Using Waqf as Social Safety Net Funding Public Infrastructure

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27 August 2015

Using Waqf as Social Safety Net & Funding Public Infrastructure

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Abstract

This study explores the economic potential of the institution of Waqf in funding necessary social and public infrastructure and to act as a permanent social safety net. In section 2, we explain the motives behind charitable giving in the real world. We discuss the factors identified in the empirical literature and experiments. We also explain the need for reinforcing incentives in order to increase the scale of charitable giving as a personal choice in a non-economic pure altruist sense. In section 3, we discuss the reinforcing incentives for charitable giving in Islamic worldview. In section 4, we explain the importance of the institution of Waqf in overall Islamic redistribution framework. We explain how the institution of Zakat, Waqf and inheritance laws together act as redistribution devices and social safety nets in an Islamic economy. Finally, in section 5, we discuss the application of Waqf in contemporary policy framework.

Keywords *Waqf, Charity, Warm Glow, Welfare, Social Mobility, Microfinance, Poverty*

JEL Codes *I22, I38, O17, Z12*

1. Introduction

It is a fact that more than a billion people live in poverty even in the twenty first century. On the other hand, there has been an unprecedented change in income disparity between poor and rich people during the last half century. Do we really have scarcity of resources due to which we cannot end poverty, hunger and famine? Nobel Laureate, Sen (1983) did research on famine in Bengal and he argued that the famine was not caused from the lack of resources. It is also striking to note that the world agriculture produces 17% more calories per person today than it did 30 years ago, despite a 70% increase in the population (Pingali, 2002).

According to a Bloomberg report, the wealthiest 300 people in the world own $3.7 trillion combined net worth as at December 31, 2013. There are approximately 1 billion poor people in the world and if it takes $30 to feed a poor person for a month, then $30 billion can feed all of the world's poor for one month. The 300 wealthiest people with their combined net worth can feed all of the world's poor for 10 years at least, but yet it does not happen. On the other hand, we see that some sport stars and silver screen artists own more wealth than the entire GDP of some countries. It is ironic that the budget of some movies and video games is more than the nationwide development spending in some poor countries. Income earned by the top 10 showbiz personalities together are more than the entire combined production value of 7 lowest income countries of the world. To put things in perspective, 10 persons selling entertainment earn more than what all people together earn in 7 countries!

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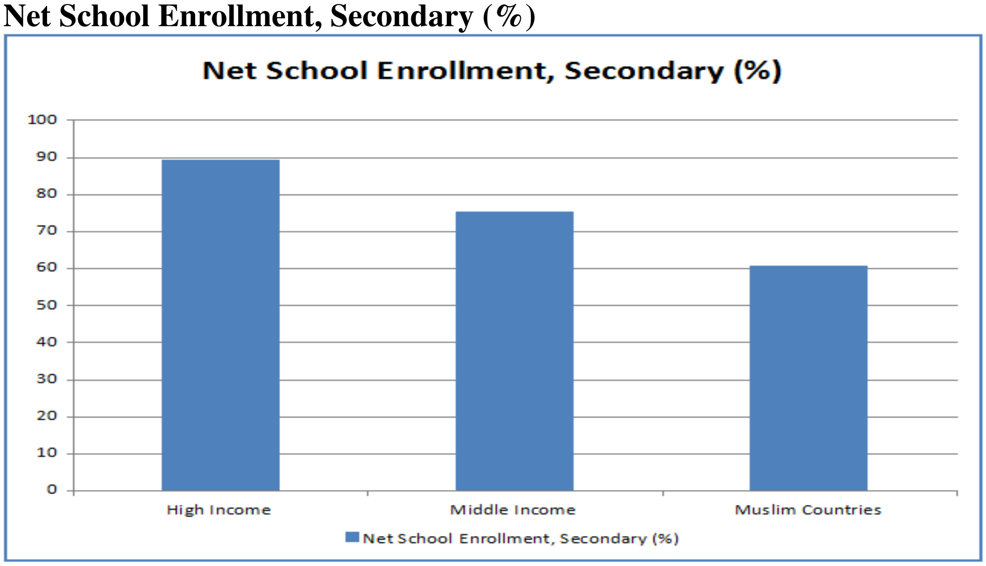
The world has enough resources to feed everyone, but the resources are not equitably distributed. The level of inequality has increased tremendously in the last 100 years. Piketty (2014) writes that 60% of the increase in US national income in the 30 years after 1977 went to just the top 1% of earners. Income inequality even in Organization for Economic Cooperation & Development (OECD) countries is at its highest level for the past half century. The average income of the richest 10% of the population is about nine times that of the poorest 10% across the OECD, up from seven times 25 years ago (OECD, 2011). Past growth experience of Japan and USA or even recent growth experience of India and China has shown simultaneous persistent increase in income inequality in these countries. Economic growth has failed to improve income distribution in these countries.

While the developed world needs to find answers for egalitarian distribution of income, the developing world has to achieve both a decline in poverty as well as egalitarian distribution of income. Most of the Muslim majority countries are generally poorer than the other countries on average. Most of the poverty resides in Africa and Asia and bulk of the Muslim majority countries are located in these continents. It is estimated that 1.37 billion of the world total population of 7.1 billion live on $1 per day. In the 57 OIC member countries, which constitute around 1.6 billion people, 31% of the total population lives below the poverty line of $1.25 per day (Alpay & Haneef, 2015). In Pakistan, Naveed & Ali (2012) in a most recent study conclude that as many as 58.7 million people in Pakistan are living in multidimensional poverty with 46% of the rural population and 18% of the urban households falling below the poverty line. Other Muslim majority countries like Bangladesh and Nigeria also have poverty headcount ratio of 43% and 62% respectively.

Due to widespread poverty and weak governments, most of the Muslim majority countries are behind in spending on schooling and health services. Hence, the level of human capital, productivity and national income remain at lower levels. Muslim majority countries had on average lower secondary school enrollment rate as compared to the high income and the middle income countries as shown in Figure 1.

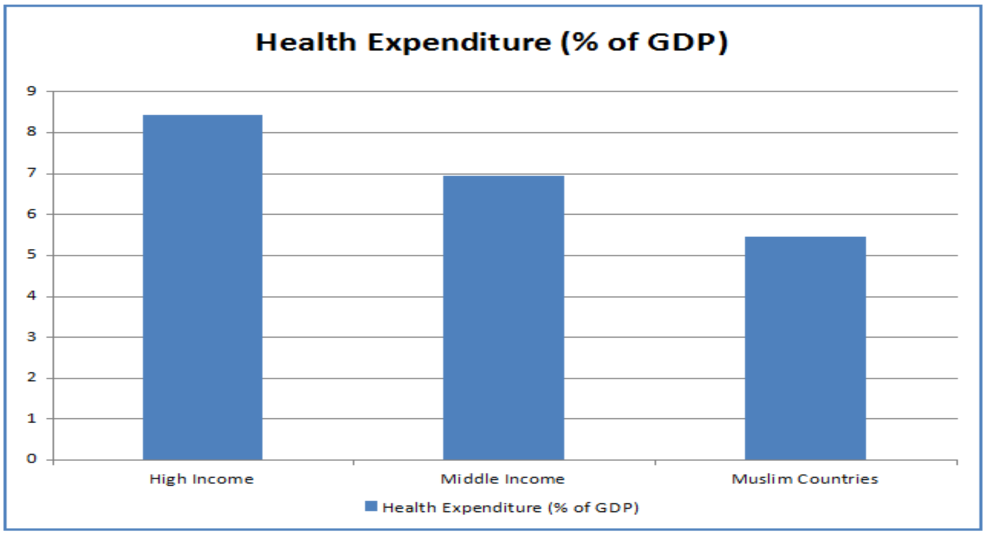
Figure 1: Net School Enrollment, Secondary (%)



Source: World Development Indicators (WDI), World Bank

Adjusting for income, if we look at health expenditure as percent of GDP in Figure 2, the Muslim majority countries had on average lower value as compared to the high income and the middle income countries. Muslim majority countries had on average lower availability of health infrastructure as compared to the high income and the middle income countries. This could partly be because of lower per capita income, lower health expenditure allocation as percent of total expenditure and high population growth rate in the Muslim majority countries.

Figure 2: Health Expenditure (% of GDP)



Source: World Development Indicators (WDI), World Bank

In this backdrop, this study explores the economic potential of the institution of Waqf in funding necessary social and public infrastructure and to act as a permanent social safety net. In section 2, we explain the motives behind charitable giving in the real world. We discuss the factors identified in the empirical literature and experiments. We also explain the need for reinforcing incentives in order to increase the scale of charitable giving as a personal choice in a non-economic pure altruist sense. In section 3, we discuss the reinforcing incentives for charitable giving in Islamic worldview. In section 4, we explain the importance of the institution of Waqf in Islamic redistribution framework. We explain how the institution of Zakat, Waqf and inheritance laws together act as redistribution devices and social safety nets in an Islamic economy. Finally, in section 5, we discuss the application of Waqf in contemporary policy framework.

2. Charitable Giving: Motives & Reinforcing Incentives

Charitable spending is not an exceptional phenomenon. Total charitable gifts of money now exceed 2% of GDP in USA (List, 2011). Alam (2010) informs that the magnitude of philanthropic giving in Muslim communities is estimated to total between $250 billion and $1 trillion annually. A recent study by the Aga Khan Foundation on Pakistan finds that giving by Pakistanis is four times the amount of foreign aid that Pakistan receives (Alam, 2010). In spite of having such a huge philanthropic wealth base, in most countries it is being either mismanaged or misappropriated. This highlights the need for organized charity which is collected, utilized and administered in a professional way.

Feddersen and Alvaro (2009) highlight that people can be socially responsible in various roles of life and real world scenarios. Citizens may endure long lines to vote in large elections even though their single vote is unlikely to change the election outcome. People recycle paper and plastic even though the impact of their individual action is environmentally negligible. Lilley & Slonim (2014) present a model and experimental evidence to explain the “volunteering puzzle” where agents prefer volunteering time to donating money when monetary donations are more efficient for providing resources to charity.

In neoclassical utility maximization stream of literature, social interactions had been explored by Becker (1974). Becker (1974 & 1976) explores intra-family relations, charitable behavior, merit goods and multi-persons interactions, envy and hatred. Later on, Andreoni (1989 & 1990) explains that people engage in impure altruism when they contribute in charity or donate for public goods. Hence, these charitable acts also emanate from self-interest, i.e. to get fame, satisfy ego or change the living environment to improve one’s own social experience and relations. In mainstream economic literature, ‘Warm glow’ is defined as the feeling of moral satisfaction generated by contributing.

Harbaugh (1998) opine that charitable donations buy two things for the givers: private warm glow and public prestige. Charities publicize the donations they receive, generally according to dollar categories rather than the exact amount. Donors in turn tend to give the minimum amount necessary to get into a category. It is true that in real world observations and laboratory experiments in contrived settings, certain factors like the presence of audience makes people behave more altruistically. Sometimes, people pay just out of peer pressure, to redeem their image in public and to avoid the guilt of saying ‘no’ (Andreoni & Bernheim, 2009).

DellaVigna et al (2009) design an experiment in which subjects donate individually (control group) or in pairs (treatment group). Those in pairs reveal their donation decision to each other. As expected, the average donations in the treatment group are significantly higher than in the control group. It suggests reluctant altruism due to peer pressure in charitable giving.

In another experiment, DellaVigna et al (2009) design a door-to-door fund-raising drive in which some households are informed about the exact time of solicitation with a flyer on their door-knobs; thus, they can seek or avoid the fund-raiser. The experiment finds that the flyer reduces the share of households opening the door by 10% to 25% and, if the flyer allows checking a `Do Not Disturb' box, it reduces giving by 30%. Hence, both altruism and social pressure affect door-to-door charitable giving.

However, Crumpler & Grossman (2008) infer from an experiment that approximately 57% of the participants made a donation even when the pure altruist did not have any incentive. Hence, charitable spending or voluntary time contribution in social causes can be due to pure altruistic reasons rather than due to factors like satisfying ego, enhancing public image or due to peer pressure.

But, what is more important is to strengthen a person's moral commitment towards social needs. Altruistic behavior is also learnt like other behaviors (Mayr et al, 2009). Praising toddlers for sharing their toys promotes future altruistic behavior even when no one is looking (Mayr et al, 2009).

Hence, in order to promote charitable spending, we require right form of learning as well as reinforcing permanent incentives. It requires a worldview which extends the responsibility of humans to society, future generations, and other living species on planet with accountability for every intentional act done by every human being. We need a worldview that regards humans as trustees for whatever material resources and mental faculties they come to possess in this world. We explain the reinforcing incentives in Islamic worldview in the next section.

3. Reinforcing Incentives in Islamic Worldview

In Islamic economic literature, Sadeq (1987) explains that Islam emphasizes the achievement of human welfare which is more comprehensive than economic welfare. Chapra (1999) also explains that while economic development is indispensable, it is not sufficient to realize overall human well being by default. In recent years, even the western concept of development has recognized the wider dimensions of human development and the role of institutions (Mirakhor & Askari, 2010).

However, human welfare in Islam encompasses economic welfare, but comprises much more than that. The achievement of human welfare is sought in both aspects of human life, i.e. worldly life and eternal life hereafter. Islamic worldview based on Tawhid (oneness of God) and belief in afterlife accountability deeply influences preferences, behavior and choices. It not only asks for change in some choices and giving religion a place in time and resource allocation, rather it presents a worldview where a human being is freed from following anyone except Allah and where a human being is equipped with spiritual rationality to act in ethical ways for the eternal bliss.

In Surah Al Imran, verse 92, Allah (s.w.t.) says, "By no means shall you attain righteousness unless you give (freely) of that which you love". Abu Huraira reported that the Holy Prophet (peace be upon him) said "When a man dies, all his acts come to an end, except three; recurring charity (sadaqah jarriyah), or knowledge (by which people benefit), or a pious offspring who prays for him".

Hence, in an Islamic framework, the incentives for socially sympathetic behavior comes from a particular distinct worldview and comprehensive notion of social responsibility and ethical behavior which is ingrained by Islam in a human being and which affects his/her preferences and economic and non-economic choices.

4. Importance of Waqf in Islamic Redistribution Framework

Zarqa (1988) points out that there are various institutions and structures in an Islamic economy to redistribute income and wealth for the fulfillment of the basic needs for all in the society. The institutions include, among others, Zakat, Waqf and Qard-e-Hasan (interest free loan).

Under Waqf, an owner donates and dedicates an asset (movable or immovable) for societal benefit. The beneficiaries enjoy its usufruct and/or income. Waqf is usually perpetual, but can be temporary and partial. In the contemporary application of Waqf, it can be established either by dedicating real estate, furniture or fixtures, other movable assets and liquid forms of money and wealth like cash and shares etc.

The cash Waqf is usually formed as a financing method to develop Waqf property or to support and build an educational institution or orphanage houses (Sadeq, 2002). Aziz (2013) argues that cash Waqf can pool more resources and wide participation of individual donors.

One of the important features of Waqf is that it provides flexibility in fund utilization as compared to Zakat. For instance, animal protection programs, environmental goods and environmental preservation expenditures can be provided more flexibly through Waqf. The institution of Waqf transforms the social capital into social and public infrastructure. It uses the values of sympathy and empathy as software to build welfare institutions on the ground as hardware. It provides permanent social safety net in the case of perpetual Waqf.

The institution of Waqf complements the institution of Zakat since government cannot take more than a prescribed portion of wealth as Zakat. Hence, private establishment of Waqf helps in sharing the burden of exchequer and also provides a source of contentment for the faithful donor in following the Islamic directives on charitable spending. The institution of Waqf is also an excellent source of building religious infrastructure for Muslims in non-Muslim majority countries. In such countries, the Muslims can share other infrastructure like schools and hospitals built by the government for all citizens. But, they cannot share the religious infrastructure with non-Muslims and the government may not pay attention to the religious needs of minority Muslims in such countries.

As compared to individual charity, the institution of Waqf is more effective in matching right targets with objective screening and providing sustainable sources of funds to the beneficiaries. In individual charity, it is often difficult to find right targets for rich people whose extended families and social circle also include people like themselves.

Besides income support and cash transfers, poor people need training, capacity building and skills improvement in order to get out of poverty and achieve social mobility. Haneef et al (2014) argue that lack of finance and business training requires institutional support to unleash the potentials of micro-entrepreneurs and to establish viable micro-enterprises. Obaidullah (2008) explains the difference between livelihood enterprise programs and growth oriented programs. The former only offer credit facility, while the latter also provide training, insurance and skills enhancement facilities. The institution of Waqf aims to improve the non-economic aspects of the poor such as health and education.

In Muslim history, Awqaf provided public utilities (roads, water and sewage), educational institutions and hospitals. Kuran (2001) admits that Waqf as an institution long served as a major instrument for delivering public goods in a decentralized manner. Even in contemporary times, Awqaf can also directly affect entitlements by providing educational scholarships and health services for the poor. Hence, the institution of Waqf can help in capacity building and wealth creation through building human, physical and financial capital.

5. Application of Waqf in Contemporary Policy Framework

One of the reasons why the institution of Waqf stagnated in recent centuries includes the rigid rules in Waqf. However, in the contemporary application of Waqf, it can be established either by dedicating movable or immovable asset(s). This provision enables the people to contribute in establishing Waqf even if they do not personally own any real estate. Mohammad et al (2006) suggest making a distinction between the perpetuity of the physical being of the object and its 'dedication' of benefits. They argue that only the value capital is to be preserved perpetually, while the investment capital may be transformed into different types of assets as deemed fit for maximizing the benefit from the Waqf.

With regards to the management, administration and governance aspect of Waqf in contemporary times, many scholars also highlight the importance of professional management transparent administration of Waqf for effective results. Alpay & Haneef (2015) recommend that there must be transparency and accountability between funding and implementing agencies for achieving the ultimate goal of poverty reduction.Hassan & Shahid (2010) argue that the professional business management technique will undoubtedly create many positive opportunities for quality improvement of the institution of Awqaf and internal delegation of responsibility. Hence, corporate structure is suitable for professional management and perpetuity.

Performance accountability is very significant since a donor to a Waqf needs to be kept informed as to the purpose for which the funds have been used for and whether the funds have been distributed to the right beneficiaries (Sulaiman et al, 2009). Another important aspect in the application of Waqf in contemporary times is the sustainability of Waqf institutions. Sulaiman & Zakari (2013) emphasize the importance of diversity in income sources for Waqf institutions. This could be achieved by looking for other viable investment opportunities. Handling divestments would require capacity building or employing qualified investment specialists to competently manage investment risks.

The permissibility of making Waqf with contemporary forms of wealth like cash and shares is that it increases the flexibility as well as wide participation. Mohammad (2011) explains that cash Waqf donations and proceeds can be used to form the capital of the bank. The bank will enable Waqf institutions to not only solve their current problems of inadequacy and illiquidity, but it can also make them more self-reliant.

Waqf with large funds can also become a super-structure under which other commercial and welfare institutions can be established. In this regard, Habib (2007) envisions a Waqf-based Islamic Microfinance institution that can provide micro financing and facilitate wealth creation of the poor. Additionally, Habib (2007) suggests that Islamic banks can use income derived from late-payment penalties and other proceeds which it cannot include in its income (like interest earnings from treasury operations). Islamic banks can create a Waqf from these funds and use these for Microfinance operations. Islamic banks can provide Microfinance at lower operating and financing costs. Most Islamic banks have excess liquidity and very low advance to deposit ratios.

In developing countries, financial services are not accessible to masses of poor people either because of supply side sluggishness or unavailability of supporting services. Saad & Anuar (2009) argue that stringent credit evaluation and missing the real target group make commercial Microfinance programs ineffective to reduce poverty. The ultra-poor severely lack access to complementary services which reduces the marginal benefit of access to finance relative to the moderate-poor. Morduch &Barbara (2002) suggest that there are strong potential synergies between Microfinance and the provision of basic social services for the clients. The benefits derived from Microfinance are interconnected and programs have found that the impact of each can increase when they are delivered together. Here lies the potential of Waqf to support Microfinance beneficiaries in enhancing the non-income aspects of their human capital potential.

Microfinance institutions also face another dilemma, i.e. tradeoff between social impact and commercial returns. Mosley and Hulme (1998) state that Microfinance intermediaries can either focus on the ultra-poor and accept a relatively lower impact or alternatively focus on the moderate-poor and achieve higher impacts. Khawari (2004) also maintains that lending bigger amounts to a few is still cheaper than lending smaller amounts to many more. Morduch (1999) also maintains that programs are highly cost-sensitive, and most rely on subsidies. This suggests that commercial Microfinance will remain unable to lift the ultra poor by having to meet double bottom line. The institution of Waqf provides flexible and unrestricted seed capital that can be used to lift ultra poor by providing interest free loans.

Rashidah & Faisal (2013) highlight that provision of education and training, better coordination and networking and technical assistance through Waqf and Zakat funds is necessary for the effectiveness and sustainability of Islamic Microfinance. The Waqf model can be used to fund the establishment of training and business support centers. The recurring costs can be managed by taking a fee in terms of requiring the trained person to further train fixed number of clients. Hence, no monetary fee will be charged for training facilities, but, the person provided with training shall further train a fixed number of other people so that the model becomes financially sustainable and maximum leverage can be obtained from the funds that are used to establish these centers and training the first few batches.

These training centers will compliment the financing functions of Microfinance institutions as the people with required human capital are expected to be more productive and hence earn income levels that can cover the cost of financing and leave some surplus for the client. It is an empirical reality that people want to donate both time and money. Hence, professionals like doctors and academicians can donate voluntary time to be part of such training centers. Such donation will enable them to contribute in social causes without having to become permanent part of the institution and leave their primary bread-earning occupation. It will also enable them to be part of social projects without having to worry about administration, finding right targets and necessary infrastructure. This will also reduce their cost of donation by reducing transaction cost and it will help them to donate more time in actual service delivery than in incurring transaction costs of matching.

Lastly, the institution of Waqf can also be used to finance public infrastructure and public goods like mosques, roads, schools and hospitals etc. Such complimentary public investments are one of the prime sources of continuous economic growth (Romer, 1986).

Conclusion & Recommendations

In this study, we discussed the importance and application of the institution of Waqf in an Islamic economy. We also discussed the reinforcing incentives in Islamic worldview for consistent charitable giving and how it ensures pure self-less altruism. Below, we list some recommendations for increasing the effectiveness of the institution of Waqf in contemporary applications.

- It is vital to improve the matching technology. Charitable spending can be seasonal and impulsive. Hence, there is a need for accessible avenues to match targets and mobilize resources efficiently.

- In soliciting Waqf contributions or investments in Waqf certificates, it is necessary to highlight the positive externalities as suggested in the experimental economics literature (Andreoni, 1995). For instance, highlighting how much difference will a contribution of $1,000 will make in funding one year schooling of certain number of children.

- It is important to provide tax incentives to engage more people and corporations towards establishing Waqf. Shirazi (2014) urges Islamic Development Bank (IDB) to encourage cash Awqaf with tax incentives to the endowers. Tax deductibility for corporations can be one such incentive that should be allowed by countries where it is not allowed already. Furthermore, tax rebates on income deducted at source of Waqf investments shall be allowed to reduce the tax burden on Waqf.

- Finally, it is important to create social awareness for creating right kind of Waqf at the right place. For instance, in many Muslim countries, only mosques are built as Waqf often very close to each other while the majority of Muslims also face shortage of basic medical and educational services.

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