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DEPARTMENT OF ECONOMICS

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Title :

Ending Exploitative Taxation :

A Zakat-Based System for Justice, Economic Growth, and Welfare for All.

For centuries, the institution of Zakat has been a cornerstone of Islamic economic thought, visualised as a powerful, designated solution to social inequality. This obligatory levy on the surplus wealth of Muslims is designed to provide a powerful financial safety net for the poor, theoretically capable of eliminating poverty, restraining economic disparities, and stimulating the economy. Many Muslim nations, from Pakistan to Saudi Arabia, have revived Zakat through formal legislation. However, a significant and persistent gap has emerged between its profound potential and its practical reality. Despite its reintroduction, Zakat has largely failed to achieve its elevated goals. The failure lies not in the concept of Zakat itself, but in its flawed execution namely, limited governmental support and chronic mismanagement. While these challenges are significant, the path to an efficient Zakat system is far more manageable than other complex economic reforms, suggesting its bright future depends almost entirely on the political will to implement it effectively.

Taxes are essentially mandatory payments collected by governments from both individuals and businesses. The primary purpose of these charges is to raise money to fund all government activities. However, to ensure this revenue stream is sustainable, the tax system must also be designed to help the economy grow. This objective can only be achieved if the tax policy is smart, meaning it must avoid slowing down economic activity known as "deadweight loss" and instead help the volume of business transactions increase.

A good tax system should not discriminate, be easy to collect, be politically acceptable, and cause the least amount of distortion. According to the majority of experts, Pakistan's tax policy is not founded on these widely accepted and obvious principles. Historically, indirect taxes, such as sales tax, have accounted for a far larger portion of government revenue than direct taxes, such as income tax. Because it skews the distribution of resources, this excessive reliance on indirect taxes is viewed as detrimental to the economy. Direct taxes have historically made up a very small portion of total revenue, so beginning at **25%** in **1949–50** and falling as low as **14–17%** in the **1970s**. A legislative effort in the **1990s** attempted to address this and succeeded in raising the proportion of direct taxes, but it was unable to raise the total amount of taxes collected in relation to the size of the economy (the tax-to-GDP ratio). Although direct taxes accounted for **32%** of overall revenue as recently as the **2019–20** fiscal year, an astounding **70%** of that amount was collected through withholding, which some contend isn't a true direct tax at all.

Zakat and taxation are fundamentally different, particularly in their source, motivation, and economic impact. Zakat is a divine mandated financial act of worship and a core religious duty. Because its foundation is in the Qur'an, its rates and rules are considered fixed. This obligation is rooted in the theological concept of amanah, or trust, which posits that God is the true owner of all wealth and people are merely its guardians. Therefore, Zakat is ideally paid willingly as an act of submission and gratitude, with a strong ethical emphasis on humility and avoiding any action that might belittle the recipient.

Taxation, by contrast, is a man made system created by a government. Its laws are flexible and can be changed or abolished to fit the state's financial needs. The motivation for paying taxes is often secular, driven primarily by the need to avoid legal penalties like fines, which can lead to reluctance or resentment. Economically, taxation can sometimes have negative side effects, such as discouraging work or savings, and its burden can be passed on to consumers. Zakat is viewed differently, as its burden isn't transferred and it is seen as creating positive incentives, like encouraging investment. It functions as a comprehensive social security mechanism, a compulsory wealth transfer intended to create a "multiplier effect" that can steadily reduce poverty.

The legal and civic relationship between the two is distinct. The duty to pay Zakat has been viewed with such historical gravity that the Caliph Abu Bakr even waged war on those who refused it. However, paying Zakat does not remove a Muslim's civic responsibilities; they are still required to pay any other legitimate, state imposed taxes. To avoid placing a "double burden" on citizens, some countries, such as Malaysia, offer tax rebates for Zakat payments.

The relationship between Zakat and economic growth is complex, with multiple theoretical models and conflicting empirical evidence. Bayinah (2017) identifies four potential causal relationships: Zakat determining growth, growth determining Zakat, a reciprocal relationship, or a simple interconnection. One proposed mechanism, cited by Alam Choudhury and Syafri Harahap (2008), involves Islamic banks collecting Zakat and channeling it into projects that influence the Gross Domestic Product (GDP) through consumption, investment, and government spending. The success of this relationship heavily depends on the effectiveness of Zakat collection, which is influenced by the muzakki's (payer's) income, knowledge, motivation, and religious attitudes. However, research findings are mixed.

Several studies conclude that Zakat has a **positive effect** on economic growth, including a panel data analysis of eight Islamic countries (Ben Jedidia & Guerbouj, 2021) and various studies focused on Indonesia (Roisyatin & Jamaludin, 2020; Suprayitno, 2020; Athoillah, 2018; Bayinah, 2017). In contrast, other studies, including a survey by Aisha (2019) and regional analyses in Indonesia (Fahmawati, 2019; Harahap, 2021), found **no significant effect** of Zakat on economic growth, even while some (like Harahap, 2021) noted its **positive impact** on poverty reduction.

Academics highlight that such a system would promote growth and justice at the same time. The wealthiest benefit from exemptions and incentives under exploitative tax regimes, whereas the poor frequently bear a disproportionate share of the indirect taxes on necessities. By focussing on wealth rather than income or consumption, a zakat-based paradigm ensures that only those with excess assets make contributions, reversing this unfairness. This satisfies the Qur'anic concept that wealth shouldn't "circulate only among the rich" and results in true economic justice. Economically speaking, zakat increases consumption, investment, and job creation by shifting purchasing power to people who would spend rather than save. When handled appropriately, zakat funds can also be used to promote healthcare, education, and microfinance initiatives, fostering long-term independence and increased national output.

However, critics argue that there are difficulties in putting into practice a system based on zakat on a national level. They highlight the lack of institutional ability, corruption, and ineffective administration in many nations with a majority of Muslims. Zakat monies may be misappropriated or misused in the absence of stringent governance, transparency, and contemporary digital infrastructure. Others argue that Zakat might not bring in enough money on its own to pay for public services like infrastructure, defence, and cutting-edge healthcare systems. Supporters, however, argue that these difficulties are more a result of problems with governance than of defects in the zakat concept itself. These issues can be reduced with the help of technology, such as national Zakat databases, digital payment integration, and yearly audits. Furthermore, a hybrid strategy that combines fair, non-exploitative taxation with Zakat could be a useful transition model.

Ultimately , the argument is as much about morals as it is about economics. Zakat-based systems embody a philosophy of social solidarity, compassion, and moral obligation in addition to being a financial tool. It sees wealth as a gift from God rather than as a personal item to be accumulated. Zakat supports moral behaviour, lowers inequality, and fosters a more peaceful society by tying social benefit and spiritual obligation together. Therefore, putting an end to exploitative taxes and switching to a system based on zakat might be a significant step towards equity, long-term economic progress, and everyone's welfare. It would change the economy from one that is built on privilege and coercion to one that is based on justice, faith, and prosperity for all.

In conclusion, present Zakat and taxation as two fundamentally different systems in their source, motivation, and economic impact. Taxation is defined as a flexible, man-made, secular obligation, often paid reluctantly to avoid legal penalties. Zakat, by contrast, is a divine, fixed, religious "act of worship" rooted in the theological concept of amanah (trust), which frames wealth as a trust deposited with us by God. This distinction means Zakat is ideally paid willingly as an act of submission and gratitude.Economically, Zakat is a superior model, functioning as a comprehensive social security system. Unlike conventional taxation, which can deter work and savings and transfer its burden to consumers, Zakat is said to have no such transferable burden and instead creates positive incentives, such as encouraging investment. It is designed to create a multiplier effect to progressively eliminate poverty.

Nonetheless, there is a noticeable discrepancy between the great potential of zakat and its actual application. It is stated that improper execution and persistent mismanagement in its implementation, rather than defects in the principle, are the main reasons why Zakat has failed to meet its lofty objectives. This disparity is reflected in scholarly research, which offers contradictory empirical data: although some studies identify a favourable correlation between Zakat and economic growth, others find no discernible impact on growth, despite acknowledging its beneficial effects on reducing poverty.

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