

Introducing Zakat to National Income Accounts

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Abstract

The study aimed to demonstrate the importance of economic zakat and its impact on macroeconomic variables such as land development, increased aggregate demand and supply, heightened overall consumption and investment, and the reduction of unemployment and inflation rates. It also sought to clarify the position of zakat within the circular flow of income and national income accounts. To the best of the researchers' knowledge, no study has addressed this issue. The study concluded that it is crucial to include zakat in national income accounts and the circular flow as a separate element. Additionally, the study highlighted the positive effects of zakat on three sectors: household, institutional, and governmental, as well as on national and personal income.

Keywords: Zakat, Circular flow, Accounts, National Income, Economic Sectors.

ادخال الزكاة في حسابات الدخل القومي

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ملخص

هدفت الدراسة إلى بيان أهمية الزكاة الاقتصادية وأثرها على المتغيرات الاقتصادية الكلية، مثل: عمارة الأرض، وزيادة الطلب والعرض الكليين، ورفع الاستهلاك والاستثمار الكليين، وتخفيض نسبة البطالة والتضخم، ومن ثم بيان موقع الزكاة في التدفق الدائري وحسابات الدخل القومي، ويحدد اطلاع الباحثين لم توجد أي دراسة قامت بذلك ، وتوصلت الدراسة إلى أهمية إدخال الزكاة في حسابات الدخل القومي والتدفق الدائري بوصفه عنصراً منفصلاً، وبينت الدراسة -أيضاً- أثر الزكاة الإيجابي على القطاعات الثلاثة: المنزلية والمؤسسية والحكومية، وعلى الدخلين: القومي والشخصي.

الكلمات المفتاحية: الزكاة، التدفق الدائري، حسابات، الدخل القومي، القطاعات الاقتصادية.

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Introduction:

Zakat is the fundamental financial pillar of Islam. It is collected from the wealthy and distributed to the poor to achieve significant goals, such as spreading cooperation and solidarity among society's members, combating poverty, and improving income and wealth equity through redistribution.

Moreover, zakat has considerable economic impacts on Islamic society, particularly regarding macroeconomic variables. It raises consumption spending by increasing effective demand for goods and services, boosts investment spending, and helps reduce the unemployment rate.

Over time, however, Muslims have neglected zakat. Zakat institutions have disappeared, and Muslim countries have abandoned their roles in collecting and distributing zakat, leading to a decline in individuals' interest in paying it. Consequently, the role of zakat in Muslim societies has diminished due to the imposition of significant taxes that have replaced zakat in the finances of Muslim countries.

Islamic economic researchers have made extensive efforts to explain the importance of zakat and its positive effects in all aspects of society. Some of the most important tools of macroeconomic analysis include circular flow and national income accounts. This research aims to clarify the position of zakat and its impact on these tools.

Study Problem:

Despite the importance of national income accounts, insufficient efforts have been made to explain the position of zakat and its impact from a theoretical and analytical perspective. The research problem can be articulated in the following main question:

- *What is the position of zakat, and what is its impact on national income accounts and the circular flow?*

Objectives of the study:

The aims of this study are to recognize how to integrate zakat-as a primary flow- into national income accounts and the circular flow within the Islamic economy, both theoretically and analytically.

Literature Review:

Economists interested in Islamic economics have studied zakat extensively. There are hundreds of papers and research studies focused on this topic. Among the most prominent studies that have examined zakat from a macroeconomic perspective are those by Choudhury⁽¹⁾ and Khries⁽²⁾, which showed the significant impact of zakat on resource allocation and increasing economic effectiveness.

Mukherji⁽³⁾ developed a model for the tax system in Islam, specifically zakat, and demonstrated that it could achieve economic goals related to equality and social security. Al-Suhaibani⁽⁴⁾ analyzed the impact of zakat on major economic aggregate variables, such as consumption, investment, employment, economic growth, inflation, and economic stability, as well as its effects on resource allocation and the distribution of wealth and income. Al-Suhaibani⁽⁵⁾ and al-Quran and al-Hakim⁽⁶⁾ analyzed zakat's impact on distribution, focusing on its effects on providing basic needs and alleviating inequalities in income and wealth distribution, as well as on the allocation of economic resources, unemployment, inflation, economic stability, and growth.

Darwish and Zain⁽⁷⁾ presented a model showing that zakat is not obligated to increase total consumption or other related variables. Ibrahim⁸ claimed that zakat is an economic policy tool that can affect several macroeconomic variables, including consumption, investment, government spending, trade balance, and national income.

Through their mathematical analysis, Alsaad and Al-Rawabdeh⁽⁹⁾ concluded that zakat induces economic growth and protects the economy from risk fluctuations, whether during a recession or inflation. Alash⁽¹⁰⁾ confirmed that zakat income could achieve economic objectives, such as increasing aggregate demand and supply. Salantout⁽¹¹⁾ explained the effects of zakat distribution on resource allocation and economic stability in Sudan.

Taiar and Saidani⁽¹²⁾ revealed that zakat plays an essential role in stimulating economic activity and achieving stability through various processes. According to Al-Hassan⁽¹³⁾, zakat achieves economic stability by controlling economic imbalances and ensuring the optimal distribution of resources and national income.

Samara⁽¹⁴⁾ argued that zakat plays a crucial role in economic development by financing development, encouraging investment, preventing hoarding, fighting economic recession, reducing inflation and unemployment rates, and increasing aggregate demand for goods and services. In his study, Shalabi⁽¹⁵⁾ found a positive impact of zakat on reducing the general budget deficit. Al-Shoqran⁽¹⁶⁾ proved that compulsory zakat will reduce dependence on taxes and its adverse effects and injustices. He also suggested that the outcomes of zakat will be higher than those of taxes, generating a surplus in the general budget.

Kahf⁽¹⁷⁾, Zarqa⁽¹⁸⁾, Faridi⁽¹⁹⁾, and Bashtawi⁽²⁰⁾ pointed to the positive impact of zakat on fiscal and monetary policies and on some macroeconomic indicators, such as resource allocation and income distribution.

By reviewing previous studies, the researchers found that there is no study, to their knowledge, that has attempted to introduce zakat into national income accounts. Therefore, this study is unique in its contribution.

Zakat, Principles & Importance

Zakat is the social and financial pillar. The Prophet, peace be upon him, stated: “Islam is built upon five pillars: testifying that there is no god but Allah and that Muhammad is the Messenger of Allah, establishing prayer, paying zakat, fasting Ramadan, and performing (Hajj) pilgrimage to the House if one is able.”⁽²¹⁾ The Holy Quran emphasizes the obligation to pay zakat: “Take, [O Muhammad], from their wealth a charity by which you purify them and cause them increase and invoke [Allāh's blessings] upon them” (sura At-Tawbah, 103). Allah says: “Establish prayer and give Zakāh and loan Allāh a goodly loan” (sura Al-Muzzammil, 20), and He promises a tremendous reward to whoever pays it and fulfills its duty: “The example of those who spend their wealth in the way of Allāh is like a seed [of grain] which grows seven spikes; in each spike is a hundred grains. And Allāh multiplies [His reward] for whom He wills” (sura Al-Baqarah, 261).

Allāh threatens those who prevent it with a painful torment: “And those who hoard gold and silver and spend not it in the way of Allāh - give them tidings of a painful punishment” (sura At-Tawbah, 34).

Zakat is not merely a financial donation or charity by paying a sum of money; it is an economic and social institution for implementing and performing the zakat obligation, coordinating its collection and distribution, and clarifying the terms and conditions related to it, including its amounts and those who deserve it, based on the Quran and Sunnah⁽²²⁾. At the same time, it is a significant economic system aiming to combat poverty and unemployment, sponsor orphans, enrich the poor, help those in need, and address financial issues.

Zakat is a continuous cash flow because it is obligatory to be paid immediately and not permissible to be delayed, according to most jurists⁽²³⁾. Even though some allow it if there are economic benefits, evading zakat has severe financial costs⁽²⁴⁾.

Implementing this system in an integrated manner will ensure a comprehensive economic renaissance⁽²⁵⁾.

Zakat’s impact on aggregate economic variables

According to leading Islamic economists, zakat has an important economic role in the Islamic economy and a significant effect on aggregate economic variables. For instance, development (*‘Imārah al-arḍ*)—in the Islamic approach—is a religious obligation that leads to a decent and happy life. The Islamic paradigm for achieving global *‘Imārah al-arḍ* is based on the zakat obligation, which serves as a fundamental instrument with a dual effect to fulfill its developmental purpose at both the production activity and distribution relations levels⁽²⁶⁾.

Additionally, zakat has a tremendous effect on various macroeconomic variables, such as aggregate demand. It has been demonstrated analytically that enforcing the zakat obligation raises both the average and marginal propensities to consume, regardless of whether the economy follows a non-linear or linear consumption function⁽²⁷⁾.

According to some studies, a society that practices zakat has a significantly greater overall consumption function than a society that does not. Although these studies lack practical proof, two indicators support this opinion:⁽²⁸⁾

1. Regardless of the nation's level of poverty, zakat is a steady and uninterrupted source of funding for social security spending, contributing to an increase in the overall consumption volume.
2. Compared to taxes, zakat is characterized by a larger percentage of national income in society, typically at least 2.5% of the money subject to zakat.

Zakat significantly affects investments. In an Islamic economy, the choice to invest is based on the marginal profitability of capital (MPK). If the MPK is positive, investment will proceed because the investor will still be required to pay zakat (2.5%) regardless of whether they invested.

Zakat also influences future expectations, which in turn affect investment decisions. As Keynes stated, expectations are how a changing future impacts the present by expanding the market through income redistribution in favor of the poor, who have a high marginal propensity to consume. Zakat contributes to improving businessmen's expectations regarding future economic activity, thus raising the marginal profitability of capital (MPK)⁽²⁹⁾.

On the other hand, one of the objectives of zakat is to lift the impoverished and needy out of poverty and into a state of production and wealth, enabling them to earn and pay zakat rather than simply receiving it. Imam Al-Nawawi states: *"If he had a profession, he would be given what he can use to purchase his craft or the tools of his craft, regardless of how much such items are worth."*⁽³⁰⁾

Zakat significantly increases employment and reduces unemployment by boosting investment and motivating wealthy individuals to seek out investment opportunities. Simultaneously, zakat raises consumption and, consequently, aggregate demand, especially for consumables. The convergence of the desire of the wealthy to invest their money with an increase in overall demand leads to the utilization of idle resources in society, resulting in a greater demand for labor and the creation of new job opportunities⁽³¹⁾.

Furthermore, zakat contributes to reducing inflation through several mechanisms⁽³²⁾:

- 1- **Consumer spending:** A significant component of aggregate demand, as mentioned earlier, zakat will increase it by transferring ownership of money from the rich to the poor, who have a high marginal propensity to spend. This spending will be focused on necessary goods and services,

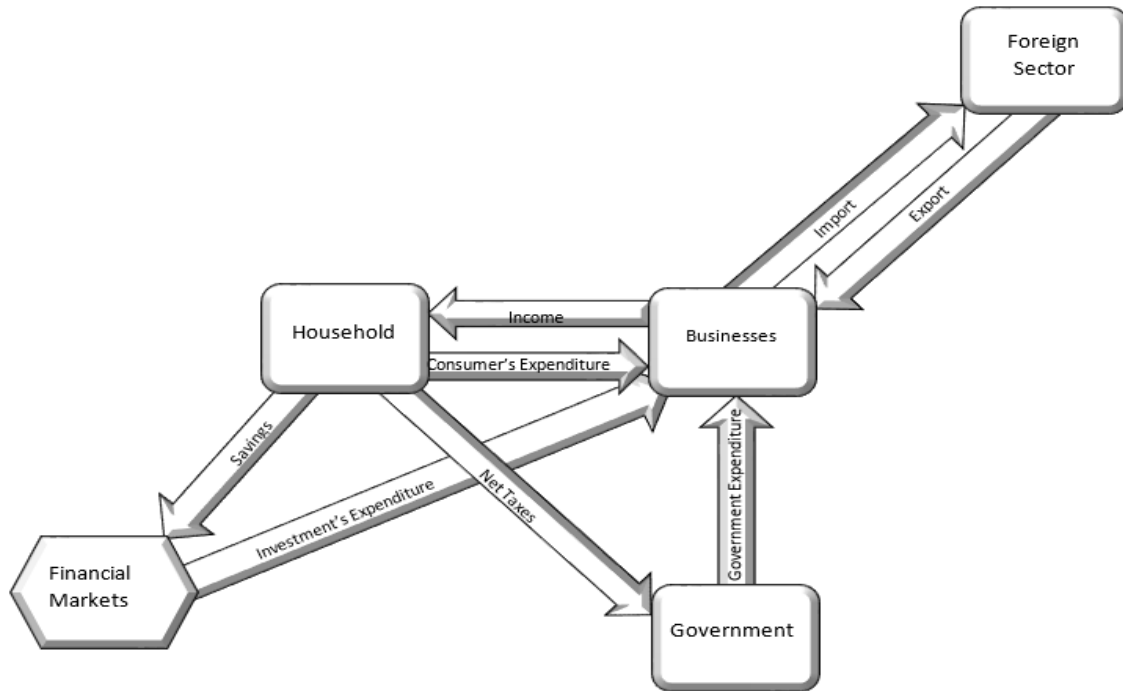
leading to an increase in the production of these goods and creating economic stability (within the responsiveness of supply).

- 2- **Investment stimulation:** The absence of interest rates and the imposition of zakat in an Islamic economy will encourage investment, as the ideal solution for capital owners is to invest their money, even with a small profit margin. This will increase production and reduce the gap between supply and demand. Additionally, zakat is given to professionals who lack sufficient funds, which also leads to an increase in production and supply.
- 3- **Effect on money supply:** Since zakat is based on accumulated wealth (savings), it might reduce the overall money supply in the economy if large sums are withdrawn from circulation or investment markets. This reduction could theoretically lead to deflationary pressures rather than inflationary ones.
- 4- **Impact on inflation:** In a study⁽³³⁾ using a modified Keynesian consumption model, it was found that zakat generates a moderate consumption effect, which negatively affects inflation.

Circular Flow and National Income Accounts

Circular Flow: An economic model that illustrates the flow of money in the economy across four main sectors: households, firms, government, and foreign entities. This model was first developed by the French economist Richard Cantillon⁽³⁴⁾ and later expanded upon by other economists; it serves as the basis for national accounts in macroeconomics. The model simplifies and demonstrates how money moves through society, with money flowing from producers to workers as wages and then back to producers as payment for products. In short, an economy represents an endless circular flow of money.

Figure (1) Circular Flow



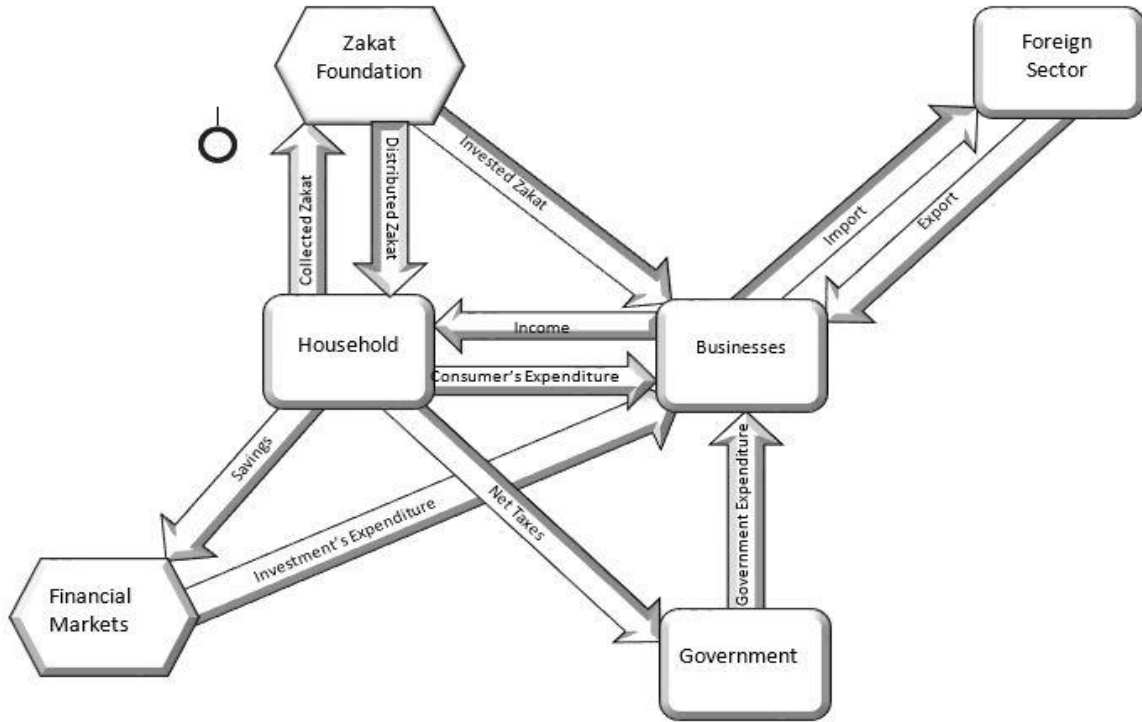
* Drawn by researchers based on macroeconomic books

National Income Accounts: The government bookkeeping system that measures the health of an economy, projected growth, economic activity, and development during a specific period, offering insight into how an economy is performing. This system includes total revenues from domestic corporations, wages paid, and sales and income tax data for companies. The most important accounts are: ⁽³⁵⁾

- a- **Gross National Product (GNP):** The monetary measure of the market value of all final goods and services produced in a specific time period by citizens of a country.
- b- **Gross Domestic Product (GDP):** The monetary measure of the market value of all final goods and services produced in a specific time period by a country. It is the standard measure of the value added created through the production of goods and services in a country during a certain period and is considered the single most important indicator to capture economic activity.
- c- **Personal Income (PI):** The total earnings of an individual from various sources.

d- **Disposable Income (DI):** The amount of money an individual has available for use.

Figure (2) Introducing Zakat to Circular Flow



* Drawn by researchers based on macroeconomic books

We assume that zakat is collected from households, which is a logical assumption even if we consider any opinion regarding mixed zakat⁽³⁶⁾. Ultimately, it is deducted from the profits of the organizers. As shown in Figure 1, there is a cash flow from the household sector to the Zakat Foundation, which we refer to as the Collected Zakat (ZC). Part of this zakat is returned to the household sector for the eight categories of individuals who are entitled to it through what is called Distributed Zakat (ZD), while another portion goes to the institutional sector as Invested Zakat (ZI) according to the conditions mentioned by both ancient and modern jurists⁽³⁷⁾ :

- a. Creating projects for poor professionals (providing them with the tools of their craft).
- b. Establishing investment projects and distributing their shares to eligible beneficiaries.

- c. Establishing investment projects for the Zakat Foundation and distributing the returns to those who are eligible.

Notes on the proposed model (Figure 1):

- 1) We have included the Zakat Foundation as mentioned above.
- 2) We did not include charity in the diagram, despite its importance in the Islamic economy. This decision was made to simplify the diagram, as charity is a flow that leaves the household sector and returns to it, meaning it does not significantly impact the cash flow between the sectors.
- 3) We did not include endowments, despite their significance, because they are often considered an investment process. Although they are part of the institutional sector, their returns (profits) go to the beneficiaries rather than the organizers.
- 4) The income stream (Y) represents the rewards of the factors of production and consists of profits (π), wages (w), and rent (R) (Shawqi, 1988). The employees' expense (w_z) is part of the wages, even if it does not appear in the model.

$$Y = \pi + w + R$$

- 5) Wages are divided into workers' wages (w_L), capital wages (equipment and machinery) (w_K), and zakat collectors' wages (Al-Āmilīyn 'Alihā)(w_z):

$$w = w_L + w_K + w_z$$

However, it must be noted that, in the model, Zakat collectors' wages are included in the distributed zakat stream and not the income directly.

- 6) Financial markets (including banks) differ from those in the non-Islamic economy by the nature of the contracts that govern them, which are subject to the provisions of Islamic Sharia.
- 7) Net taxes refer to the difference between taxes and governmental aid. There is no doubt that the state's sources are multiple in Islam, but most of them, especially the permanent ones, can be classified as part of taxes, such as land tax (al-Kharāj), tithes (Al'ushr), and others. To simplify the diagram, we have excluded profits from public economic projects, which have been combined with government spending. Here, net government spending (G_p) is defined as government spending (G) minus the government's profits from its economic projects (π_G):

$$G_p = G - \pi_G$$

- 8) Taxes are considered a flow from the household sector to the government sector, even if they are collected from the institutional sector, as they are deducted from the profits of the organizers that ultimately go to the household sector.
- 9) Collected Zakat flows from the household sector to the Zakat Foundation and is divided into:

- a- Zakat collectors' (al-‘Āmilūn ‘alayhā) wages go to the domestic sector as part of wages.
- b- Invested zakat goes to the business sector.
- c- Payments to the other 7 categories (distributed zakat).

Zakat and National Income calculations:

Gross domestic product (GDP) is calculated through two approaches: Expenditure approach and Income approach.

1) Expenditure approach: There is no difference in the calculations when including zakat in this approach, GDP will equal the expenditure of the 4 sectors:

$$GDP = \text{Consumption} + \text{Investments} + \text{Government Expenditure} + \text{Net Export}$$

$$GDP = C + I + G + NX$$

2) Income approach: It starts by calculating the National Income (NI) which equals all factors of productions' incomes

$$NI = \text{wages} + \text{profits} + \text{rents}$$

$$NI = w + \pi + R$$

$$\text{wages} = \text{wages of private sector workers} + \text{Salaries of government employees} \\ + \text{zakat collectors' wages}$$

$$\text{profits} = \text{corporate profits} + \text{banks profits}$$

$$\text{Rent} = \text{rent} +$$

$$\text{National Income (NI)} = \text{Net National Product at Cost (NNP}_{\text{cost}})$$

$$\text{Net National Product at Market Price} = \text{Net National Product at Cost} + \text{Indirect Taxes} - \text{Subsidies}$$

$$NNP_{\text{market}} = NNP_{\text{cost}} + IT - \text{sub}$$

$$\text{Gross National Products} = \text{Net National Product at Market Price} + \text{Depreciation}$$

$$GNP = NNP_{\text{market}} + \text{Dep}$$

Personal Income (PI): The total earnings of an individual from various sources.

$$\text{Personal Income (PI)} =$$

$$NI + \text{Incomes received but not gained (IR)} - \text{Incomes gained but not received (IG)}$$

$$IR = (\text{Distributed Zakat} - \text{Zakat collectors' wages}) + \text{retirement wages} + \text{social security} \\ \text{benefits and salaries}$$

$$IG = \text{Deductions (health insurance, retirement, social security, etc.)} + \text{Undistributed profits} \\ + \text{Profits' taxes}$$

Disposable Income (DI): The amount of money an individual has available to use

$$DI = NI - \text{Collected Zakat} - \text{Direct Taxes}$$

$DI = \text{Consumption} + \text{Saving} + \text{Doles}$

Conclusion

Based on the findings, it can be concluded that:

- 1- Zakat is an important flow in the circular flow of an Islamic economy.
- 2- The Zakat Foundation should be included in the circular flow due to its unique characteristics and should be separated from the government treasury.
- 3- Zakat is a flow that affects the three main sectors: household, business, and government.
- 4- Zakat has a positive effect on national income, personal income, and consumption.

Footnotes

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