Muslims. But if no funds exist, there must be no obligation on *Bait al Mal*. In this case, if its harm becomes general, it is then treated as *fard kifayah* on all Muslims until it is fulfilled by those who are able among them just like fighting. But if it is the kind whose harm does not become overwhelming, such as roughness of a short cut road, with the presence of another long road, or interruption of a drinking fountain, with the presence of another one, the elimination of its obligation on *Bait al Mal* because of lack [of funds] does not make it obligatory on all Muslim since a substitute exists.

If two obligations on *Bait al Mal* co-exist, and it could not fulfill both, while it can take care of one only, [funds] must be spent to that which [if not fulfilled] becomes a debt on it. But if there were no sufficient fund even for this, it is permissible for the government—if it fears damage—to borrow, on behalf of *Bait al Mal* what it spends for [dues that become like] debts, but not for [the category of] benefits. Later governments are bound to repay such loans if it becomes possible for *Bait al Mal*.

If a surplus of revenues of *Bait al Mal* over its expenditure happens, jurists differ on how to deal with the surplus. Abu Hanifah suggests that it should be saved in *Bait al Mal* [as a reserve to be used] for what ever happens to Muslims [in the future] of [unexpected] events. While of Shafi'i's view is that it must be utilized for the general interests of Muslims without making any saving, since [future] catastrophes, when they take place, must be financed by impositions on them [i.e. Muslim_s].

APPENDIX III

مختارات من كتاب الاموال لابي عبيد ص ٥٢٨ - ٥٣٩

١٦٣٢ - قال : حدثنا حجاج عن ابن جريج قال : أخبرني عمرو بن دينار قال أخبرني مسلم بن شكرة - قال و قال غير حجاج : مسلم بن المصباح ' أنه سأل ابن عمر : أعلمت أخذ من المسلمين العشر : قال : لا ، أعلمه

١٦٣٣ - قال : حدثنا عبدالرحمن عن سفيان عن ابراهيم بن مهاجر ، قال : سمعت زياد بن حدير يقول "أنا أول عاشير عشر في الاسلام قلت" قلت : من كنتم تعشرون قال : ما كنا نعشر مسلماً ولا معاهداً ، كنا نعشر نصارى بني تغلب"

١٦٣٤ - قال : حدثنا عبدالرحمن عن سفيان عن عبدالله بن خالد العبسي عن عبدالرحمن بن معقل قال : "سألت زياد بن حدير : من كنتم تعشرون قال : ما كنا نعشر مسلماً ، ولا معاهداً - قلت : فمن كنتم تعشرون ؟ قال : تجار الحرب ، كما كانوا يعشروننا اذا أتيناهم"

١٦٠٩ - وهو مفسر في الحديث الذي بحدوثه عن عطاء بن السائب عن حرب بن عبيدالله النقفى عن جده - أبي امية - أن رسول الله صلى الله عليه وسلم قال : "ليس على المسلمين عشور " انما العشور على اليهود ، النصارى"

١٦٣٠ - و كذلك الحديث الذي ذكرناه مرفوعاً حين ذكر العاشر ، فقال "هو الذي يأخذ الصدقة بغير حقها"

١٦٣١ - قال أبو عبيد : فاذا زاد في الاخذ على أصل الزكاة فقد أخذها بغير حقها

١٦٠٢ - وكذلك وجه حديث ابن عمر حين سئل "هل علمت عمر أخذ العشر من المسلمين ؟ فقال : لا - لم أعلمه"

قال أبو عبيد : انما نراه اراد هذا ، و لم يرد الزكاة - و كيف ينكر ذلك ، و قد كان عمر وغيره من الخلفاء يأخذونها عند الاعطية ، و كان رأى ابن عمر دفعها اليهم ؟

١٦٣٣ - وكذلك حديث زياد بن حدير حين قال "ما كنا نعشر مسلماً ، ولا معاهداً" ، انما أراد اننا كنا نأخذ من المسلمين ربع العشر ، ومن أهل الذمة نصف العشر -

١٦٣٤ - فاذا كان العاشر ياخذ الزكاة من المسلمين اذا أتوه بها طائعين غير مكرهين فليس بداخل في هذه الاحاديث ، فان استكرهم عليها لم آمن أن يكون داخلاً فيها ، وان لم يزد على ربع العشر ، لان سنة الصامت خاصة : أن يكون الناس بهم مؤتمنين عليه -

١٦٣٩ - فاذا كان العاشر يعمل بهذا لم يلزمه شئ من هذا التعليل - وكيف يكون هذا مكروهاً ، وقد فعله عمر بن الخطاب : والائمة بعده ؟ ثم لانعلم أحداً من علما أهل الحجاز ، والعراق ، والشام ، ولا غير ذلك كرهه ، ولا ترك الاخذ به - وكانوا يرون ما أخذه العاشر مجزياً من الزكاة

١٦٥٠ - منهم أنس بن مالك ، والحسن ، وابراهيم

١٦٥١ - وكان مذهب عمر فيما وضع من ذلك : أنه كان يأخذ من المسلمين الزكاة ، ومن أهل الحرب العشر تاماً لا نهم كانوا يأخذون تجار المسلمين مثله اذا قدموا بلادهم - فكان سبيلاً في هذين الصنفين بيناً واضحاً

١٦٦٢ - قال أبو عبيد : وكان الذي يشكل على وجهه أخذ أهل الذمة ، فجعلت أقول : ليسوا بمسلمين ، فتؤخذ منهم الصدقة - ولا من أهل الحرب ، فيؤخذ منهم مثل ما أخذوا منا - فذم أذر ما هو ، حتى تدبرت حديثاً له ، فوجدته انما صالحهم على ذلك صلحاً سوى جزية الروس ، وخراج الارضين

باب

(ما يأخذ العاشر من صدقة المسلمين ، وعشور أهل الذمة والحرب)

١٦٥٥ - قال : حدثنا معاذ بن معاذ عن ابن عون عن أنس بن سيرين قال : "بعث الى أنس بن مالك فأبطات عليه ، ثم بعث الى ، فاتيته - فقال : ان كنت لارى انى لو أمرت بك أن تعض على حجر كذا وكذا مر ضاقي لفعلت ، اخترت لك عين عملى فكرهته ، انى أكتب لك سنة عمر - قلت : اكتب لى سنة عمر - فكتب : يؤخذ من المسلمين من كل أربعين درهما درهم - ومن أهل الذمة

من كل عشرين درهما درهم -، ويمن لا ذمة لث من كل عشرة دراهم درهم - قلت له : ومن لا ذمة له ؟ قال : الروم ، كانوا يقدمون الشام ،

١٦٥٦ - قال : حدثنا أبو معاوية عن الأعمش عن إبراهيم بن مهاجر - عن زياد بن حدير قال : " استعماني على العشر ، فأمرني أن آخذ من تجار أهل الحرب العشر ، ومن تجار أهل الذمة نصف العشر ، ومن تجار المسلمين ربع العشر "

١٦٥٧ - قال : حدثنا حفص بن غياث عن الشيباني عن الشعبي عن زياد بن حدير قال : " أمرني عمر أن آخذ من تجار أهل الذمة مثلي ما آخذ من تجار المسلمين "

١٦٥٨ - قال : حدثنا عبدالرحمن بن مهدي ومحمد بن جعفر عن شعبة عن الحكم عن إبراهيم بن زياد بن حدير قال : " أمرني عمر أن آخذ من نصارى بني تغلب العشر ، ومن نصارى أهل الكتاب نصف العشر "

١٦٥٩ - قال : حدثنا اسحاق بن عيسى عن مالك بن أنس عن ابن شهاب عن السائب بن يزيد قال : " كنت عاملاً على سوق المدينة في زمن عمر - قال : فكنا نأخذ من النبط العشر " -

١٦٦٠ - قال : حدثنا أبو المنذر و يعقوب بن بكير ، و أبو نوح ، اسحاق ابن عيسى ، و سعيد بن عفير ، كلهم عن مالك بن أنس عن ابن شهاب عن سالم بن عبدالله بن عمر عن أبيه قال " كان عمر يأخذ من النبط : من الزيت والحنطة نصف العشر ، لكي يكثر الحمل إلى المدينة : و يأخذ من القطنية العشر "

١٦٦١ : قال وحدثني ابن عفير - - - - - من الخول

١٦٦٢ - قال : حدثنا ابن أبي مريم عن يحيى بن أيوب عن يحيى بن سعيد عن رزيق حيان عن عمر بن عبدالعزيز مثل ذلك

١٦٦٣ - قال : حدثنا عبدالرحمن عن سفيان عن عبدالله بن محمد بن زياد بن حدير قال : " كنت مع جدي بن حدير على العشر ، فمر نصراني بفرس قومه عشرين ألفاً فقال : ان شئت أعطيتنا ألفين و أخذت الفرس ، و ان شئت أعطيتنا ثمانية عشر ألفاً "

١٦٦٤ - قال أبو عبيد : و انما فعل عمر في العشر ما فعل لما أملتك من مصالحته اياهم عليه ، و لم يكن ذلك بعهد النبي صلى الله عليه وسلم ،

لان الذين صالحهم لم يكن شرط عليهم منه شيئا - وكذلك دهر أبي بكر ،
و انما فتحت بلاد العجم فى زمن عمر - فلذا كان الذى كان

١٦٦٥ - قال : حدثنا ابن زائدة عن عاصم بن سليمان عن الشعبي قال :
"أول من وضع العشر فى الاسلام عمر"

١٦٦٨ - قال أبو عبيد : والوجه الاول الذى ذكرناه من الصلح أشبه بعمر ،
و به كان يقول مالك نفسه

١٦٦٩ - قال أبو عبيد : فاذا مز الذمى بالمال على العاشر ، فان سفيان
كان يقول : "لا يأخذ منه شيئا حتى يبلغ مائة درهم ، فاذا بلغ مائة درهم أخذ
منه نصف العشر"

١٦٨٠ - وقال غيره من أهل العراق : لا يأخذ منه شيئا ، حتى يبلغ
مائتي درهم

١٦٤١ - قالوا : فان قال : على دين ، أو قال : ليس هذا المال لى ، وحلف
عليه ، فانه يصدق على ذلك ، ولا يؤخذ منه شئ

١٦٤٢ - قالوا : وانما يؤخذ منه الصامت ، والمتاع ، والرقيق ، وما
أشبه من الاموال التى تبقى فى أيدي الناس - فأما اذا مر بالفواكه وأشباهها
التي لا تبقى فى أيدي الناس ، فانه لا يؤخذ فيها منه شئ

١٦٤٣ - قالوا : ولا يؤخذ منه فى المال الواحد أكثر من مرة واحدة
فى السنة وان مر به مرارا

هذا قول أهل العراق

١٦٤٤ - وأما مالك فانه كان أشد من هذا قولاً من هؤلاء ، قال : اذا
مر الذمى بالمال على العاشر لتجارة أخذ منه نصف العشر ، وان لم يبلغ
مائتي ، قال : وان ادعى أن عليه ديناً لم يقبل منه قوله ، وأخذ منه نصف العشر
فال : وكذلك يؤخذ منه ان مر بقا كهيئة ، أو غيرها مما يبقى فى أيدي الناس ،
أو لا يبقى ، بعد أن يكون للتجارة -

١٦٤٦ - فأما الذين قالوا من أهل العراق : لا يؤخذ من الذمى حتى يبلغ
بالمائة مائتي درهم ، فانهم شبهوه بالصدقة ، و ذهبوا الى أن عمر حين سمي ما يجب

في أموال الناس التي تدار للتجارات أنما قال : يؤخذ من المسلمين كذا و من أهل الذمة كذا ، و من أهل الحرب كذا ، و لم يوقت في أدنى مبلغ المال وقتاً

قالوا : ثم رأيناه قد ضم أموال أهل الذمة الى أموال المسلمين في حق واحد - فلهذا حملنا وقت أموالهم على الزكاة اذ كان لا دنى الزكاة حد محدود - وهو المائتان - فأخذنا أهل الذمة بها ، والغينا مادون ذلك

١٦٤٨ - وأما سفيان في توقيت المائة أن يؤخذ منها و يترك مما دو نها ، فمذهبه فيه : أنه لما رأى أن الموظف على أهل الذمة هو الضعف مما على المسلمين ، في كل مائتين عشرة ، جعل فرع المال على حسب أصله ، وأوجب عليهم في المائة خمسة ، كما يجب عليهم في المائتين عشرة ، ليوافق الحكم بعضه بعضاً -

وأسقط مادون المائة ، كما عفى للمسلمين عما دون المائتين ، فصارت المائة للذمة كالمائتين لمسلمين سواء - فهذا رأيه في أهل الذمة - ولست أدري ما وقت في أهل الحرب - غير أنه ينبغي أن يكون في قوله : اذا مر أحدهم بخمسين درهما و يجب عليه فيها العشر

١٦٤٩ - قال أبو عبيد : و قول سفيان هو عندي أعدل هذه الأقوال ، وأشبهها بالذي أراد عمر بن الخطاب ، مع أن عمر بن عبدالعزيز قد فسر ذلك في كتابه الى زريق بن حيان الذي ذكرناه : أنه كتب اليه " من مر بك من أهل الذمة فخذ مما يديرون في التجارات : من كل عشرين دينارا دينارا فما نقص فبحساب ذلك ، حتى تبلغ عشرة دنائير ، فان نقصت ثلث - ثلث دينار فلا تأخذ منه شيئا "

١٦٨٠ - قال أبو عبيد : فعشرة دنائير انما هي معدولة بمائة درهم في الزكاة - و هو عندنا تأويل حديث عمر بن الخطاب مع تفسير عمر بن عبدالزير ولا يوجد في هذا مفسر هو أعلم منه - و هو قول سفيان

قال أبو عبيد : فذا ما في توقيت ادنى ما يجب فيه الحقوق من أموال أهل الذمة والحرب

١٦٨٢ - وأما اختلافهم في ممره على العاشر مراراً في السنة ، و قول سفيان وأهل العراق فيه : انه لا يؤخذ منه في ذاك كله الا مرة واحدة ، و قول مالك وأهل الحجاز : انه يؤخذ منه كلما مر و ان كان ذلك في السنة مراراً ،

إذا كان اختلافه من مصر الى مصر آخر سواه . فان ذلرواية في هذا عن الامامين :
عمر بن الخطاب ، و عمر بن عبدالعزيز قد كفتنا النظر فيه .

١٦٨٥ - قال : حدثنا محمد بن كثير عن حماد بن سلمة عن عطاء ابن السائب
عن ابن زياد بن حدير : "أن أباه كان يأخذ من نصراني في كل سنة مرتين ،
فأتى عمر بن الخطاب ، فقال : يا أمير المؤمنين ، ان عا ملك يأخذ منى العشر
فى السنة مرتين ، فقال عمر : ليس ذلك له ، انما فى كل سنة مرة ، ثم أتاه فقال :
أنا الشيخ النصراني ، فقال عمر : وأنا الشيخ الحنيف ، قد كتبت لك فى
حاجتك" -

١٦٨٣ - قال : حدثنا يزيد عن جريد بن حازم قال : فرأت كتاب عمر
بن عبدالعزيز الى عدى بن أرطاة "أن يأخذ العشور ، ثم يكتب بما يأخذ منهم
البراة ولا يأخذ منهم من ذلك المال ولد من ربحه زكاة سنة واحدة ، ويأخذ من
غير ذلك المال ان مر به" -

١٦٨٥ - قال أبو عبيد : فحديث 'عمر هذا هو الذى عدل بين قول
أهل الحجاز وأهل العراق : أنه ان كان المال الثانى هو الذى مر به بعينه
فى العرة الاولى لم يؤخذ منه فى تلك السنة ، ولا من ربحه أكثر من مرة ،
لان الحق الذى لزمه قد قضاها ، فلا يقضى حق واحد من مال واحد مرتين ،
وان كان مر بمال سواه اخذ منه - وان جدد ذلك فى كل عام مراراً اذا كان
قد عاد الى بلاده ، ثم اقبل بمال سوى المال الاول - لان المال الاول لا يجزى
عن الاخر ، ولا يكون فى هذا أحسن حالاً من المسلم - الا ترى انه لو مر بمال
لم تود زكاته اخذت منه الصدقة ثم ان هر بمال آخر فى عامه ذلك لم
تكن اخذت منه الزكاة أنه يؤخذ منه ماله هذا أيضا ؟ لان الصدقة الاولى لا تكون
قاضية عن المال الاخر -

قال أبو عبيد : فهذا مافى أهل الذمة

١٦٨٦ - فأما أهل الحرب فكلهم يقول : اذا انصرف الى بلاده ثم عاد
بماله ذلك ، أو بمال سواه : أن عليه العشر كلما مر ، لانه اذا دخل دار الحرب
بطلت عنه أحكام المسلمين ، فاذا عان الى دار الاسلام كان مستأئفا للحكم ، كالذى
لم يدخلها قط ، لا فرق بينهما

APPENDIX III

Selection from Abu Ubaid, p. 528—539*

1632—From Muslim bin shukarah, that he asked Ibn ‘Umar : Did you know that ‘Umar took ‘Ushr from Muslims ? he said : no, I did not know it.

1633—Ziad bin Hudair says : I am the first ‘Ashir [‘Ushr collector] who collected ‘Ushr in [the history of] Islam. [Ibrahim asked] whom did you use to collect ‘Ushr from ? he says : we used not to collect ‘Ushr from a Muslim or person of the pledge, we used to collect ‘Ushr from the christians of bani Taghlib.

1634—Zaid bin Hudair was asked : whom did you use to collect ‘Ushr from ? he said : traders [from the land] of war, the same way as they used to collect ‘Ushr from us when we go to them.

1639—The Prophet (p) said : “There are no ‘Ushur on Muslims, ‘Ushur are only on jews and christians.”

1640—Also the saying of Prophet (p) when he mentioned the ‘Ashir that “he is that who takes the sadaqah without its due right”.

1641—Abu ‘Ubaid says : if [the collector] increases what he takes over the original *zakah* then he took it without due right.

1643—Abu ‘Ubaid says : the statement of Ziad bin Hudair “we used not to collect ‘Ushr from a Muslim or a person of the pledge” only means that we collected from Muslims one fourth of the ‘Ushr and from people of pledge one half of the ‘Ushr.

1649—Abu ‘Ubaid about scholars of Hijaz, Iraq, and Syria : they used to view what is taken by the ‘Ashir as a payment of *zakah*.

1651—Abu ‘Ubaid says : the opinion of ‘Umar about what he imposed was [as follows] : he used to collect from Muslims the *zakah* and from people of [the land of] war the ‘Ushr [i.e., 10%] complete because they used to collect from Muslim traders the same when they go to their lands.

1660—Ibn ‘Umar says : ‘Umar used to take from nabatians [non-Muslims from Roman lands], one half of a tenth on oil and

wheat, in order for carrying [them] to Madinah to increase, and on the beans on tenth.

* not all the Arabic section of appendix III is translated. Also narrator's chains are omitted.

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Allocative and Stabilizing Functions of Zakat in an Islamic Economy

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Introduction

The uniqueness of Zakat as a self-contained fiscal system is a point that has been confirmed by modern Muslim scholars. The ends and means of Zakat system are fully described by the Holy Qur'an and Sunnah in terms of target group (i.e. Zakat-worthy categories), collection bases and rates, to the extent that there is little room for human discretion to interfere with its set rules. In particular, the collection and allocation stages are carefully synchronized, thus making it impermissible to freely manipulate a lagged interval between them as a policy control tool. Thus, the temptation expressed by some scholars¹ of reserving a portion of a prosperous period's Zakat proceeds to the treatment of a future glut—as conventional stabilization policy would recommend—may run at variance with the received *shariah* practices of Zakat. It appears in the light of *shariah* that collected Zakat proceeds of a given period are to be exhaustively allocated amongst its documented eight worthy categories as clearly spelled out by the Holy Qur'an². Moreover, the motivation for international transfer of Zakat surplus, whenever that occurs at a national level, minimizes the possible role of Zakat reserves for national stabilization objectives. Ibn Taymiyya in his *Fatawa* reports that Omer bin al-Khattab reproached Mi'az bin Jabal for distributing the Yemen Zakat proceeds among the Medina people, remarking :

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1. See Ziauddin *et al* (15).
2. See Part—I, p—1 above.

“I have not delegated you (to Yemen) as a tax-collector”.

and that Mi'az answered : (yet But I could not find a taker !”

This implies that collected Zakat proceeds should be urged up to find a suitable spending target rather than being reserved, even if it were done across the political boundaries of the Muslim community.

Thus at the outset we have ruled out the role of Zakat reserves and aimed at seeking an alternative stabilization function of Zakat which respects the shariah allocative constraints. This partly explains the reason why we have approached the stabilization function through the allocative role of Zakat. We have deliberately devoted Part—I of this study to what we have considered the allocative function of Zakat, with special attention to the relevance of shariah *tamleek* restriction within a modern context. This first part acts a necessary background to the stabilization problem to which we have devoted Part—II. The approach adopted here is basically theoretical and argumentative, and the analysis made simple, yet no mathematical formulations were felt necessary to adopt.

PART—I

The Shari'ah Allocative Function of Zakat in a Modern Context

Here we are using the term “allocative function” in a rather special sense which is rather uncommon in fiscal policy terminology. In the latter context is used to describe the process whereby total resource use is divided between private and social goods¹. In this context we use it to describe the allocation of Zakat proceeds among the eight Zakat-worthy categories as specified by the Quranic aya :

“Alms are for the poor and the needy, and those employed to administer the (funds); for those whose hearts have been (recently) reconciled (To Truth); for those in bondage and in

1. Musgrave and Musgrave (2), p. 7.

debt ; in the cause of God ; and for the way farer. (Thus it ordained by God and God is full of knowledge and wisdom.”

(A. Yousif Ali Translation: S. IX, aya (60)—Al-tawba.

It is reported that a man came to our Prophet (peace be upon him) asking for a helping from Zakat fund, and that the Prophet replied: God has not approved of a prophet's or any other person's judgement in the matter of *Sadqat* (i.e. Zakat). He, rather, retained this right for Himself by allocating it among eight worthy categories. Hence, if you belong to any one of them I shall help you". This hadith is one amongst several other evidence which confirm the category-specific allocative function of Zakat. In fact it is the consensus amongst shari'ah scholars that Zakat proceeds be allocated exhaustively among the documented eight worthy categories. It is only the problem of how to define the borderlines among these categories that has pre-occupied the attention of shari'ah scholars.

There is also the problem of whether the *Sadqat* aya implies a strict priority order or not. Such subtle shariah difference are fully treated in the appropriate texts, and so they do not concern us here. However, the general consensus is that treatment of poverty and need is the central target of Zakat and its upper most priority. This is a definite priority which justifies the study of the Zakat allocative function into two man sections, as we shall do below. In the first section we examine the role of Zakat as a means of fighting poverty. In the second section we lump up all the other claims on Zakat, and give special attention to the problem of *tamleak* and its relevance to our present time.

1-1 Zakat as a Means of Fighting Poverty

It appears that early Muslim scholars have treated the eight worthy categories, not only as exhaustive, but also as mutually exclusive ; thus precluding overlapping amongst them. In line with this treatment the poor and needy are defined as distinct categories. The popular view of the major scholars of jurisprudence (mazhabs),

with the exception of Hanafi's is that the poor (faqir) category shows a more pressing state than the needy (miskin). Yet, the pressing state considered by early scholars does not stand for desperate poverty or deprivation as the modern standards might imply. They¹ define "poor" as those who lack sufficient provisions for a single year, whereas the "needy" are those with living means short of securing a life support. Thus, at the upper boundary of the "needy" group are those who enjoy a stable income stream with wealth which nevertheless place them below what is considered a "normal living standard". For example Imam Malik makes it possible to give Zakat to a house-owner with a domestic servant.² It is needless to emphasize that what is to be regarded as "normal Living standard" is a level which has to be worked out at any point of time depending on the state of social affluence.

In a properly functioning Islamic society the extremes of poverty and wealthiness should not exist, as there is a wide variety of distributional channels³ which act as a centripetal force bringing most muslims towards a central average of living standard.

Despite the consensus of scholars on the upper priority of poverty treatment, yet there is difference of opinion as regards the extent of need satisfaction which Zakat should secure. At one end the Hanafi's set a maximum of 20 dirhams per worthy person, while at the other end the Shafi's call for a whole life-support provision. The latter view is held to be consistent with Omer bin al-Khattab principle: Giving lavishly enough to eradicate poverty. The logical interpretation of this principle, which we tend to support, is that: instead of disbursing Zakat in a consumer's good form it should partly be disbursed in terms of producer's goods.

According to Dr. Qaradawi, able and qualified worthy persons, who are competent enough to work with a capital good, should be treated in accordance with this Shafi'i principle. As regards unable dependants (children; old-aged; disabled) they should be supplied

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1. This is the view of major mazhabs except for Hanifi's.
 2. See Al-Dardir (3) p. 444.
 3. See Al-Zarqa, A. (14).

with a single year's consumer goods' provision, in accordance with the Maliki principle.¹ Incidentally, it is a view for which Dr. Qaradawi has found support in one of the Hanbali sources.²

1.1.1 The Limitations of Physical Capital Good Transfer

Despite the immediate intuitive appeal of the above treatment, yet it is not workable enough in the modern economic context. On one hand, the traditional concept of real investment : that it is capable of securing safe and stable returns over life has been radically challenged by rising inflation and increasing uncertainty.

On the other hand, the dwindling role of small scale craftsmanship and self-employed units, gradually superseded by corporate capital and large-scale productive units, should render the piece-meal transfer of physical capital an infeasible practice. As long as the greater bulk of working population are full-time employees, there is little room for giving Zakat in terms of physical good transfers. Such a treatment as advocated by Dr. Qaradawi is only pertinent to small scale economic ventures and workshops, like blacksmiths, carpenters, tailors, farmers, retailers . . . etc. It is true that for such capital-scarce (or capital-saving) activities, the addition of a suitable capital good should help raise labour productivity appreciably. And if market conditions of demand are sufficiently conducive, this would raise the level of money income. And if the price-level is sufficiently stable, real incomes would also go up. However, the choice of the suitable capital good and the stable price-level are not at all easy to grant.

In fact it is often the case, specially during economic recessions, that businessmen complain of deficient demand rather than scarce capital, as idle capacity tends to exist. Alternately, during tight business conditions, stable real incomes can hardly be maintained due to demand-pull inflationary pressures³ Hence, unless we are

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1. Whenever we refer to Shafi'i and Maliki principles we are keeping this point in mind.
 2. See *Fiqhul-Zakat* ; by Qaradawi, (io) p. 571.
 3. We shall be assuming away cost-push or structural causes of inflation for simplifying the stability problem in part-II.

visualizing a self-stabilizing economy or a highly vigilant stabilization policy such a life support interpretation of the Shafi'i principle can hardly work.

It is interesting to explore such questions in the context of an Islamic economy as this is, incidently, what we hope to discuss in the second part of this study. But this does not really solve the problem. For, even if the stability problem is relegated to a secondary importance in a properly functioning Islamic economy, there is still the problem that most of the able poor are full-time employees who, like unable dependants, cannot benefit from transferred capital goods. It is not only due to the time-constraint and other employer regulatory restrictions, but also due to the official nature of most salaried work. Hence, the distinction which Dr. Qaradawi makes between able and unable persons does not really help in this context, except within a very limited scope.

1.1.2 The Equities Transfer Alternative and its Merits

If we generalize the idea of capital ownership transfer to include all income-earning assets, whether physical or financial, then the able/unable classification shall be redundant. Even an "unable" person can have a legal title to an income-earning financial asset. If Zakat proceeds are transferred to worthy persons in terms of equities, this would help improve their living standards by securing an additional income source in terms of dividend payments. Such an alternative enjoys the following merits :

- (1) The general trend of a growing economy is compatible with the merging of casual economic activities and smaller units of productive capital into larger units. In this way the large-scale economies can be reaped and higher incomes accrue to the capital owners.

At the same stroke capital incorporation is consistent with the Islamic doctrine of social co-operation and collectivism. Hence, the Islamic state should encourage dispersed capital units to consolidate and incorporate.

- (2) Giving a low-income employee or a wage-earner a sense of

ownership, does help elevate his productive morale, specially if it were his employer unit. It also helps lessen trade-unionist devotion and class-consciousness.

- (3) In an Islamic economy where interest-based finance is forbidden and speculative practices banned, common stock (equity) prices tend to be quite stable. In fact one of the main causes of the wild fluctuations in stock prices in the western world stock exchanges is the high leverage ratios of the corporate enterprises.¹ In an Islamic economy all economic activities are almost identically unlevered² due to the dominance of the profit-sharing rule.

Other stability related problems are treated more formally in the second part of the study. Hence, it is a plausible alternative to utilize Zakat proceeds partly in this way. It is of little value whether the Zakat-Worthy person is "able" or "unable" in Dr. Qaradawi's sense. However, there should be an alternative criterion for combing the "Shafi'i" and "Maliki" principles. In other words, we should seek a certain criterion to combine the two disbursement modes (producers' goods transfer and consumers' goods transfer) other than the able/unable criterion.

It is our viewpoint that such a criterion relates to the possible use of "the disbursement mode" as a stabilizing instrumental policy-control variable. Thus, we postpone this matter to the second part of the study where the stabilization objective is more formally treated.

Other Claim on Zakat and Tamlcek Condition.

It is reported that Imam Shafi'i and Imam Ahmed bin Hanbal call for the total coverage of all Zakat-worthy categories, except for share of Zakat collectors (alamilin aliyha) whose share automatically

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1. See Francis (5), Chapter.
 2. The Leverage ratio is defined as the Debt/Equity ratio of the company's capital. See Francis () pp. 356—358).
for the stability effects of this ratio on stock prices.

vanishes if Zakat is paid without a medium.¹ However, Imam Malik and Abu Hanifa do not impose such a restriction of total coverage. This stand agrees with what Abu Obeid reports about Ibn Abbas that it is no matter whether the whole Fund is allocated to single category.² As Dr. Oaradawi has plausibly argued, the matter rests eventually on the relative size of collected Zakat proceeds and the 'need' strength among the various categories, provided that poverty treatment takes its unnegotiable share.

We are not here to demonstrate how the other claims on Zakat are to be allocated amongst the remaining six categories. We would rather pay more attention to the relevance of *tamleek* condition to our present day problems. Some scholars of *tafseer* (exegesis) have remarked that the first four categories are entitled to Zakat payments as a legal right, while the other four receive them as a situational right. That is, slave-emancipation, debt support service, *ibn al-Sabil*, and *jihad* are all situational claims, in the sense that payment is not made to the use of a Zakat-worthy person; rather it is paid for the treatment of a given situation. For example what is paid for debtors goes directly to their creditors as debt service.

The problem of *tamleek* has pre-occupied modern muslim scholars more than it did to the classical scholars of the major *mazhabs*. As we mentioned above, the early scholars recommended hard and fast rules for allocation of Zakat, so that for them the eight Zakat-worthy categories were almost mutually exclusive and exhasutive. The assimilation of Zakat within the complex modern economic context is in fact the main reason for this new interest for wavering the *tamleek* condition. We shall consider this problem in the context of the seventh Zakat-worthy category, that is "spending in the way of Allah" (SIWA). This is the most important source for wavering the *tamleek* condition, though there are other possible sources: e.g. should Zakat be paid to the poor directly or indirectly through charity institutions which cater for them? The last issue is not so critical as far as we are concerned. Hence, we shall confine our attention to the SIWA source only.

1. See Qaradawi (10) pp. 579—593.

2. Ibid pp. 686—694.

1.2.1 The Tamleek Principle in the Modern Context.

Spending in the way of Allah (SIWA) has been a simple concept to define for early scholars of the four *mazhabs*. It simply stood for the finance of military *jihad* though different views were expressed as to whether or not purchases of armament should be financed from Zakat.

However, there is a tendency among modern scholars to broaden the concepts of *jihad*, and hence the scope of SIWA. The view is that all types of activity which reinforces the Muslim state in the sphere of international challenges, are SIWA items. More specifically, the formation of the basic economic infrastructure (...high-way roads, bridges, canals, rail-ways etc.) is regarded as a Zakat-worthy category in line with *jihad*.

Among the modern advocates of this view are Imam Mawdudi, Hassan Khan, Sheikh Shaltut, and others. It is a view originally referred to Iman al-Razi in his *tafseer* to the *sadqat* aya. Few other scholars like Kasani of the Hanafi school and other Hanbali scholars are also reported to support this view.¹ Yet, it is worth-emphasizing that it is an exception to the general consensus of the major *mazhabs*.

Among modern scholars who adhere to the early consensus is Dr. Qaradawi, though he has plausibly extended *jihad* to include peaceful means of propagating the Islamic mission to the non-Muslim world.

It is our view point that the *tamleek* condition should not be wavered under the implicit rationalization : that it is better to treat poverty indirectly via a strong-based efficient economy than the direct hand-to-hand disbursement of Zakat. The concept of *jihad* should be maintained at its earlier consensus, and even for this well defined category the finance should only be partial. It is the responsibility of the state to explore other economic resources for the purchase of the highly specialized military equipments, and other capital-intensive

1. Ibid., pp. 635—669.

military investments. Hence, all *quasi-jihad* forms which do not relate directly to the propagation of the Islamic mission to the non-Muslim world should seek other financial sources. If we cherish this practice of quasi-jihad model building, the Zakat system shall soon suffer from the shaky and indeterminacy properties of secular social insurance systems.

Secular social insurance systems, to take the U.K. example, are notorious for their versatility and tractability to the ruling party's way of thinking. At one stage a ruling political party selects the short-cut way of solving the pressing human needs. Thus, it raises progressive income taxes to help finance more government spending on social insurance schemes. Yet at another stage a ruling party chooses the indirect way. It relieves the upper class savings to encourage private investment, thus making drastic cuts in public spending on social insurance schemes. The theory is that a more efficient economy should spontaneously solve poverty problems !

God has saved us the effort to theorize in this way in the matter of sadaqat, and sunna has discreetly presented Zakat mainly as the legal title of the poor in the wealth of the rich. The Zakat Fund had historically been separated from the central budget and the *tamleek* condition had always been observed.

2.2 1. The Tamleek Condition in a Development Context

The development Orientation of the quasi-jihad argument is very obvious as it is the headache of Less Development countries, and Muslim countries in particular, to establish a sound economic infrastructure to facilitate the smooth functioning of the economy and the achievement of growth targets. Thus modern Muslim thinkers seem to adopt such a development-oriented utilization of Zakat proceeds in line with contemporary thinking which believes, justifiably though, that the "vicious cricle" of poverty can only be broken by development planning. The latter does require the diversion of massive economic resources, concentratedly, to the finance of the necessary infrastructure which may extend from the basic transport and communication systems to the more developed public utility services.

However, we are arguing below that the wavering of the *tamleek* condition of Zakat to suit global development objectives is a view point which conforms to a traditional development approach that is no longer popular. It is more interesting to note that modern development thinking in its confrontation to the poverty problem has come to the conclusion that it is indispensable to establish a Zakat-like system associated with a *tamleek*-like restriction! It has been the result of a two-decade experience of development planning that has led to the questioning of such abstract concepts like achievement of a given growth-rate with its concomitant capital/output ratios, gross fixed capital formation rate and related economic aggregates. Such impressive statistical aggregates tend to hide tremendous disparities within the nation as experience has revealed. "Overall economic growth and social progress did not mean much improvement in the circumstances of the poorer segments of the population".¹

Development is a truly painful process as long as the building of social capital requires abstention from current consumption or even the complete disequilibrium of people's modes of living. But, wealth owners are usually the least to suffer. Rather, they tend to be the recipients of the immediate gains from the massive development related projects. It is the gist of the traditional capitalist development approach that the fate of the poor, who are after all the targets of development, should not be a concern in the early stages of development. This is the simple implication to be drawn from the so-called Kuznet's curve, or A. Lawis model of development. Even devoted egalitarians of the western world used to sanction such a strategy for the ultimate eradication of poverty i.e. that the process of capital accumulation in the short-run should inevitably be inequitable till economic growth spreads out evenly and the fruits of development be reaped in the long-run. It is needless to demonstrate the built-in rigidities of the free economy which has failed such an approach, since in recognition to this failure that equitable development programs have emerged as an alternative strategy.

Only at this stage has modern development thinking come closer

(1) Streeten et. al. (12) p. vii

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to the adoption of a Zakat like system, namely a redistributinal approach to development planning. It is not difficult to perceive such a similarity in the current literature which speaks of *target group* problems. Bell for example, defines a *target group* as those "who are not only poor but also relatively homogeneous with respect to the effect that a given set of policy instruments might have upon them" e.g. small farmers, landless labourers, the urban unemployed, the rural under employed, and the recent migrants who have taken a causal job. Hence, the single-minded concern with pure growth strategies based on the strict priority of building up the capital infrastructure and overal productive capacity of the economy, has been considerably transformed over time. It is true that the only way absolute poverty can be eliminated on a permanent and sustainable basis is to increase the productivity of the working population. But direct methods of increasing national productivity must be supplemented with efforts to maintain living standards of special disadvantaged target groups like those mentioned above. The analogy with Zakat-worthy groups is very obvious, and this is in fact an avowed recognition for the indispensability of such a specialized system to be adopted as an integral part of a national development plan.

This analogy can be put to sharper focus when the *tamleek* condition is introduced. We may appreciate how equitable development economists care for the securing of efficient policy measures which aim at solving specific *target group* problems. Such efficiency is defined in terms of "leakage effects" to non-target groups. An efficient policy measure seems to be the one that has minimum leakage effects to non-target groups.²

A tamleek-like controversy can be perceived clearly enough in the context of a well defined "basic needs approach", of which the redistributinal strategy can be considered a special version. Many economists seem to have preference to what is called the "count cost and deliver" (CCD) approach as an implementation of the basic

(1) See Chenery et al. (2) p. 90

(2) See Chenery et al. (2) Chapter III, IV,

needs strategy. This CCD approach "consists of counting the number of the deprived, figuring the cost of the goods and services needed to eradicate deprivation, and delivering them to the target groups",¹ Obviously, this approach is characterized by zero leakage effects, and thus enjoys a high efficiency scale if adopted as a policy instrument. Again the close proximity to the strict *tamleek* condition of Zakat is obvious enough.

In fact most of the discussion about the practical aspects which relate to the implementation of the basic needs approach on target groups, seem to have a counterpart in the Zakat disbursement aspect to its worthy categories. Yet, it appears that a three-decade experience in contemporary development thinking is gradually converging towards the adoption of a Zakat-like system not very much different from the one that early Muslim scholars have established on the basis of the Qur'an and Sunna. Such a tendency is indicated by Paul Streeten² who concluded a sketch review of development theories remarking that :

"The evolution... shows that the concepts have become decreasingly abstract and increasingly disaggregated, concrete, and specific. Starting from the G. N. P. and its growth, a highly abstract and unspecified conglomerate of goods and services, irrespective of what and for whom, development then turned towards employment, a somewhat more specific goal. Then discussion was increasingly narrowed down to particular groups of unemployed. But employment also was seen to have serious limitations. Ideas were further narrowed to identify deprived groups of individuals and families..."

Is it not really ironical that some of us would allow for the adaptation of Zakat rules to suit the finance of an outmoded pure growth strategy of development planning at the time the latter is being adapted to encompass our Zakat system !

In the preceding part we have considered the allocative function of Zakat as means of fighting poverty within a modern context. We

(1) See Streeten et. al. (12) p, 27.

(2) Ibid, p. 72.

have questioned the general practicability of the Zakat disbursement mode: that able poor be provided with physical capital goods in line with the shafi'i principle, while unable poor be provided with a single year's provision of consumer's goods, in line with the Maliki principle. We have argued that such a criterion, which is recommended by Dr. Qaradawi, has a very limited scope within the contemporary economies where the bulk of the able poor tend to be the low income full-time employees. Employer regulatory restrictions, time-constraints, and nature of salaried job may all render the able/unable criterion of very little relevance except for primitive crafts work and small self-owned enterprises. On the other hand the Islamic state should encourage dispersed and casual economic units to incorporate and consolidate in order to reap large scale economies, and to promote the Islamic spirit of fruitful cooperation among society members.

Thereby, we have examined the possibility of giving special weight, to the transfer of equity asset holdings. This possibility renders the able/unable criterion almost redundant as even the unable dependants could be provided with equity assets. This point has led us to seek an alternative criterion for combining the Shafi'i and Maliki principles, other than the able/unable one. We have, however, expressed the view that the suitable alternative criterion is to use this producer/consumer goods disbursement mix as a policy control instrument for affecting economic stability whenever necessary. This aspect is investigated more formally in Part-II below, together with other stability-related issues.

As regards the other claims on Zakat, they have been touched only briefly, giving special attention to the relevance of the *tamleek* condition to the modern context. Specifically, we have examined the development-oriented content of the contemporary view which allows for the finance of the basic economic infrastructure out of Zakat under the title of "Spending In the Way of Allah", or as an indirect means of poverty eradication. We have criticized this view on grounds that the recent approach to development planning is moving away from the pure growth strategies towards a mixed

strategy which contains special programs for the direct maintenance of poverty stricken *target groups* with minimal leakage effects.

PART—II

The Stabilization Function of Zakat

We have concluded the previous part with the following queries :

- (i) Could real investment guarantee a steady and reliable income flow over the life-cycle of a property owner in an Islamic economy ?
- (ii) What is the alternative criterion for combining the the Shafi'i and Maliki disbursement modes other than the Dr. Qaradawi's "able/unable" criterion? We have seen that as long as a Zakat-worthy person may be allocated Zakat in equity form, there is less room for distinguishing between able and unable persons.

The first query leads to the discussion of whether an Islamic economy is self-stabilizing, or that deliberate stabilization policy is necessary. The second query leads to the possible use of "disbursement mode" as an instrumental policy-control variable. Thus the first section of this part deals with the first question, while the second section deal with the second question.

2.1 The Stability Property of an Islamic Economy

Stabilization policy is normally devised for the treatment of cyclical fluctuations in the volume of economic activity as measured in terms of real G.N.P. The objective of stabilization is normally defined in terms of a steady growth rate accompanied by full utilization of capital and labour resources. Stability is desirable as it implies growth promotion with minimum risk and uncertainty. An unstable economy suffers from major dislocations in production and employment at the trough of the business cycle, and accelerated inflation at the peak of the cycle.

If growth is self-sustained as it is generally the case in developed industrial countries, then the major concern of fiscal and monetary

policy is the stabilization objective. Naturally, this renders the LDC's at a disadvantage, as it is often the case that development plans which aim at security or achieving – a target growth – rate run afoul with the stability objective. Experience of LDC's has confirmed this point. It is partly one main reason why the tight monetarist policies recommended by IMF economists, to treat rising inflation in LDC's, defeated the real growth objectives.¹

No doubt, such development oriented problems require special attention of Muslim scholars –as after all these are the real pressing problems of the Muslim world. However, we shall assume away such considerations, as we are only concerned with the analytical properties of Zakat in terms of its stabilization function. Thus, we shall assume a self-sustained growing economy with an equilibrium growth rate determined endogenously by its *free* market forces. We also assume a given state of technological knowledge, and a population growth-rate which is compatible with the equilibrium growth-rate of real G.N.P.

2 2 1 The Trade-Cycle and its Relevance to Islamic Economy

The general feature of a cycle is that an expansion of economic activity is succeeded by a contraction in an alternating renewal process. Empirical evidence of developed industrial countries has revealed such almost regular upward and downward oscillations of a growing G.N.P. The troughs and peaks of such oscillations are generally referred to, respectively, as the *contraction* and *expansion* phases of the cycle.

In theory it is assumed that each phase of the cycle contains within it the seeds to generate the succeeding phase. This is the approach which regard cyclical fluctuations as the product of endogenous market forces. There is, yet, another approach which relates cyclical fluctuations to exogenous factors e.g. changes in the demographic structure of population ; changes in the international terms of trade ; major technological innovations ; and major climatic and natural changes, wars, ... etc.

(1) See Togel-Din (13).

Hence, taking the last approach even an ideal Muslim society may reflect such fluctuations. Economic recessions, shortage, draught (... etc) are all possible as signs of *fitna* and *ibtila* :

“Be sure we shall test you with something of fear and hunger, Some loss in goods on lives or the fruits (of your toil), but give glad tidings to those who patiently persevere”
(S. II., aya 155) – El-Baqara.

However such fluctuations are usually non-regular in nature. Economists have paid more attention to the regular cyclical fluctuations which are the product of endogenous market forces. The theory of the business cycle relates to the study of such phenomena. In what follows we shall assume away exogenous influences, so as to focus on the regular cyclical pattern of a free market (closed) economy.

2.2.2 A Theory of the Trade Cycle.

The literature on the trade-cycle exhibits various approaches which attempt to explain such a phenomenon.¹ In what follows we shall adopt the widely accepted capital adjustment theory of the trade cycle. This theory proposes an *impetus* which cyclical behaviours, and a *propagation mechanism* for the cycle.

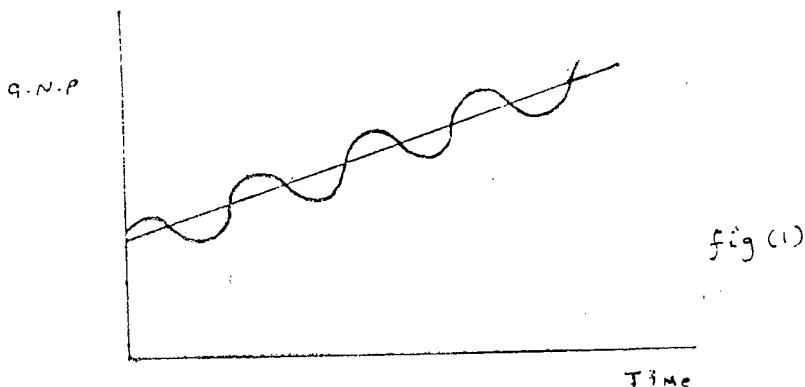
In a steady-state growing economy labour supply and capital stock both grow at equilibrium growth rates. In this case the *actual* capital/output ratio always equals the optimal capital/output ratio, which is assumed constant.² In a growing economy this implies that future expectations are never disappointed i.e. ex-ante quantities are always equal to ex-post ones. According to the capital adjustment approach the *impetus* of the business cycle is the initial divergence between the actual and the optimal capital/output ratio. This divergence occurs as a result of mistaken expectations of businessmen who lately discover that they either have too much or too little capital stock to meet the demanded output. The impetus can work either way :

(1) For example ; The Random Shocks approach by Frish; See Frish (6)

(2) This is due to the assumptions of 2.1.1 above.

- (a) If actual capital/output ratio falls short of the optimal one, then businessmen discover that they have too little capital to produce the demanded output. Thus, investment has to grow more rapidly than it should do in the steady-state equilibrium until capital stock is fully adjusted to its desired level.
- (b) If actual capital/output ratio exceeds the optimal one, then businessmen discover that they have too much capital to produce the demanded output. Thus, investment must be reduced below its steady-state equilibrium, and disinvestment takes place till capital stock is fully adjusted to its desired steady-state level.

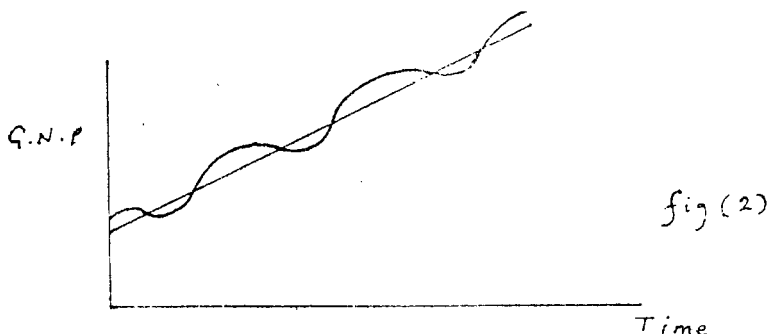
In case (a), the economy experiences an expansion (or a boom), while in case (b) it experiences a contraction (or a recession). Once the impetus has taken effect either way, then the cycle is propagated by the multiplier-accelerator mechanism. In its most abstract form the business cycle is believed to be propagated by such a mechanism which, under certain conditions, produces regular symmetrical cycles. This symmetric phase implies that the duration of the contraction phase is always equal to that of the duration of the expansion phase. See fig (1) below :



However, historical data¹ has given empirical evidence that contraction phases generally last shorter than expansion phases. This

(1) See Levacic (8), Chapter 11

means that the symmetrical property of the knave multiplier-accelerator mechanism does not work in practice. A more realistic alternative is provided by fig. (2) below:



This property has been explained on the grounds that the capital adjustment principle does not operate symmetrically over the two phases of the cycle. When case (a) is relevant (see the top of page 19) businessmen undertake net investment to remove the discrepancy between desired and actual capital stock. Hence at the expansion phase of the cycle the rate of *actual* net investment is determined by the accelerator relationship. Thus, the multiplier accelerator mechanism does work at the upswing of the cycle.

However, when case (b) is relevant the accelerator only determines the desired rate of disinvestment but not its actual rate. The actual rate of disinvestment depends on the rate of depreciation. Thus, the multiplier-accelerator mechanism does not work at the downswing of the cycle. Goodwin developed a non-linear accelerator model with a variable capital/output ratio to explain this property.

An alternative explanation, which is more relevant to Islamic economics, is due to Hicks who utilized the concept of autonomous (non-induced) investment. According to Hicks autonomous investment is the bottom rock which is not eroded by induced disinvestment in the recession phase of the cycle. It provides resistance against the propagation of economic recession, and it accounts for the fact that economic contractions last shorter than economic expansions. Hicks has justified autonomous investment on grounds that long-term buoyant expectations of some businessmen would induce them to

carry net investment despite the prevailing pessimism created by recession.

2.2.3 The Relative Stability of the Islamic Economy:

The previous discussion implies that even a properly functioning Islamic economy cannot be purged of endogenously produced cyclical fluctuations. This will be the case unless business expectations are always met; or unless central planning supercedes free market enterprising; or unless a stagnant subsistence economy is upheld. These are all either unreasonable or non-Islamic!

However, is it really desirable, that the Islamic economy pursues a monotonous steady-state growth path, reflecting no variations, whatsoever? Mild oscillations are inevitable in a healthy growing economy, as long as they do not cause any serious dislocations. Hence, the question to ask is how serious these oscillations are in a properly functioning Islamic economy, compared to a secular free market economy. We are arguing below that a properly functioning Islamic economy is more stable than secular one, given the background of section (1.1) above.

¹In an Islamic economy where businessmen behave in accordance with Islamic rationality, the profit motive is not the dominant factor affecting investment decisions. This implies that Muslim entrepreneurs would carry a larger volume of net autonomous investment compared to secular entrepreneurs. On the other hand Islamic values which impose a sense of social responsibility on muslim entrepreneurs should restrain the rate of induced disinvestment quite substantially.

This is bound to create autonomous investment at a higher rate than in a secular economy. Thus, using the Hicksian approach, we should expect the contraction phase to last shorter than in a secular economy.

(1) The objective function of a Muslim entrepreneur encompasses an altruistic component beside the profit motive; e.g. see Siddiqi (11). Chapter, 1.

2. The second factor relates to the elimination of interest and adoption of profit-sharing means of finance e.g. equity participation. It is worthwhile looking at the effect of this factor at the two phases of the cycle, starting with the expansion phase below :

- (a) It is admitted by western economists that at the upswing of the cycle with bouyant business expectation equities act as a hedge against inflation,¹ while demand for interest-bearing bonds rises due to inflationary tendencies :

“.....Price-level inflation encourages borrowing. Business and personal investment of many kindscan be expected to rise with the general price-level, while loanscan be paid off in dollars of reduced buying power.”

(Christy Clenderin. p-12.)

Hence interest-financing is associated with a sharper upswing at the expansion phase of the cycle, than equity financing. This implies that the inflation-rate would generally be lower in an Islamic economy which operates mainly with equity participation, The point that equities act as good hedges against inflation should be more pronounced in an Islamic economy. The fact that all Islamic firms are unlevered,² and that speculative practices are prohibited by a well-controlled Islamic Stock-Exchange should help stabilize stock prices to a great extent.

- (b) An interest-financed economy is liable to a sharper downswing at the contraction phase than an equity-financed one. The expansion phase ends up leaving most firms with high leverage ratios. As business expectntions become bleak, common stock holders become worried to selling out their holdings. Stock prices start to fall faster³ than the general

(1) The empirical support for this theoretical point is rather weak in developed industrialized economies due to high leverage ratios.

(1) This is used in a relative sense, as contractual debt obligations are not totally excluded (e.g. rents)

(2) This is an empirical observations systematically confirmed over a 100 years data base ; see Di cr (4) ch. 7

level of economic activity, due to the high leverage-ratios. This is because contractual debt-commitment have to be met out of the already depressing profits, and the residual profit share of common stock holders diminishes, leading to panic selling out of stocks

Thus businessmen have strong reasons to disinvest, or at least to stop net investment at this stage.

The Islamic economy should, therefore, be relieved of such a drastic downswing since Islamic firms are typically unlevered ; there are very little contractual committment to meet. Moreover the autonomous invstment attitudes among stockholders should restrain their selling motives in the face of bleak expectations.

3. The third factor is Psychological. Secular economies, which deliberately nuetralize the religious factors, tend to shape people's states of mind in conformity with business conditions.

Bouyant business expectations make investors and consumers over-optimistic, so that they all cherish risk taking. Investors extend their economic committments too far. Consumers suppress their risk-averse precautionary motives, promote their living standards and entertain themselves too much. Optimism and over-confidence prevails, and people behave as though there is no return to the old hard times !

Bleak business expectations produce just the contrary results. Pessimism spreads in snowball fashion and risk-aversion increases. Investors liquidate their economic committments at a faster rate than necessary. Consumers drastically reduce their spending, to make business life even worse off. Except for a few venturous enterprenuers, a general state of despair and ill-confidance prevails in business life.

Such a materially-shaped mentality, which secular writers wish

to promote is typical of what God describes in the Qur'an :

“When we give men a taste of Mercy, they exult thereat. And when some evil afflicts them because of what their (own) hands have sent forth, behold. they are in despair” (S XXX, ayr (36), *ibid*,

“Truely, man was created very impatient. Frenful when evil touches him. And niggardy when good reaches him,”
(S LXX, aya : 19, 20, 21)

A genuine Muslim enjoys a state of mental and emotional stability which is robust against material life fluctuations. He constantly reminds himself of the Qur'anic parables which advice him to strike a balance between the extremes of pessimism and optimism.

“In order that ye may not despair over matters that pass you by, Nor exult over favours bestowed upon you, for God loveth not any vainglorious boaster”

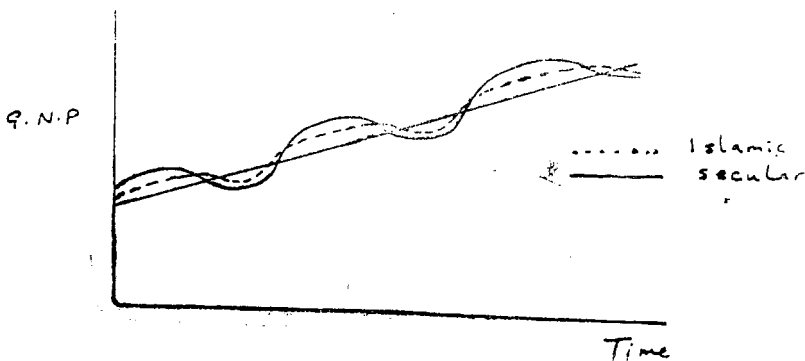
(S. LVII, aya (23)

El-Hadid.

2.3. Conclusion about Relative Stability of Islamic Economy

There is a strong reason to believe that an Islamic economy enjoys a definite relative advantage over the secular one in terms of stability.

The cyclical oscillations to be expected in an Islamic economy are much damper, having shorter contraction phases and longer expansion phases compared to a secular economy. This point is represented in fig. (3) below :



N.B. We are assuming equal growth-rate and equal stock of wealth in the two economies, although a zero-interest rate economy (ZIRE) is expected to have a higher growth-rate than a non-ZIRE economy¹ *citris paribus*-

2.4. The Stabilization Role of Zakat

Policy makers usually require a set of controllable tools which they may freely manipulate to satisfy stabilization objectives. The question is whether Zakat can satisfy such a fiscal objective.

However, we have just shown that there are strong reasons to expect a self-stabilizing Islamic economy. It may follow that need for deliberate stabilization will not be as urgent in an Islamic economy as it is in secular economies-assuming away developmental problems.

Nevertheless, it is worth-while investigating into the stabilizing potential of Zakat. In what follows we deal with the conventional medium term stabilization function. The Analysis is based on the theoretical background of the previous section.

2.4.1. The Tools of the Stabilization Function :

Using the previous background of section (2.1) and sub-section (2,2.1) above we may introduce the following notions :—

- (a) *The Disbursement Mixing Ratio (SMR)*. This ratio is simply defined in volume terms as the mixing ratio of consumer to producer goods in the disbursement mode of Zakat. This DMR may vary from year to year, but there is an Equilibrium DMR (EDMC) which corresponds to the optimal capital/output ratio. Hence, in the steady-state growth path there is a given EDMC which is associated with the equilibrium long-term growth-rate.
- (b) *Zakat Collection Mode (ZCM)* : At the steady-state growth path, where the economy performs most efficiently, Zakat

(1) This point has been proved by Dr. Mcherji-in an unpublished research "The Theory of a Growing firm in a Zero Interest Economy" ; International Centre for Research in Islamic Economics ; Jeddah,

is collected annually in the normal routine, which we call the RZCM. Among other things this Routine implies that there is no need to collect Zakat dues in advance from some persons, though it is permissible. It also implies that there is no point in imposing Zakat on the value of real productive assets so long as they are fully utilized in production. Yet the actual ZCM might differ from the RZCM, mostly due to deflationary tendencies.

- (c) *The Equilibrium Share of other Claims on Zakat (ESOC)*: We also assume, in line with the above notions, that total Zakat proceeds are allocated between "poverty need" and "other claims" in a given ratio which is compatible with the steady-state long-term equilibrium growth. This ratio is devoted by ELOG, and is also assumed given at equilibrium.
- (d) *The Equilibrium Zakat Yield (EZY)*: This is the only time-dependant variable among the other three notions. The EZY is defined as a function of the equilibrium national output at a given time point. It is generally collected via RZCM. It is to be allocated between poverty treatment and other claims in accordance with the ESOC defined above.

(i) Now suppose that the impetus of the trade-cycle works in the expansionary direction, due to businessmen discovering that their actual capital/output ratio is smaller than the optimal one. Thus net investment must grow at a faster rate than the long-run equilibrium growth-rate, until capital stock is fully adjusted to its desired level.

At this stage the DMR must be reduced. Otherwise, if the consumer/producer mix of Zakat disbursement is left unchanged at its long-run equilibrium ratio, EDMR, this would allow the multiplier-accelerator mechanism to sharpen the upswing of the expansionary phase and shorten its duration.¹ Thus the DMR must be

(1) It is clear that the EDMR would help fuel demand-pull inflation unless the acceleration effect is controlled by reducing consumer demand.

reduced below EDMC giving more weight to producer goods' disbursement, and less weight to consumer goods. This is a double-edged weapon. In one way it enables capital stock to be adjusted quickly enough to its desired level as more Zakat proceeds are now utilized in the purchase of equities. In another way the demand pressure is minimized by the diversion of more Zakat proceeds away from consumer goods disbursement; thus reducing the accelerator effect.

Hence, by reducing the DMR ratio we are able to dampen the upswing of the expansionary phase of the cycle, and to prolong its duration, *citris paribus*.

(ii) Now suppose that due to disappointed expectations businessmen discover that they have over-invested. The economy, then embarks on a downswing towards the contractionary phase of the cycle.

In this case the DMR variable must be raised, thus giving more weight to consumer goods disbursement, and less weight to producer goods. This treatment is called for due to a deficient demand prospect. Hence in this way the tendency towards induced disinvestment is minimized, and the economy recovers fairly quickly from the recession. This makes the contractionary phase damper and shorter.

However, at this stage the collected Zakat proceeds would fall below its EZY level due to lower incomes and profits. Unless additional resources are sought the collected Zakat proceeds might not suffice to treat the deflationary situation. Thus the RZCM must be changed so as to permit the collection of Zakat dues in advance from the wealthier people. It is also possible to levy Zakat on "hoarded" real assets which are left idle due to production cuts.¹ The ESOC ratio may also be raised during the deflationary phase, thus giving more weight to the "poverty/need" category and less to the "other claims".

(1) Or non-fulfillment of the target output. This is a controversial point in *sdari'ah* though we have allowed for it here, hoping for a more formal treatment in future.

In this way the EZY could be approximately maintained even during recession by suitable changes in RZCM and ESOC ratio.

We have just shown that stabilization is achievable by appropriately manipulating the DMR variable. The other changes in RZCM and ESOC only refer to the necessary adjustments which must be made so that the disbursement mixing ratio works as a policy-control variable at the downswing.

2.4.2. "Tokens", as Disbursement Mode Controls :

How can we ensure that the disbursement mixing ratio (DMR) of "consumer/producer "goods" is taken care of by Zakat recipients? Clearly, if Zakat is paid out in the ordinary national token money (paper notes or coins) to the worthy-persons, then it is completely at their disposal to decide how to spend it. In this case the DMR is completely determined by the preferences of the recipients, and there will be no way to use this quantity as a policy control tool. Thus, if the preceding discussion on stabilization is to hold any water we must define the DMR as a controllable quantity.

One way of achieving this end is through the use of special Zakat created tokens. To some extent they look fairly similar to food-stamps in U. S. A. or milk token in U. K. The idea is that Zakat proceeds whether in money or real forms, be kept as a reserve fund, and specialized tokens be issued on its basis and disbursed to their worthy-persons in this form.

We may visualize two broad categories :

- First : Consumer good tokens : Those which are only confined to the purchase of specific consumer goods and related services. Administrative controls shall see to it that such tokens cannot be circulated for the consumption of non-permissible goods, or saved for more than a year.
- Second : Producer good tokens : Those which can only be used for the purchase of specific capital goods, including equities.

If this system¹ were properly assimilated, the Islamic economy would have access to an additional policy control instrument that enhances monetary and fiscal policy tools. Namely, it is the Zakat Disbursement Mixing Ratio (DMR).

Conclusion

The main findings of this part relate to the stabilization role in a growing Islamic economy. We have arrived at the conclusion that a free market Islamic economy is expected to be far more stable than the secular one. The main factors which may account for this comparative advantage are: a) First, autonomous investment is expected to be larger in an Islamic economy at the contraction phase of the cycle, due to the assumed Islamic principle of rationality which consists of an altruistic component beside the pragmatic profit motive. b) Second, abolition of interest and prevalence of profit-sharing methods of finance render Islamic firms unlevered. Thus the destabilizing role of high leverage ratios which operate in secular economies are ruled out. c) Third, the secular psychology of business which exposes the levels of economic activity to the extremes of optimism and pessimism, runs afoul with Islamic values.

Then, we considered the possible use of Zakat Disbursement Mixing Ratio (DMR) of consumer/producer goods, as a stabilizing tool, given the basis of the capital adjustment theory of the trade cycle. Needless to emphasize, the stabilization problem could in fact be more complex, and it may turn out that the DMR tool could only provide a partial aid to the overall stabilization policy. Yet, if our assumptions about the ideal Islamic economy are fulfilled, and need for stabilization becomes less urgent than it is in secular economies, then this DMR could play a decisive role for restoring the balance.

We have deliberately ignored all other possible causes of economic instability apart from the simple demand-pull inflationary one. As an analytical point of departure this makes the analysis simple,

(1) The author has elsewhere worked out a detailed proposal for the operations of Zakat created tokens that satisfies least cost through the Banking System.

though it is worth while for a future research to examine the possibility of other destabilizing causes. For instance, should an Islamic economy be susceptible to cost-push inflation, or structural inflation? The former tends to be associated with unionist pressure, while the latter tends to be associated with capitalist development planning. This is not a simple question to answer, though it may a priori appear that a growing Islamic economy may be less susceptible to such pressures than to a possibly mild demandpull inflation.

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Economic Development Through Regional Cooperation

A Customs-Drawback Union of Islamic Countries

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ABSTRACT

[If the idea of an Islamic Economic Unity is taken seriously, a trade liberalisation scheme must be adopted by the OIC member countries sooner or later. Unconditional trade liberalisation, however, results in an unequal distribution of the costs and benefits of integration and in a polarisation of manufacturing industries in the more advanced Islamic countries. Less developed countries which lose industrial capacities in intra-group competition often complain that the more advanced countries gain manufacturing production at their expenses. Hence they demand some compensation or/and take recourse to restrictive practices (e.g. non-tariff trade barriers) with disintegrating effects. Empirical evidence can be found in most of the existing integration groupings where Islamic countries are members. Since the conventional compensation methods do not solve the problem, a new integration form for a 'conditional' trade liberalisation should be considered: the customs-drawback union (CDU). The CDU ensures that no integration country will be worse off after joining the group than it would have been if it had continued the previous national protective tariff and industrialisation policies. The CDU incorporates automatic incentives for a reversal of the direction of trade flows if the intra-group trade develops in an unbalanced way, and it sets incentives in favour of a location of new manufacturing industries in the less developed member countries of the grouping (which record an intra-group trade deficit). Further, a CDU could integrate existing free trade areas and customs unions without unreasonable violation of integration treaties in force at present (as it would be the consequence of traditional trade liberalisation forms). Thus,

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the CDU seems to be superior to free trade areas and customs unions insofar as it results in less costs of integration for the less developed group members without a sacrifice of substantial benefits for the group as a whole.]

After the redress of the Ottoman Empire and the liquidation of the caliphate by the Turkish National Assembly in 1924, the last symbols of the unity of the Muslim World were removed. But when the Islamic countries gained their political independence after World War II, the idea of the umma - the Islamic community—was revitalized in the 1960s. In the discussions about the unity of the Muslim World, economic matters attracted wide attention. An often advanced argument was that the Islamic countries became only politically independent but were and are economically still under the domination of the strong industrial countries of the North. The Islamic countries, which are—as a group—well endowed with natural resources, should endeavour by joint action to remove these dependencies and to push ahead their economic development. National peculiarities cannot be denied, but the common religion of Islam should be a strong foundation for the international solidarity within the Muslim World.

1. The Goal of Islamic Economic Unity and the OIC

In the early 1970s, the Organisation of the Islamic Conference (OIC) was set up and soon began to propagate closer economic relations among the member states. This was not a basically new idea, and the economic rationale for cooperation and integration among Islamic countries was much the same as it was for the many non-Islamic groupings where Islamic countries are members in. In the late 1970s, under the impression of increasing protectionism of the industrial countries and of serious debt crises of a growing number of developing countries, the idea of collective self-reliance and mutual assistance became very popular among the countries of the South—the OIC members included.

The traditional approach towards an intensification of the economic relations within a group of countries was to reduce trade barriers and to establish a free trade area or a customs union. If the

idea of an Islamic Economic Unity is taken seriously, the OIC countries must adopt, sooner or later, a trade liberalisation scheme. At present, the OIC lays more emphasis on a liberalisation of factor movements, and in 1981 the Islamic countries signed an Agreement on the Promotion, Protection and Guarantee of Investments among Member States of the OIC which will enter into force after the ratification by at least ten countries. But in the last instance, the movement of capital (in the sense of financial means) is of macro-economic and developmental importance only when it is followed by movements of real goods.

The flow of capital from some wealthy oil countries to some larger and more advanced Islamic countries (and the flow of labour from the densely populated to the oil rich countries) was made possible by bilateral agreements between the countries concerned (or even without that). The capital exporting countries have an interest in the employment of funds in profitable enterprises in the recipient countries, and these enterprises—in the absence of incentives for a redirection of trade flows towards Islamic countries—typically produce goods for the (protected) domestic markets of the capital importing countries or for markets in the industrial countries, but rarely for markets in other Islamic countries. The Investments Agreement of the OIC will probably have only a marginal impact for the intensification of economic relations among Islamic countries if it is not supplemented by a trade liberalisation scheme which enlarges the national markets (esp. of the small Islamic countries) and sets incentives for a more encompassing sectoral and regional reallocation of industrial activities within the Muslim World. This would lead to increasing movements both of factors of production and of manufactured goods not only bilaterally but on a multilateral basis.

Thus, closer economic cooperation must result in an increase of the intra-group trade ; protective national tariffs, however, hinder an expansion of this trade. (and in consequence, also of multilateral factor movements). Therefore the liberation of trade among the Islamic countries can be seen as a precondition for closer economic relations.

2. Trade Liberalisation Experiences in Existing Integration Groupings

Islamic countries are members in a remarkably large number of economic co-operation and integration groupings, and any proposal directed towards the gradual establishment of an Islamic Common Market or Islamic Economic Unity should take into account the experiences gained from the practice of these groupings. For an assessment of the costs and benefits of a particular institutional arrangement for trade liberalisation and integration, one can take a look at the following nine groupings.

1. Egypt, Iraq, Jordan and Syria formed the Arab Common Market (ACM) in 1964 and abolished all tariffs on locally produced agricultural, animal and mineral products in 1971 and on manufactured goods in 1973. Libya joined the ACM in 1977. Mauritania in 1980, PDR Yemen in 1982: these countries did not yet implement the free trade provisions. The results of the trade liberalisation programme are disappointing: The shares of the inter-ACM exports in total exports of the ACM countries grew in the 1970s but were reduced again in the recent past. Only for Jordan intra-ACM exports accounts for 15% of total exports in 1983: of Syria the share is 2% and for all other ACM members it is less than 1%. Asking for the reasons, one has to note that the ACM became a free trade area only formally: in practice, non-tariff trade barriers "remained major obstacles to a more rapid expansion of intra-ACM trade¹". Tariff concessions were often offset by non-tariff restrictions which became a widely used instrument for the continuation of protective policies for domestic industries.

2. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates set up the Gulf Cooperation Council (GCC) in 1981. In 1983, they abolished customs duties on intra-GCC trade in agricultural and animal products processed from locally obtained materials and on "manufactured goods made from imported raw materials if domestic value added constitutes at least 40 per cent of the cost of the finished product and nationals own at least 51 Per cent of the equity of the firm producing it²". In 1982 (the year before the abolition of

1. ECWA (1985), p. 10; for the trade figures see AMF (1985).

2. BCWA (1985), p. 16.

tariffs), the ratio of intra-GCC trade reached a maximum of 26.9% in Bahrain and ranged from 0.6 to 8.0% of total exports for the other countries. By the end of 1983, i.e. after the abolition of tariffs in March, the maximum in Bahrain was reduced to 24.1% and the other countries recorded ratios between 0.2 and 4.4%; the volume (in US\$) of intra-GCC trade decreased in all member countries³. And since the GCC members did not harmonize their general industrialisation and fiscal policies, complaints can be heard about distortions in the intra-group competition: Most countries "are wary of opening their markets to Saudi-made goods which benefit from generous government subsidies and other incentives⁴".

3. Liberia and Sierra Leone formed the Mano River Union (MRU) in 1973; Guinea joined in 1980. In 1981, a customs union was completed. "Disappointingly, however, trade between the members has not been affected in any significant way⁵"; it was and still is minimal. Among the main reasons are the near-total absence of infrastructural linkages between and the use of three different currencies by the three member countries⁶.

4. Cameroon, Congo, Central African Republic, Equatorial Guinea and Gabon are the present members of the Union Douaniere et Economique de l'Afrique Centrale (UDEAC)⁷, which was established in 1956 but revised substantially in 1975. Since then UNDEAC is a customs union, but the intra-union trade is insignificant: The average share of intra-UDEAC exports in total exports was only 1.8% in 1983⁸. A peculiarity of UDEAC is its tax unique (single tax): Enterprises admitted to this scheme and producing industrial products in one member country for the market of the other members, are exempted from all duties and taxes on imported inputs. They are subject to a single tax which is fixed at a level beneath that of the

3. See AMF (1985a).

4. Allen (1985), p. 10.

5. Sesay (1985), p. 130.

6. See *ibid.*, pp. 128—131.

7. Central African Customs and Economic Union.

8. The share was 4.75 % for Cameroon but less than 1% for all other members; figures computed from IMF (1984).

customs duties for imports of the respective finished good from outside UDEAC. The single tax is levied by the country where production takes place, but the receipts are transferred to the countries where the products are consumed⁹. By this procedure, the consuming countries shall be compensated for the loss of customs revenues when imports from member countries replace former imports from outside UDEAC. The consequence of this procedure is that the single tax works, in practice, just like an intra-union (preferential) tariff: thus, one may say that factually UDEAC is internally not even a free trade area. The technique of the single tax system seemingly does not promote very effectively the expansion of the intra-group trade.

5. 16 countries¹⁰ formed the Economic Community of West African States (ECOWAS) in 1975. In 1979, a trade liberalisation programme was started, but—esp. for manufactured goods—delays occurred repeatedly, and it has been criticised that “ECOWAS, 8 years after its creation, continues to exist only on paper¹¹”. The existence of two smaller integration groupings within the ECOWAS region (MRU and CEAO turned out to cause major problems because certain important provisions of the ECOWAS treaty are incompatible with the rules and regulations in force in the MRU and CEAO. For example, the MRU has introduced and the CEAO envisages a common external tariff for imports from outside the respective group. A number of countries are outside MRU and CEAO but inside ECOWAS which strives for reduction and abolition of tariffs for trade among all its members. Besides these problems—which strain negotiations in ECOWAS—, there is another provision seriously limiting the possible impact of the ECOWAS trade liberalisation programme. The ECOWAS rules of origin prescribe that tariffs are abolished only for products where at least 35% of the value-added is contributed by firms in ECOWAS countries whose

9. See, for example, UNCTAD (1982), paras, 368—369, Yadi (1979).

10. Benin, Burkina Faso, Cape Verde, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo.

11. Diouf (1984), p. 14.

equity is held to at least 20% in 1981, 35% in 1983 and 51% in 1989 countries by ECOWAS nationals. "Since Ivory Coast and Senegal at present account for a high proportion of the manufactured exports amongst Community members, this ownership provision will ensure that the trade liberalisation provisions of ECOWAS will remain largely without practical effect until such time as the affected member states are able and willing to comply with the ownership provisions, or these provisions are modified¹²".

6. 11 countries¹³ launched the Preferential Trade Area for Eastern and Southern Africa (PTA) in 1981. The long term goal is the establishment of a common market and, later on, of an economic community. Initially the PTA members shall strive for a preferential or free trade area ; then a common external tariff shall be introduced. The PTA has many similarities with the ECOWAS, including (in principle) the problematic rules of origin, "and the ECOWAS, the PTA promises to be a long time getting off the ground¹⁴".

7. 10 countries¹⁵ formed the *Communaute Economique des Etats de l'Afrique Centrale (CEEAC)*¹⁶ by the end of 1983. In the long run, intra-group trade shall be liberalised completely and a common external tariff shall be introduced. It was pointed out that "in a group of countries with little in common besides shared borders and the fact that they are all among the world's least-developed states, many details are still to be ironed out, and the *Eccas Ten* have allowed themselves a 'transitional period' of 12 years in which to do it¹⁷".

8. Benin, Burkina Faso, Ivory Coast, Mali, Mauritania, Niger

12. Robson (1983) p. 118.

13. Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Somalia, Swaziland, Uganda and Zaire

14. n.a. (1982), p. 6264.

15. All UDEAC members (Cameroon, Congo, Central African Republic, Equatorial Guinea, Gabon) plus Burundi, Chad, Rwanda, Sao Tome and Principe and Zaire.

16. Economic Community of Central African States, ECOCAS.

17. n.a. (1983), p. 9.

and Senegal put in force the *Communaute Economique de l'Afrique de l'Ouest* (CEAO) in 1974¹⁸. The CEAO was established as a preferential trading area; plans for an introduction of a common external tariff in 1986 can hardly be realized. The share of intra-CEAO exports in total exports increased from 8.4% in 1977 to 8.9% in 1980 and 10.6% in 1983¹⁹. While imports of non-processed (mainly agricultural and mineral) commodities of CEAO countries are duty free, a regional cooperation tax with a preferential margin of 50% or more is levied instead of customs duties on imports of manufactured goods produced in member countries. Although a redistributive element was incorporated in the regional cooperation tax and a Community Development Fund was established, the industrial activities concentrate in the more advanced countries (Ivory Coast and Senegal) which are intra-group exporters. On the other side, the land-locked members (Burkina Faso, Mali and Niger) are intra-group importers, and it "is certain that...(they) will one day...pose the issue of their own industrial development, should the CEAO continue to operate through these mechanisms²⁰".

9. Indonesia, Malaysia, Philippines, Singapore and Thailand created the Association of South East Asian Nations (ASEAN) in 1967; Brunei joined in 1984. Unlike the aforementioned groupings, ASEAN is no integration but just an economic cooperation grouping. In the field of trade, the ASEAN Preferential Trading Arrangement (PTA) entered into force in 1978. The intra-ASEAN trade as a proportion of total ASEAN trade rose from 16% in 1977 to 23% in 1983²¹. This, however, is not a success of the PTA since only 2% of the intra-ASEAN trade is subject to the preferential treatment²². "Given member countries' obsession with their national interests, most items offered for tariff cuts under the PTA are marginally traded or completely non-tradable²³".

18. West African Economic Community.

19. Figures computed from IMF (1984).

20. Diouf (1984), pp. 28—29.

21. See Sricharatchaya (1985), p. 53.

22. See n.a. (1986), p. 88.

23. Sricharatchaya (1985a), p. 76.

3. Economic vs Political Assessment of Integration

The record of the listed integration schemes is not very impressive. The stimulation of the intra-group economic relations, leading to an increased volume of intra-group trade, was in most cases at best marginal. The main reason seems to be that governments very often are not really willing to open their markets for competitors from other integration countries. The following summarized observations support this view :

—Negotiations on trade liberalisation are, esp. in large grouping, lengthy and often delayed (ECOWAS, PTA, CEEAC).

—Items which governments offer for tariff concessions can be large in number but negligible in relevance in the intra-group trade (ASEAN).

—Intra-group tariffs can be formally abolished but actually reintroduced by the adoption of a compensation-oriented tax systems for goods produced and traded within the group (UDEAC).

—When tariffs are abolished, governments can take recourse to non-tariff restrictions for the protection of national industries (ACM, in the future ?).

—If economic policies are not harmonized, exchange rate manipulations, fiscal and other incentives can be utilized for a protection of domestic industries (GCC, CEAO).

The poor record of integration groupings of developing countries and the evasive tactics of many governments regarding a 'real' liberalization of intra group trade are in contrast to the economic rationale for the formation of free trade areas or customs unions : It is usually argued that the national markets for most developing countries are too small for the establishment of plants of optimum size and for the realisation of economies of large scale production. Hence the enlargement of the markets (and their protection) is seen as a prerequisite for a more rapid industrial development (in the first stage of an inward-oriented and import-substituting type).

This economic argument pays attention to the welfare and

development of the integration grouping as a unity and does not care much about the regional distribution of the costs and benefits of the market enlargement. This, however, is the main concern of national governments for whom the domestic industrial development is a major political objective. It has been observed, for example, that in terms of natural endowments the countries of West Africa are extremely complementary, but that in practice the developmental potentials have not been exploited. This "lack of complementarity was created and maintained by nationalistic development policies for light, import substitution industries.... Manufactured products are similar and intended for the internal market ; agricultural and mineral raw materials are exported to Northern countries²⁴".

If the tariff-protected industries of integration countries are very similar in their basic orientation, but differ substantially in their levels of efficiency and sophistication—because, for example, some countries with larger markets are generally more advanced in their economic development, then some countries have to be in for a loss of industrial production. This implies a devaluation of invested capital and temporary unemployment. For most governments, this is politically not acceptable. "Frustrations and conflicts arise when a country perceives that its markets have been flooded by its partners' products when its cannot make reciprocal gains on its own. Such fears are fully justified, for no country wishes to be a mere agricultural appendage to its more developed neighbours²⁵".

4. Types of Islamic Countries and Gains and Losses from Integration

Although the exact costs and benefits of a sectoral and esp. regional reallocation of industrial activities within an intergation grouping after the liberalisation of trade (or/and factor movements) cannot be specified in advance for particular countries, it is possible to formulate some plausible hypotheses on characteristic features of types or groups of countries which will probably either gain or lose from the integration. Some basic data for such a classification of the

24. Diouf (1984), p. 20.

25. Diouf (1984), p. 27.

45 countries of the very large and heterogenous Islamic grouping are given in table 1.

A first group of 12 countries²⁶ is characterized by small domestic markets (with GDPs of less than 1,000 mill. US\$ in 1983) and low per capita incomes (GNP per capita less than 1,000 US\$ in 1983). It is not very likely that these small countries have developed manufacturing industries which could pass successfully an intra-union competition. These countries must be prepared to lose industrial capacities.

Table 1

1. GDP (in mill. US\$) 1983
2. GNP per capita (in US\$) 1983
3. Share of Manufactures in GDP (in %) 1982
4. Manufactured Exports in % of Manufactured Production 1982
5. Manufactured Exports to High-Income Oil Exporting and Other Developing Countries in % of Total Manufactured Exports 1982
6. Merchandise Exports to High-Income Oil Exporting and Other Developing Countries in % of Total Merchandise Exports 1982

	1	2	3	4	5	6
Afghanistan	—	—	—	—	—	20.9
Algeria	72200	2320	10	2.0	23	5.9
Bahrain	4920*	10510	—	—	—	60.1
Bangladesh	10640	130	7a	54.5	53	52.3
Benin	930	290	—	—	—	25.3
Brunei	—	21140	—	—	—	18.2
Burkina Faso	900	180	—	—	—	32.2
Cameroon	7220	820	11	9.6	61	8.9
Chad	320a	—	—	—	—	34.4

26. Benin, Burkina Faso, Chad, Comoros, Djibouti, Gambia, Guinea Bissau, Maldives, Mali, Mauritania, Sierra Leone and PDR Yemen.

Comoros	—	—	—	—	—	—
Djibouti	—	—	—	—	—	94.9
Egypt	27920	700	27	3.6	22	35.9
Gabon	—	3950	—	—	—	14.1
Gambia	—	290	—	—	—	29.7
Guinea	1910	300	—	—	—	9.7
Guinea-Bissau	—	180	—	—	—	62.4
Indonesia	78320	560	13	6.4	68	24.5
Iran	—	—	—	—	—	38.5
Iraq	33563*	—	—	—	—	63.3
Jordan	3630	1640	14	74.9	78	57.9
Kuwait	21330	17880	7	174.7	72	46.8
Lebanon	2394	—	—	—	—	—
Libya	31360	8480	3a	7.3	36	23.4
Malaysia	29280	1860	18	59.7	33	44.7
Maldives	—	—	—	—	—	69.9
Mali	980	160	—	—	—	19.5
Mauritania	700	480	—	—	—	4.3
Morocco	13300	760	—	—	—	22.7
Niger	1340	240	—	—	—	21.9
Nigeria	54570	760	6	2.1	—	23.9
Oman	7460	6250	1*	426.2	88	26.6
Pakistan	25880	390	17	33.9	45	57.4
Qatar	6419*	21210	—	—	—	27.9
Saudi Arabia	120560	12230	4	13.5	89	31.4
Senegal	2570	440	15	29.2	75	30.4
Sierra Leone	950	330	—	—	—	14.8
Somalia	1540b	250	6	1.1	45	83.8
Sudan	6850	400	7	1.5	30	59.1
Syria	16850	1760	—	—	—	29.7
Tunisia	7020	1290	13	90.6	30	17.6
Turkey	47840	1240	22	32.5	55	53.7
Uganda	3360b	220	—	—	—	13.5

U.A.E.	27520	22870	9*	28,9	87	19.7
Yemen A.R.	3710	550	—	—	—	69.2
Yemen P.D.R.	850	520	—	—	—	31.4

a) 1981, b) 1982,*) figures from AMF sources.

Sources : World Bank (1984, 1985), AMF (1984, 1285, 1985a), own calculations.

The second type of countries are the oil-rich or oil-processing high-income countries with a GNP per capita of 10,000 US\$ and more ; 6 countries²⁷ belong to this group. They dispose of large financial means allowing them to give strong fiscal incentives, subsidies and other governmental support to their domestic or intra-group industries. If these countries wish to expand their manufacturing industries (which presently contribute less than 10% to their GDPs), then they have the means to do so, and trade liberalisation might be to their Advantage.

The majority of the remaining 27 Islamic countries, however, is neither very small nor oil-rich ; these countries have GDPs of more than 1,000 mill. US\$ and per capita GNP of more than 1,000 US\$. For an assessment of the possible effects of a trade liberalisation policy, some more informations about the production structure and the trade orientation must be considered. Plausible assumptions are that the intra-group liberalisation is the more likely to the advantage of a country

—the more the manufacturing industry contributes to the GNP,

—the more the manufacturing industry is outward-oriented, i.e. the more manufactured goods are exported,²⁸

27. Bahrain, Brunei, Kuwait, Qatar, Saudi Arabia, U.A.E.

28. The relation of exported manufactured goods to the manufactured production (used here as an indicator) can reach figures of more than 100% (as it is for Oman and Kuwait, see table 1) because the exported manufactured goods may originate from domestic production or from imports, i.e. the export figures include re-exports which have a high importance for some countries (including Lebanon and Jordan).

—the more of the manufactured exports is suitable to meet the import demand of other integration countries; an indicator for this is the share of manufactured exports to the oil exporting and other developing countries in total exports.

Data are available for 17 of the 27 countries, and two groups of countries can be distinguished.

—The first group is formed by 6 countries²⁹ with inward-oriented manufacturing industries: 10% or less of the manufactured production are exported. Inward-orientation and import-substitution are conducive to inefficiency in industries esp. when the protective tariffs are high and the national markets are small; in these cases intra-union competition could be dangerous for the domestic industries. However, not all the countries of this inward-oriented group are small³⁰ so that a clear statement about the costs and benefits is not possible for this group.

—The manufacturing industries of the 8 countries³¹ of the second group can be characterized as outward-oriented: 20% and more of their manufactured goods are exported.³² The contribution of the manufacturing industries to the GDPs ranges from 13 to 23%,³³ and between 30 and 78% of the manufactured exports go to oil exporting and other developing countries.³⁴ It is very likely that these countries with relatively strong and outward-oriented manufacturing industries with respectable positions in the markets of other oil and non-oil

29. Algeria, Cameroon, Indonesia, Libya, Somalia, Sudan.

30. For example, Algeria and Indonesia are countries with large markets.

31. Jordan, Malaysia, Morocco, Oman, Pakistan, Senegal, Tunisia, Turkey.

32. One must keep in mind, however, that this indicator may overestimate the outward-orientation of domestic manufacturing industries: see note 28.

33. An exception is Oman with only 1%.

34. The figure for Oman is 88%, but most of Oman's manufactured exports are re-exports. The high percentage for Jordan is also due to substantial re-exports.

developing countries could gain from an Islamic trade liberalisation programme.

The task here is not to predict precisely which countries would gain and which would lose from trade liberalisation for exact and individual forecasts, more informations about national peculiarities are needed. Here it is sufficient to show that it is highly probable that the establishment of a free trade area or customs union would lead to a very uneven distribution of the costs and benefits among different groups or types of countries. Hence it becomes a necessity to look after the economic interests of those countries which are in the-danger of losing manufacturing industry capacities.

5. Planned Industrial Specialisation for Compensation of Integration Losses ?

Fiscal compensation schemes which can be found in some existing integrations have been installed to compensate for forgone tax and tariff revenues. However, financial transfers cannot replace 'real' plants. Therefore, in practice a growing number of integrations fall back on another approach for the support of the weaker member countries. They make efforts to come to more 'balanced' regional distribution of new industries by recourse to intergovernmental negotiations and a kind of central location planning for those new industries which are of developmental interest because of their pronounced backward and forward linkages with other lines of production. There are several variants of this **planned industrial specialisation**, but their common denominator is that in negotiations on the governmental level a comprehensive industrialisation programme is formulated which allocates to each country particular industries. The establishment of these industries shall be promoted exclusively in the appointed countries and they shall be protected as infant industries by a common external tariff.

Although the basic idea of the planned industrial specialisation became quite popular, there are serious doubts whether it is a practicable and effective solution of the distributional problems in such large and heterogenous groupings like the OIC.

—The planned industrial specialisation presupposes that to each

country of the grouping at least one industry will be allocated. The identification of potentially feasible and the selection of economically sensible projects and the consideration of national interests cause problems in the intergovernmental negotiations which grow at an outstanding rate with an increase in the number of participating countries. The problems are most serious in groupings where the members differ widely in their endowment with natural resources and productive factors and in their levels of development and industrialisation.

—Suppose these problems could be solved and the member countries agree on a particular distribution of new industries. Then the final criteria for this regional distribution are more political than economic considerations. But if governments want to set up a particular industry in country A for political reasons, the location would only by chance be identical with that one which an entrepreneur would have chosen for (micro-) economic reasons. As a consequence, there is always the danger that entrepreneurs would set up the same lines of production in another country, e.g. in B, when the production costs are substantially less than in A. These firms with a cost advantage could overthrow the 'administered' firms in the intra-group competition. This would endanger the balance of the whole regional industrial structure which was negotiated by the governments. Even if—in an extreme case—the government in B would, in the interest of A, counteract the establishment of the competing firm, it is highly possible that the regional monopoly of A for the output of its industry would economically be eroded by the development of substitutes, produced either in other integration countries or imported from the world market.

—But suppose the negotiated distribution of industrial locations would turn out to be persistent. Then—with high probability—there would emerge a number of regional monopolies for particular products which are protected against the international competition by the common (or harmonised) external tariff. Monopolies always tend to operate inefficiently. One form of inefficiency could be that the production is done by a larger number of workers than really necessary (under efficiency conditions). The additional costs of inefficiency will be borne by the customers of the monopoly who

have to pay higher prices than under competitive conditions. In the case of a regional monopoly within a large integration grouping, the inefficiency may be quite welcome to the national government of the production country: The inefficiency effects a higher national employment and income while the excess costs burden the customers who are mainly residents of the other integration countries. Although the tariff-protected regional monopolies cause welfare losses for the integration as a whole, the national governments of the production countries would hardly favour a policy which will reduce the inefficiencies (e.g. by a reduction of the tariff protection).

Especially when the monopolies are industries with pronounced backward and forward linkages, their inefficiencies will spread over wide parts of the integration industries, thus giving 'wrong' price signals to a large number of production lines. In consequence, industrial specialisation may end up in a the planned wrong specialisation of large parts of the industrial sector, and this can hardly be regarded as a positive contribution towards development.

The obvious problem is to find an institutional arrangement which yields advantages of trade liberalisation but avoids the negative consequences (industrial polarisation) of conventional integration approaches. What should be clear, however, is that it seems impossible to come to an absolutely equal distribution of costs and benefits among the integration countries. It is more reasonable to look for a solution which ensures that no country would become worse off after joining an integration grouping than it had been if it would have continued its previous national development and protective customs policies. In the following, a model for a 'conditional' trade liberalisation will be outlined that shall ensure a distribution of costs and benefits which satisfies this criterion of 'not worse off'—if not perfectly then at least much better than any conventional 'unconditional' form of trade liberalisation in combination with some compensation efforts.

6. The Customs-Drawback Union for 'Conditional' Trade Liberalisation

The 'conditional' free trade shall be realised by the institutional

arrangement of a customs-drawback union (CDU).³⁵ As distinct from free trade areas or customs unions, in a CDU national protective tariffs are not abolished but maintained so that all imports, including the intra-group imports, are formally subject to the same customs duties as previously. But factually the tariffs shall lose their protective effects for the intra-group trade if this trade develops in a 'balanced' way. This means that a country may be defeated in some lines of production by intra-group competitors but is successful in other productions so that despite some efficiency-improving sectoral and regional reallocations the manufacturing sector will not shrink as a whole. In terms of intra-group trade this implies that additional imports are balanced by additional exports. The factual neutralisation of tariffs then will be achieved by a system of (import) customs certificates which are sold and purchased at a 'certificate exchange' functioning similar to conventional stock exchanges.

(a) Basic Elements and Mechanisms

Suppose that four countries—A, B, C and D—form a CDU. To keep the first presentation simple, it is assumed that before the establishment of the CDU, all countries traded with each other (and with the rest of the world) but that the bilateral trade balances between them were all zero. Then a balanced development of trade in a CDU would imply that all the intra-group trade balances should remain in equilibrium, i.e. no intra-group deficits or surpluses should occur.

Suppose a company in A imports manufactured goods from B. Then, in a CDU, the customs administration of A will send the importer a customs duty assessment, specifying the tariff burden of the imports and the period of time (e.g. 2 months) within which the assessment has to be settled. Simultaneously, the customs administration of A issues a customs certificate (CC) with a face value equal to the duty assessed, a given validity (e.g. 4 months), and an attestation of the country of origin of the imported goods (in the example : B). If the CCs are named with respect to the attested country of origin,

35. The idea of a CDU was first presented by Elkan (1965, 1966), but it was widely neglected so far.

then the administration in A could issue B-CCs, C-CCs and D-CCs. A-CCs would be issued by the customs administrations of the countries other than A, etc.

The CCs can be used to extinguish assessed duties up to the face value of the certificate. CCs are credited to the assessed duties by the customs administrations of that country which is attested in the CC and after which it is named. For example, the A-CCs are credited by the customs administration in A to duties assessed for imports into A originating from the other integration countries. The customs duties will be cancelled by an amount equal to the face value of the presented CCs, and the importer has to pay only the remaining amount (which may be zero). CCs can only be used to extinguish assessed duties; if an importer would present CCs with a face value exceeding the assessed duties, the customs administration would not pay out the difference.

The CCs which an importer gets together with his customs assessment cannot be used by him directly for a reduction of his duty payments because the issuing administration does not accept the own CCs. The importer has to 'exchange' the received CCs against CCs of those types which are accepted by his customs administration. These CCs were received by importers in the other countries for imports from his country. The exchange of CCs would take place on a market with CC-prices freely determined by the supply of and demand for CCs of a given type.

To clarify the mechanisms, figure 1 shows a two country model. It is assumed that A runs a trade balance deficit against B, i.e. A's imports from B surpass B's imports from A. B runs a reciprocal trade balance surplus. As a result, there will be a shortage of CCs accepted in the deficit country (A-CCs) and an abundance of CCs accepted in the surplus country (B-CCs). The CC-prices are as follows:

—Abundance: Since CCs have no direct use for the receiving importer and since they expire after a given period, the original CC-holders have to offer their CCs for sale on the market. In case of surplus supply, the sellers will compete and run down the price next to zero, i.e. to a minimum price which just covers their transaction costs.

—Shortage : For importers it is attractive to buy CCs as long as the price is less than the face value because the assessed duties will be cancelled by an amount equal to the face value. If there is a demand for larger quantities (in terms of face values of CCs than available (excess demand), then the purchasers will bid up each other and drive the price next to the face value, i.e. to a maximum which differs from the face value only by the transaction costs of the purchasers.

Thus, depending on the trade balance, the market price of CCs will fluctuate

—more or less rapidly—between

—a minimum next to zero if the CC-issuing country runs a trade balance surplus (export surplus), and

— a maximum next to the face value if the CC-issuing country runs a trade balance deficit (import surplus).

(b) Protection and Stimulation

For an assessment of the protective and trade stimulating effects of a CDU one has to consider the net burden of the importers, i.e. the difference between the assessed duties, the expenses for buying and the revenues from selling CCs.

—In a trade deficit country the importers need CCs which are short in supply. The price of these CCs would be near to the face value so that it would make no substantial difference either to pay the full assessed duties or to buy a respective quantity of CCs. Hence the imports into a deficit country are factually burdened by the tariff and the import competing industries are protected in a CDU as under the previous national customs policy. The CCs issued by the customs administration of the deficit country are on the market in too large quantities to earn a price substantially above zero. Hence the sale of CCs does not bring revenues which could reduce the burden of customs duties on imports.

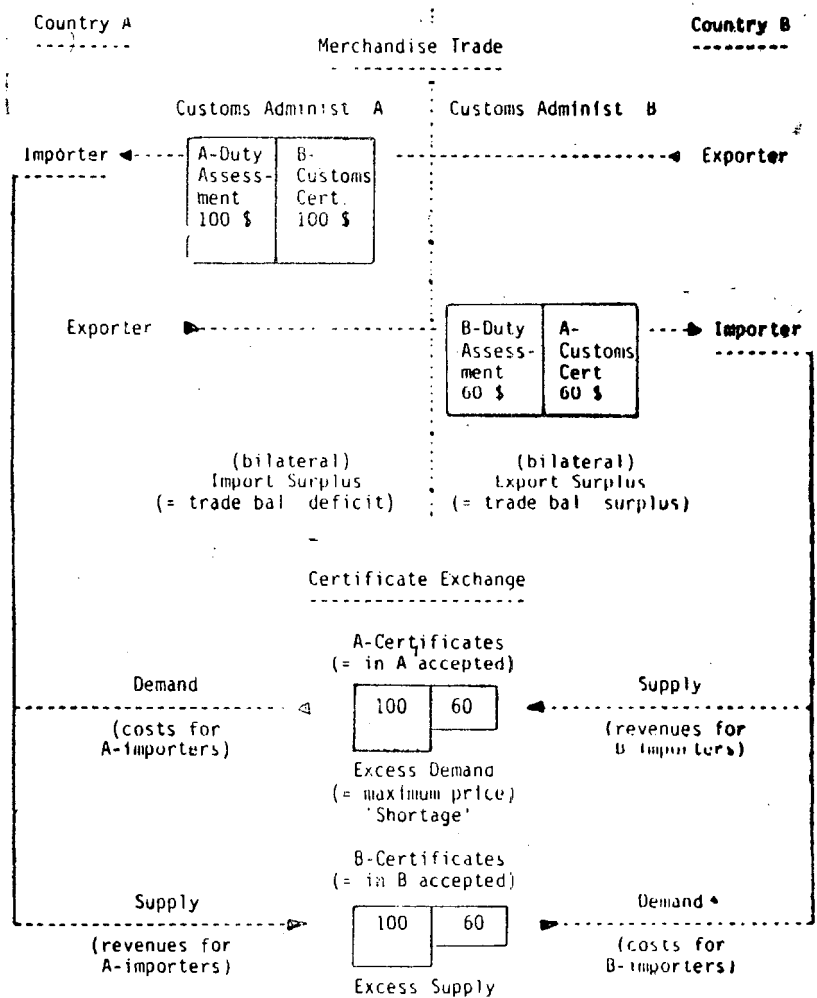


Fig. 1 Basic Mechanisms of a Customs-Drawback Union

—In a trade surplus country the importers need CCs which are issued in excess and are available at a minimum price. Hence the importers can avoid the actual payment of the assessed duties by buying CCs at minimal costs. Then factually imports are duty-free. In addition, the importers can sell the received CCs which are short in supply, at the maximum price to the importers in the deficit countries. The revenues from this sale of CCs have the same effect as import subsidies of the surplus country or export subsidies of the deficit countries with a rate equivalent to the tariff rate of the importing surplus country.

This combination of burden and relief of the intra-group trade provides an automatic system of incentives for a reversal of trade flows in case of an 'unbalanced' development resp. disequilibrium. The protective effects in the deficit country are the same as under the previous national protective tariff policy, but the complementing stimulating effects for its exports are unknown in a system with purely national customs policies. These trade stimulating and reversing effects are more powerful than incentives in a free trade area due to the incorporated subsidy dimension of the CDU mechanism.

A CDU of Islamic countries would comprise far more than two countries. This gives rise to the possibility that more than one country records a trade balance deficit resp. surplus, and hence there can be trade among countries with the same kind of trade imbalance. This trade among countries with the same kind of trade imbalances is factually duty-free: Suppose A and C are trade deficit countries, B and D trade surplus countries. A-CCs and C-CCs are both at their maximum price, B-CCs and D-CCs at their minimum price. As a consequence, importers in A (B) who import from C (D) can sell the received C-CCs (D-CCs) for the same amount that is needed to purchase the demanded A-CCs (B-CCs). The purchase of these CCs does not cause any (subs'antial) net-expenses (since the costs are covered by the revenues from the sale of the received CCs) so that the imports are factually duty-free.

Figure 2 summarizes the net burden and relief for imports with respect to the trade balance situation of the countries involved.

Figure 2: Protection and Stimulation in a CDU

		from	exports of	
			trade surplus country	trade deficit country
imports of :	trade surplus country		duty-free	duty-free and subsidized
	trade deficit country		duty-paid	duty-free

—With respect to trade among countries with the same kind of trade imbalance, the effects of a CDU are the same as in a free trade area; intra-group trade is duty-free, and this is the incentive to replace imports from third countries by imports from integration countries.

—With respect to trade among countries with opposite trade balances, a CDU has

—for the deficit country the same effects as the previous national protective customs policy in relation to imports from surplus countries, but combined with free trade in relation to other deficit countries,

—for the surplus country the same effects as a combination of a free trade area plus subsidies for exports of the deficit to the surplus resp. imports of the surplus from the deficit country and free trade in relation to other surplus countries.

This set of incentives shall guarantee that no member of a CDU will be worse off after joining the integration compared to the previous national protective policy, and it promotes an expansion of the balanced intra-group trade with gains for probably the majority of countries (but with losses for none).

(c) Impact on Location Decisions for New Industries

The trade creating and trade diverting effects of a CDU are similar to those of a customs union or free trade area (except with respect to the intra-group deficit countries and their market protection). But in addition to that the CDU-mechanism has an important impact for the regional distribution of new industries which is unknown in conventional forms of unconditional trade liberalisation. In customs unions or free trade areas, the mere existence of some external agglomeration economies in the more advanced member countries can heavily influence the entrepreneurial decisions on the location of new factories; there are no countervailing forces in favour of the less developed member countries without agglomeration economies. But in a CDU such forces do exist, presupposed these countries run persistent deficits in the intra-group trade while the more advanced countries record trade surpluses. This combination of levels of

development and directions of trade balances is but a very plausible one.

If then a company decides to set up a manufacturing plant in a deficit country, it can supply the total integration market duty-free. But it would miss some agglomeration advantages of a location in a more advanced country. These forgone advantages, however, might be (depending on their quantitative relevance) more than offset if the company establishes in addition to the production plant in the deficit country a trading enterprise in the more advanced surplus country which imports the goods manufactured in the deficit country. The trading enterprise will get a customs duty assessment which can be settled by the presentation of CCs issued by other countries for imports from the surplus country. These CCs are issued in excess and are available on the market at the minimum price. But the trading enterprise has also received CCs from its customs administration for imports from a deficit country into the surplus country, and these CCs are in shortage and can be sold at the maximum price. The revenues from the sale of these CCs can be achieved only when the goods are manufactured in the less developed deficit country. These revenues—which have to be balanced with the agglomeration economies in the more advanced countries—have much the same effect as subsidies granted by a manufacturing promotion policy in the deficit country—with the very important difference that these ‘subsidies’ in a CDU do not burden the budget of the less developed deficit country,

There is no guarantee that in a particular case the factual ‘location subsidy’ would exceed the agglomeration economies in the more advanced countries, but in general there would be incentives for industries where agglomeration economies play no eminent role to locate new plants in the less developed integration countries with persistent intra-group trade deficits and to supply the markets of the surplus countries by own import enterprises there. The CDU—unlike conventional integration forms—induces the entrepreneurs to quantify and calculate the (importance of) agglomeration economies, and this in combination with the factual location subsidies probably promotes more effectively the industrialisation of the least developed Islamic countries.

d) Superiority in Relation to Existing Conventional Integration Schemes

When the Islamic countries think about a trade liberalisation scheme, they must take into consideration the membership of most of them in a relatively large number of non-Islamic integration groupings. Many of these strive for the establishment of a common external tariffs, and in negotiations for the creation of an Islamic Common Market with internal free trade, this may cause problems similar to those of ECOWAS, PTA and ECOCAS. Many Islamic countries which are members in existing groupings would have problems to join an Islamic customs union or free trade area without violating treaties which are in force at present.

Here an advantage of the CDU would be that there is no need for a formal abolishment of the present tariffs, i.e. the common external tariffs of existing customs unions with Islamic members can be maintained. An economic devaluation of preferences in existing preference or free trade areas may result from a participation of the Islamic members in an Islamic CDU, but this would not be in an 'unconditional' way: The devaluation would be the result of an extension of the preferential or free trade from the members of the existing grouping to all Islamic countries, but that would only happen when the trade between the existing grouping and the (rest of the) Islamic World develops in a 'balanced' way, i.e. when the existing group's additional imports do not exceed the additional exports to the Islamic World. This reduces the uncertainty with respect to the future benefits of a membership in an enlarged Islamic integration, and this may improve the willingness of many countries to participate in the Islamic intergration: Their new membership must not necessarily or immediately violate the treaties in force, and if new negotiations in the existing groupings become necessary, the 'conditional' devaluation of preferences could facilitate a consensual amendment of the present integration treaties.

6. Conclusions

Without further detailed empirical studies (e.g. on the volume and composition of the trade among Islamic countries, on the effective

customs duties, on factor and resource endowments, on exchange rate and trade regimes, on priorities in development and industrialisation policies, etc.) it is impossible to quantify the impact of an Islamic CDU for the trade position and industrial development of any particular country. But such countrywise quantifications and assessments of costs and benefits of a CDU do not seem to be necessary in the context of this paper : A basic assumption here was that the (long run goal of an Islamic Economic Unity has to be taken seriously ; this implies that a viable scheme for the enlargement of markets must be found. Therefore the assessment of the costs and benefits of a CDU must not take the status quo (or other existing or possible non-Islamic integration groupings) as a basis for comparisons but alternative schemes for the trade liberalisation. It is not necessary to show an 'absolute advantage' of an Islamic CDU ; it is sufficient to show the 'comparative advantages' in relation to other intergration forms (whatever the absolute advantages or disadvantages may be, i.e. without questioning the idea of an Islamic integration itself).

In the second chapter of this paper, the problems and failures of the existing integration groupings with Islamic members—which took recourse to conventional forms of trade liberalisation—have been recorded. Then the functioning of a CDU was outlined, and this approach seems to be superior because it can—for conceptual reasons—mitigate or avoid most of the problems which were responsible for the poor record of the existing applications of conventional integration schemes. The crucial point is that a CDU ensures that no country will be worse off after joining the integration than it was before or would be under national protective policies or as a member in a non-Islamic grouping. This should facilitate intergovernmental negotiations, and it eliminates the main reasons why governments retarded tariff reductions or took recourse to non-tariff restrictions ; exchange rate manipulations and support for domestic industries will no longer bring advantages for one country at the (net-) expense of the other integration members.

A problem that is not solved by the CDU-mechanism is the loss of revenues from customs duties (mainly) in the surplus countries, partially also in the deficit countries). For some countries which

heavily rely on these revenues for the financing of the budget, budgetary transfers or other forms of fiscal compensation must be introduced. This is a real problem, but it is not a specific disadvantage of a CDU : customs unions and free trade areas show the same defect.

What may look like a disadvantage is that the scope for the efficiency-improving sectoral and regional reallocation is more limited in a CDU (where the trade deficit countries are at least partially exempted) than in a customs union or free trade area. But this is, in the last instance, not a real disadvantage because those additional reallocations that take place in conventional integrations but not in a CDU are those which result in a loss for the less developed countries and which then give rise for the various disintegrating practices and strategies of the injured countries.

On the other side, the CDU has the important advantage of the built-in 'subsidy' in favour of deficit countries : The earning from the sale of CCs issued by deficit countries can stimulate the imports from resp. the exports of these countries, and if the deficits are persistent then these earnings can have an important influence on location decisions for new production plants. Summing up, the finding is that a CDU has in comparison to conventional forms of unconditional trade liberalisation (free trade areas, customs unions) no specific defects but offers some advantages which could effect a more equitable distribution of the costs and benefits of economic integration among Islamic countries, and therefore it deserves some more attention in consultations of OIC subsidiaries and committees.

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Comments on Prof. Dr. Volker Nienhaus' Paper

By

DR. EMIN CARIKCI*

This research paper is among one of the author's several papers on Islamic economics and Islamic economies. No doubt that the author has substantial credit for his original contributions to both of these areas. In the present paper he is trying to present a workable model of economic development to be achieved through economic cooperation. The author believes that any grouping of the Organization of the Islamic Conference (OIC) countries would effect the benefits which they can provide and derive from their membership of other integration groupings. In other words he is trying to promote trade among OIC member countries inspite of constraints on the existing trade relations of these countries as members of other integration groups. Because, "many Islamic countries which are members in existing groupings would have problems to join an Islamic customs union or free trade area without violating treaties which are in force at present" (p. 27). For example, there are two small integration groupings namely Mano River Union (MRU) and West African Economic Community (CEAO) within the Economic Community of West African States (ECOWAS). These two smaller integration

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** Ideas expressed in this comment are solely the responsibility of the author and in no way reflect the views of the IRTI or IDB.

groupings created major problems within the community, because, "certain important provisions of the ECOWAS treaty are incompatible with the rules and regulations in force in the MRU and CEAO" (p. 6).

The author also realizes that, the existing integration grouping of developing countries (which are based on conventional theory of integration) have not succeeded in achieving their goals (pp. 3—9). One serious difficulty inherent in such conventional groupings is what the author terms as "polarization" of post integration industrial estates in more developed member countries at the expense of the least developed member countries (p. 17). Should the OIC member countries then follow such conventional schemes? The author says that there is a better non-conventional model which basically aims to benefit some members without harming others. This he calls the model of Customs-Drawback Union". The model is extendable to any set of countries including the existing integration groupings. The author expects that this model will not have any adverse (trade diversion) effects on trade relations of the member countries among themselves or the rest of the world (p. 18).

I. Comments Related to Background Material Related to the CDU Model

"Before having a detailed look at the model it would be better to make some points regarding the author's stand on existing state of cooperation among the OIC member countries.

1. The most important point in this regard is the understanding of the author that "at present, the OIC lays more emphasis on a liberalization of factor movements, and in 1981 the Islamic countries signed an Agreement on the Promotion, Protection and Guarantee of Investments among Member States of the OIC which will enter into force after the ratification by at least ten countries" (p. 2). Then the author also goes on saying that the Investment Agreements of the OIC will probably have only a marginal impact for the intensification of economic relations among Islamic countries if it is not supplemented by a trade liberalization scheme" (pp. 2—3).

To an outsider this gives an impression that great achievements may have been so far made in factor movements among OIC member countries without having any improvement in trade. But in reality this agreement so far is not implemented because as of March 1986 when the Standing Committee on Economic and Commercial Cooperation held its Second Session in Istanbul, only 12 members had signed and so far 7 members ratified the agreement (see OIC/COMCEC/2—86/D/1).

Implementation of the Investment Agreement of the OIC is very important point for understanding the reality of cooperation among Islamic countries. We should see this point from two aspects : (a) Potential for cooperation, (b) the achievements made in the utilization of these potentials.

This is a reality that some member countries of the OIC have surplus financial resources and while some others have surplus natural and/or human resources. The essence of cooperation is therefore utilization of these resources through joint production activities. That is why the OIC have given priority to the Agreement on the Promotion, Protection and Guarantee of Investment among Member Countries of OIC. We believe that no meaningful progress in trade promotion is foreseeable in the case of the member countries unless some joint industrial base is established. This also supports the author's notion that cooperation with one group should not adversely affect membership in other groupings. Emphasis on only trade promotion among member countries is bound to create trade diversion. The only way to minimize trade diversion and to establish a healthy atmosphere about the movement of both financial capital and labour migration is joint production among member countries. We also believe that implementation of the Investment Agreement of the OIC will have substantial impact for the intensification of economic relations among Islamic countries even if it is not supplemented by a trade liberalization scheme.

2. Second and third sections of the paper (pp. 3—10) is too long as a summary but too short to give useful insight about the working of the existing integration schemes which the author has

tried to cover. One may agree in very general terms with the conclusions of the author, presented on p. 9, regarding the inefficiency of the existing integration groupings. But, specific conclusions may not stand critical evaluation. For example, the author's main conclusion on pp. 14—15, "Here it was sufficient to show that is highly probable that the establishment of a free trade area or customs union would lead to a very uneven distribution of the costs and benefits among different groups or types of countries" which is based on his plausible hypotheses and assumptions that "It is not very likely that these small countries have developed manufacturing industries which could pass successfully an intra-union competition. These countries must be prepared to lose industrial capacities' (p. 11).

Regarding these conclusions and other conclusion on pp. 11 and 13—14, one should not neglect that all the existing integration groupings accord special preferences to their least developed member countries in terms of tariff barriers and resource allocation. The entire conclusions of the author in section 4 are based on the theoretical conception of totally free integration movements which does not exist in reality among the integration groupings of developing countries.

In fact, the least developed members of the different integration groupings have certainly profited from preferential trade instruments such as privileged access to the markets of the more developed countries and temporary exemptions from the Common External tariffs, preferential allocation of integration industries and their financing through sub-regional and regional banks, special tax incentives for industries that locate in these countries and finally preferential treatment in agricultural sector and physical infrastructure. For example, even though at the OIC level member countries have not reached any agreement on an economic grouping, substantial efforts are being done by IDB in helping the least developed members. Similar is the case for other integration groupings which have established multilateral development financial institutions.

3. According to author, the decline in inter-Arab Common Market (ACM) trade is caused by the failure of the implementation

of the free trade provisions and non-tariff trade barriers ; in the case of GCC due to "distortions in the intra-group competition" (p. 4). One can also claim that only a few percentage decline in intra-GCC trade in US dollar term most probably resulted appreciation of the dollar in 1983. In the case of ACM decline in intra-ACM trade most probably caused by the general austerity measures of the most of the non-oil producing member countries of the ACM during the early 1980's. Because during the 1979 --1984 period, most of the non-oil producing and exporting countries have been severely hit by the second external shock. This was caused by combination of more expensive oil, historically high real interest rates, the longest recessinn of 1980—83 since 1930's and more trade barriers in the industrial world, During the first part of 1980's overwhelming majority of non-oil producing countries have adopted stabilization and liberalization policies for dealing with their high external debt and to reduce internal economic distortions to the minimum level. These policies were also important reasons for holding back the growth of intra-union trade in most of integration groupings in recent years.

II Evaluation of the Customs-Drawback Union for "Conditional" Trade Liberalization

Regarding the Customs-Drawback Union (CDU) model presented by the author I divide my comments in three different sections :

- (a) Mechanism of the CDU scheme.
- (b) Can the CDU achieve what the author claims it can ?
- (c) Alternative suggestions for promoting trade among OIC member countries.

A. Mechanism of the CUD Scheme

1. The CDU scheme claims to promote trade in a manner which helps countries with Balance of Trade (BT) deficits to export more, retain duties on imports, hence restricting imports ; and does the opposite for countries with BT surpluses.

2. The scheme is based on the following elements :

- (a) Pareto optimality : at least one member of the CDU

(union) is better off without making others worse off (page 18).

- (b) All CDU members issue (import) Customs Certificates (CCs) showing country of origin of goods. Thus, in a two country model, country A only issues custom certificates of country B (B—CCs) and vice versa.
- (c) These CCs are used to clear duty on imports upto the face value of the certificate. Country A can only use A-CCs issued by country B to clear its import duties.
- (d) There is a free market in these CCs. Hence demand and supply determine their prices.
- (e) Taking the example of two country CDU :

Country A has a BT deficit

Country B has a BT surplus

Country A (deficit) issues B-CCs (B-Certificates)

Country B (surplus) issues A-CCs (A-Certificates)

In the market there will be :

Excess demand for A-CCs (issued by B) value high

Excess supply of B-CCs (issued by A) value low.

Since duties can only be paid by customs certificates (CCs) issued by the other countries, then high value of A-CCs means maximum duty paid by country A for imports (deficit country). Hence domestic industry of deficit country (A) is protected.

Low value of B-CCs means minimum duty paid by surplus country (B). Hence it will be incentive to import. In other words, since A-CCs are short in supply and they are high value to the importers of the country A, it means that country B importers have an incentive to import more, because they can then sell the increased A-CCs back to country A's importers. In this sense the revenue from those sales act as import subsidies of the surplus country/or export subsidies of the deficit country.

B. Does the CDU Model Achieve what the Author Claims it can ?

1. On a purely theoretical level the CDU model is ingenious in that it provides an automatic incentive for more advanced members to increase import, while affording (giving) protection to the lesser developed countries. However, this is in itself the basic weakness of the scheme. If the purpose of expansion of trade is to enjoy economies of scale, better allocation of resources and other dynamic benefits of trade creation, then the CDU will certainly not provide the optimum solution and perhaps not even achieve the "second-best" situation. This is so because the CDU protects the deficit country and basically tries to redress the balance by encouraging the surplus country to import more. Although this can be more balanced liberalization of trade, it certainly is not the most efficient.

2. The CDU is preferred by the author because it will not disrupt protected industries. There are practical advantages in this making the scheme politically viable. However, there are two problems with the "new" distribution of benefits created by the CDU scheme. First, import/tariff duties are a declining function of a BT surplus, i.e. the lower the deficit the less duties collected by the government. Second, the gains from buying and selling CCs go to private companies, individuals, or most likely to institutional investors. This loss of revenue to the government and the resulting distribution of benefits might make the CDU unacceptable. For example, multinationals in the surplus BT country could be the main beneficiaries.

3. The efficient operation of the CDU will depend on certain important institutional factors such as efficient market for the CCs based on complete information about trade situation, realistic exchange rate policy and perfect capital mobility between countries for purchasing and selling the CCs. These are such factors which do not exist in developing countries. In its impact on the capital account of Balance of payment, the CDU proposal seems to defeat its own purpose. For example, exchange of CCs will generate capital flows among members countries of the Union. If country A is a deficit country, it has to buy A-CCs which are issued by country B

(surplus country), market value of A-CCs will be close to face value. Then, those will be capital outflow from deficit country A to surplus country B which should put downward pressure on the exchange rate of deficit country. If there is a controlled or fixed exchange rate policy in country A, the exchange rate of deficit country will be overvalued. Overvaluation of the currency will create detrimental effect on the export of this deficit country. Then this is contradictory to the CDU's aim of finding solution to the foreign exchange problems of the deficit country. Therefore, the scheme needs to be re-evaluated in the light of its possible implications for exchange rates.

4. Even if these factors are considered less important, the complicated nature of the CDU scheme itself is a negative factor.

C. Alternative Suggestions for Promoting Trade Among OIC Member Countries

1. Keeping in view the balance of payment difficulties of non-oil exporting member countries, any proposal of trade liberalization should not impose difficulties regarding foreign exchange requirements. It has been shown that the CDU proposal is not taking into consideration this fundamental reality. For that purpose all the major factors which work as trade barriers must clearly be identified. Among these factors the CDU proposal concentrates only on tariff barriers. It should also be noted that this proposal is only based on commodity trade and thereby on balance of trade problems. In fact, the main issue of the developing countries is how to find solution to the problems of current account deficit and overall balance of payment equilibrium, rather than just trade balance.

In the light of collapse of commodity prices member countries have no other option but to increase non-commodity exports such as manpower services, insurance and banking services, transportation and communication services and packages of profitable investment opportunities to foreign investors. The CDU proposal does not take into account these requirements which have recently become crucial items in the current account balance of most of the member countries. In most of the labour surplus Islamic countries workers remittances and other service incomes are financing major part of their balance of trade deficits.

2. As mentioned above, CDU model is based on relative importance of tariffs as a trade barrier. In fact there are many other barriers for international trade. Tariffs are only one of them. If the main obstacles to increase trade among developing countries are many non-tariff trade barriers and lack of infrastructural linkages, then CDU model is an attempt to provide only partial solution to the problems of trade promotion among the member countries.

Main non-tariff trade barriers are prior export import licencing, import permits, quotas, import prohibitions advance deposits, subsidies, intervention of particular state agencies in purchase of certain items, technical regulations such as health, safety and protection, customs regulations and other requirements. Harmonization and simplification of non-tariff trade barriers among Islamic countries should be given priority. Because, diversity of national legislation on non-tariff trade barriers can easily cancel out the preferences which are granted for regional imports though tariff cuts. Profitability of CCs for surplus country importers could be also easily cancelled by the existing non-tariff trade barriers.

3. Due to recent intensification of non-tariff trade barriers in both developed and developing countries, presently the percentage of managed trade reached around 50 percent of total world trade. During the first part of 1980's, the industrial lobbies of the West have moved from the support of "free" trade to "fair" trade; and the importance of bilateral agreements, counter-trade and state trading practices have become main devices in international trade. There are over 500 publicly owned organizations in developing countries engaged in the field of foreign trade and import-export operations. Currently, state trading is playing a major role in the development strategies of most of the Islamic countries, and they control a substantial percentage of their international trade. If these are the realities in both developing and developed world, we cannot depend on only conditional and unconditional liberalization remedies to increase trade among the Islamic countries. Islamic countries should also start to investigate how to increase closer economic cooperation through their state trade organizations.

Conclusion

We agree with the author that the most crucial policy issue of the regional economic groupings of developing countries is how to design measures which produce an equitable distribution of costs and benefits arising from economic integration? If the proposed CDU scheme can be re-evaluated and improved in the light of its possible implications, on efficiency ground, current and capital accounts of balance of payments, institutional deficiencies, expected negative effects on realistic exchange rate, exploitation of CCs by the speculators and decline in tariff revenues then it will be much more workable. We believe that if the above considerations are taken into account and incorporated into the proposed CDU scheme, the model improves considerably.

We also believe that the CDU model is not applicable at the OIC level. It might be more successful in a smaller integration group in which most of the members are more developed and have highly efficient financial markets. Rather than being alternative to conventional integration systems, CDU model would profitably be applied to some extent simultaneously. Because, to achieve its aim of expanding trade the CDU model would require that there is enough trade between member countries in manufacturing goods. But in reality the least developed countries hardly export any manufactured commodity even though the author aims at helping those countries.

Recently, existing integration schemes are taking or contemplating integration and economic cooperation measures not only in gradual tariff and trade liberalization, but also in other areas. For example, integration schemes, especially at subregional level are seeking to coordinate industrial production plans and other macro policies such as monetary, fiscal and foreign exchange policies, and joint venture programmes for transport and communications. Therefore, momentum of regional and subregional integration might still be maintained and intensified at the subsectoral levels, even if there is recent decline in intra-group trade as a result of implementation of stabilization and liberalization programmes. In fact, due to protectionist attitudes

of developed countries toward developing countries' export goods, the Islamic countries have no choice except to find out ways and means of how to increase economic cooperation and economic integration among themselves.

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IRTI/IDB has now set of unpublished studies in economic coopera-

tion, some of which could be highly valuable for this project. These are :

Awan R. Kazim, "The Role of Shipping—Some Major Issues and Policy Options for OIC Member Countries", 1985.

Carikci Emin, "The Economic Impact of Temporary Manpower Migration in Selected OIC Member Countries : Bangaladesh, Pakistan and Turkey", 1984.

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