THE ROLE OF ZAKAT IN OVERCOMING INFLATION AND UNEMPLOYMENT: REVISITING THE TRADE-OFF THEORY

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Abstract: The present study aims to examine the role of zakat in addressing unemployment and inflation, while also revisiting A.W. Phillips’ trade-off theory. The study adopts a qualitative methodology, using library research to critically analyse how zakat could address unemployment and inflation. The study argues that the optimal application of zakat could overcome the issue of unemployment while maintaining price stability. This is true since zakat can be distributed in two forms: consumptive and productive. Therefore, an increase in aggregate demand will always be followed by a rise in aggregate supply; the distribution of zakat in the consumptive form will increase aggregate demand, while the distribution of zakat for a productive purpose will increase aggregate supply. An increase in aggregate demand would in turn increase production, thus absorbing more labour as a result. This is where zakat addresses unemployment. On the other hand, a rise in aggregate demand will initially inflate the aggregate price. However, since the increase in aggregate demand is simultaneously followed by an increase in aggregate supply due to the distribution of zakat in its productive form, the price remains stable. Aggregate demand and aggregate supply cross at an equilibrium point. More importantly, the price is stable while the quantity of production is at its highest level. The findings of the study serve as a reference point for regulators formulating fiscal policy embedded in the zakat system.

Keywords: Zakat, Inflation, Unemployment, Trade-off, A.W. Phillips, Fiscal Policy

Introduction

Inflation and unemployment have become major macro-economic issues in many countries for two reasons. Firstly, inflation and unemployment are the two most common economic indicators of how well a country is doing. Secondly, inflation and unemployment bring about an adverse impact on both developing and developed countries.
Many macro-economic studies explain how government policies address both inflation and unemployment. Many governments and policymakers have introduced policies, strategies, and models addressing both issues, and which conclude that inflation and unemployment cannot be overcome simultaneously. If the focus of a government policy is price stability, unemployment rates will increase and vice versa. This is known as the trade-off theory, introduced by A.W. Phillips in 1958. In his article, ‘The Relation between Unemployment and the Rate of Change of Money Wage Rates in the United Kingdom, 1861–1957,’ Phillips concluded: “when the demand for a commodity or service is high relative to the supply of it we expect the price to rise, the rate of rise being greater the greater the excess demand. Conversely, when the demand is low relatively to the supply we expect the price to fall, the rate of fall being greater the greater the deficiency of demand.” However, Phillips’ theory began to collapse when many developed countries in the 1970s and Asian countries in 1997 suffered from both high unemployment and inflation due to financial crisis. The question thus brought to the fore was: if Phillips’ theory collapses when inflation and unemployment are concomitantly moving in a negative direction, is there any instrument that could address both inflation and unemployment simultaneously?

This article argues that zakat, the third pillar of Islam, can play a significant role in addressing both inflation and unemployment simultaneously. The potential size of annual zakat collections worldwide is enormous, being estimated at between US$200 billion and US$1 trillion. The World Bank and the Islamic Research and Training Institute (IRTI) of the Islamic Development Bank (IDB) estimate that the global potential of zakat is US$550-600 billion per year. Nevertheless, official zakat institutions worldwide currently only collect US$10-15 billion every year. As a sub-system of Islamic teachings, however, the optimal application of zakat could resolve the issue of unemployment while maintaining price stability. This is particularly true since the nature of zakat distribution addresses not just consumption, but also production. Consequently, an increase in aggregate demand will always be followed by an increase in aggregate supply; thus an equilibrium point is maintained.

Many studies have examined the impact of zakat on economic growth, while others explore the role of zakat in poverty alleviation. By contrast, a cursory review of the existing literature demonstrates that, to the best of the authors’ knowledge, nothing has been written about the role of zakat in addressing both inflation and unemployment. This paper, therefore, aims to fill that gap in the existing literature. Following this brief introduction, the paper is organised as follows. After a review of the concepts of zakat, inflation, and unemployment, the paper examines past studies relevant to the subject in question, before
proceeding to delve into how *zakat* can impact both inflation and unemployment. This final part of the paper will also shed critical light on how the concept of *zakat* revises Phillips’ theory. The concluding part of the paper presents a set of policy recommendations.

**Literature Review**

*Zakat*

*Zakat* comes from the Arabic word *zaka*, meaning ‘to grow, increase, and purify.’ Ibn Taymiyyah said: “the soul of the person who pays *zakat* becomes purified from greed and avarice, and the blessings in his wealth increase.”9 Legally, *zakat* refers to the transfer of a portion of wealth to one or more rightful recipients (*asnaf*), as outlined in the Qur’an.10 As the third pillar of Islam, *zakat* is obligatory on every Muslim who owns assets of a minimum amount set by shariah (*nisab*) and that is possessed for a year (*haul*).

The distribution of *zakat* is restricted to eight categories of beneficiary:12 the poor (*faqir*), the needy (*miskin*), *zakat* personnel (*amil*), people whose hearts are inclined towards Islam (*mu’allaqah qulub*), those in bondage (*fi al-riqab*), indebted people (*gharimin*), wayfarers (*ibn al-sabil*), and those in the path of Allah (*fi sabilillah*). The sources of wealth subject to *zakat* include: livestock, gold, silver, agricultural products, animal products, minerals, business inventories, capital goods, and the earnings of workers and professionals. The conditions for *nisab*, *haul*, and the rates of *zakat* vary across these categories. For instance, the *zakat* on agricultural products need not necessarily meet the condition of *haul* as it is levied immediately upon harvest. The rate also varies, being 10 per cent for crops watered naturally and 5 per cent for those watered artificially. Meanwhile, the rate of *zakat* on business inventories is set at 2.5 per cent of net asset value during the prevailing year.

Apart from its spiritual and moral dimensions, *zakat* is part of the socio-economic system of Islam. *Zakat* stimulates the economy by allowing the poor (*faqir*) and needy (*miskin*) to become economically productive. By instituting *zakat*, Islam prevents the widening of the gap between rich and poor, allowing a certain portion of the income of the wealthy to be channeled to the have-nots. *Zakat* can also be used for various additional socio-economic purposes, like education, healthcare, social welfare, and promoting the productivity of the poor. Therefore, from an economic point of view, *zakat* serves as an effective measure in the socio-economic system of Islam.
Inflation

Inflation refers to a substantial and consistent increase in the general price level of goods and services over the long term. In other words, inflation is a process of continuous decrease in the value of currency. It is a process, not merely a high or low price level at a point in time. A high price level does not necessarily indicate inflation. It can only be considered inflation if there is a persistent increase in the general price level over time.

In conventional economics, two diametrically opposed views exist concerning the sources of inflation, the Keynesian and the Monetarist. The Keynesian school recognises three types of inflation: demand-pull inflation, cost-push inflation, and expected inflation. Demand-pull inflation occurs when aggregate demand for goods and services exceeds aggregate supply. Cost-push inflation is an increase in aggregate price level due to a decline in aggregate supply, thus increasing production costs. Theoretically, if productivity decreases, aggregate supply drops and price levels increase. Expected inflation is an aggregate increase in price level in tune with expectations about the overall price of goods and services over a certain period. In contrast to these three categories, the Monetarist school acknowledges only one determining factor in inflation: excessive money supply. Therefore, a government can control inflation either by easing or tightening money policy.

In Islam, inflation is defined as an increase in general price levels due to excessive money supply. Al-Maqrizi (766-845AH/1364-1441CE), a Muslim economist who was a disciple of Ibn Khaldun, divides the root causes of inflation into two: natural inflation and human error inflation. Natural inflation results from natural factors a government cannot control. It is caused by either an increase in aggregate demand or a decrease in aggregate supply. An increase in aggregate demand for goods and services pulls up demand for production, which in turn causes an increase in production costs/prices. At this juncture, in full employment situations, inflation occurs due to an increase in aggregate demand. In a conventional economy, this is called demand-pull inflation. Similarly, a drop in average production levels would also push up price levels due to an increase in aggregate demand. In a conventional economy, this is called cost-push inflation. In a nutshell, therefore, natural inflation originates from either excessive money supply or a decrease in production due to natural disasters, wars, or embargoes. Apart from natural factors, inflation can also be triggered by human factors, such as corruption and bad administration, excessive taxes, and excessive seignorage.
Unemployment

The word ‘unemployment’ did not come into use until the end of the nineteenth century; according to the Oxford English Dictionary, the term was first used in 1895. Etymologically, ‘unemployment’ signifies a state of involuntary idleness, where a person remains jobless for various reasons over a certain period. The International Labour Organisation passed a resolution in 1982 that an individual is deemed unemployed if he/she is jobless for a particular period, despite being available for work and actively seeking a job.

Generally, there are three forms of unemployment:

1. Frictional unemployment, or when workforces are temporarily unemployed or not working. This may be due to persistent movement, whether from one area to another or one job to another, or due to different stages in life cycle.

2. Structural unemployment, or a situation where there is a mismatch between demand and supply for a workforce. This mismatch might emerge when demand for certain types of labour either increases or diminishes. While structural unemployment is also a form of frictional unemployment, it normally lasts longer.

3. Cyclical unemployment, which occurs due to a decrease in demand for goods and services, causing a drop in production, often resulting from economic recession. In response, employers might reduce their workforce.
The Phillips Theory

Inflation and unemployment are major economic problems in both developing and developed countries. Theoretically, the two problems cannot be resolved concurrently as pushing a country's economy into full employment will invoke inflation. This is because economic development requires investment in infrastructure projects; government spending on investment increases demand for goods and services, which in turn increases production and, ultimately, employment. This again causes an increase in demand for goods and services, inflating general price levels.

On one level, governments can increase interest rates to reduce inflation. When interest rates rise, investors are reluctant to invest their money in the real sector, preferring to place it in financial institutions. As a result, money circulation reduces, aggregate demand falls, the economy slumps, and the price of goods and services decreases. Yet, unemployment rates will increase under these circumstances because employers reduce their workforces due to drops in aggregate demand. This is what economists call a trade-off.

As mentioned, the trade-off theory linking inflation with unemployment originated with British economist, A.W. Phillips. His study examined the relationship between unemployment rates and inflation in England between 1861 and 1957. The study found a negative relationship between unemployment and inflation; if inflation was low, unemployment was high, and vice versa.\textsuperscript{23} This theory was further examined and substantiated by Samuelson and Solow, using empirical date from the United States covering the period 1900 to 1960.\textsuperscript{24} The Phillips theory is illustrated by the following curve, known as the Phillips curve:

![Phillips Curve](image)

**Figure 2**: Phillips Curve

Source: Phillips, 1958
The horizontal line represents the workforce unemployment rate, the vertical line inflation. With low unemployment, inflation is high. If inflation is low, unemployment is high.25

**Previous Studies**

A cursory review of the available literature reveals several studies examining the impact of *zakat* on economic growth, public welfare, and poverty alleviation.26 For example, Sarea explored *zakat* as an indicator of economic growth, arguing that it can contribute to economic development in terms of poverty alleviation and reduction of both unemployment and inflation.27 Furthermore, Mahat and Warokka, using macro-economic data from 19 Muslim countries produced between 2004 and 2010, concluded that *zakat* is a powerful, implementable economic growth policy.28

Yusoff, examining panel data from the 14 states in Malaysia, discovered that both *zakat* and education play a significant role in GDP (Gross Domestic Product).29 In a similar vein, Azam et al. discovered that *zakat* has a positive impact on economic development in Pakistan. In particular, micro evidence suggests that *zakat* impacts positively and significantly on household welfare, while macro analysis indicates a positive effect on economic growth.30 In contrast, Khasandy et al. found that *zakat* distribution in Indonesia did not contribute significantly to economic growth or social welfare.31

Other studies have examined the impact of *zakat* on poverty alleviation.32 For instance, Hassan and Ashraf argue that both theoretical and empirical evidence substantiates *zakat*'s role in poverty alleviation. Theoretically, the object of *zakat* is to facilitate socio-economic justice, “so that the wealth may not (merely) make a circuit between the wealthy among you.”33 In this context, poverty alleviation is the main priority of *zakat*, with the poor and needy being the most important category of eligible recipient (*asnaf*).34 It is not permissible, for example, to distribute *zakat* funds to the army while the poor and needy require food, shelter, and other necessities.35 Metwally argued that *zakat* distribution increases purchasing power and consumption among the poor.36

Empirically, Abdullah et al. used the BNDI (Basic Need Deficiency Index) to argue that *zakat* distribution can reduce poverty and inequality in Pakistan.37 In a similar vein, Raimi found that *zakat* and *waqf* models serve as sustainable social safety nets in Nigeria,38 with Hashem discovering a similar pattern in Egypt.39 Sheikh and Ismail, meanwhile, concluded that *zakat* is supportive of sustainable goals (SDGs), including alleviation of: poverty, hunger, ill health, education inequality, unemployment, poor economic growth, and income inequality.40 A study by Noor also confirmed that *zakat* is a powerful tool for attaining SDGs.41
Although these studies cover the role of zakat in economic growth, poverty alleviation, financial inclusion, and the attainment of SDGs, to the best of the current authors’ knowledge, no study examines the role of zakat in addressing inflation and unemployment. The present paper therefore aims to fill that gap, examining the impact of zakat distribution on inflation and unemployment, while also revisiting A.W. Phillips’ trade-off theory.

Discussion

The Role of Zakat in Controlling Inflation

Zakat can control inflation via two analyses: quantitative and qualitative.

Firstly, a quantitative analysis can address natural inflation. This type of inflation occurs due to a mismatch between aggregate demand and aggregate supply. In this context, as a fiscal instrument, zakat plays an important role in income and wealth distribution, stimulating consumption. While governments can allocate zakat funds to all eight eligible recipients (ashnaf) as prescribed by shariah, the poor and needy take priority. From a zakat perspective, the structure of society is divided into three classes:42

1. **Muzakki**, or those with an excess of assets who are obliged to pay zakat. They have a spending pattern as follows:

\[ FS = C - Z + In + Sh + Wq \]  \hspace{1cm} (1)

where FS is final spending, C consumption, Z zakat, In infaq (spending), Sh sadaqah (alms), and Wq waqf.

2. Middle classes, or those who are neither recipients nor payers of zakat. They have spending patterns as follows:

\[ FS = C + In + Sh \]  \hspace{1cm} (2)

3. **Mustahiq**, or those who are eligible to receive zakat. They have two expenditure patterns:

1. \[ FS = Z \]  \hspace{1cm} (3)

2. \[ FS = Y + Z \]  \hspace{1cm} (4)
where $Z$ is zakat, $C$ consumption, and $Y$ income. The first model signifies consumption that originates entirely from zakat. This category includes faqir, ibnu sabil, and fi sabilillah. The second model refers to the poor and needy, or those who have an income, but one that is insufficient to meet their basic needs. In this situation, their final spending exceeds their income level, making them eligible for zakat.\textsuperscript{43}

\begin{figure}
\centering
\includegraphics[width=0.5\textwidth]{structure.png}
\caption{The Structure of Society from a Zakat Perspective}
\label{fig:structure}
\end{figure}

\begin{figure}
\centering
\includegraphics[width=0.5\textwidth]{ideal_structure.png}
\caption{The Ideal Structure of Society from a Zakat Perspective}
\label{fig:ideal_structure}
\end{figure}

It is noteworthy that zakat not only aims to meet the basic needs of the poor, but also strives to enhance their productivity so they can meet their own needs. During the Prophet’s lifetime, the distribution of alms therefore took the form not only of consumptive substance, but also productive capital. As a result, a mustahiq can elevate his status to the middle class and, eventually, muzakki. Thus, the above structure is expected to change into Figure 4:
The distribution of zakat will therefore increase mustahiq income and purchasing power. In other words, according to Metwally, zakat will increase the consumptive power of mustahiq.46 The following graph illustrates the impact of zakat on consumption:

![Figure 5: Impact of Zakat on Consumption](source: Metwally (1992))

The transfer of wealth from the rich to the poor therefore increases the latter’s consumption; Line C of the curve consequently shifts upward to C+Z after inclusion of zakat. The distribution of zakat has, therefore, a significant impact on aggregate demand, as illustrated in Figure 6:

![Figure 6: Impact of Zakat on Aggregate Demand](source: Authors)

An increase in income through zakat elevates the level of aggregate demand from AD₁ to AD₂, thus shifting the equilibrium from a₁ to a₂. At a glance, zakat therefore increases the price level from P₁ to P₂ due to a rise in aggregate demand. However, the distribution of zakat also increases productivity because it is distributed in both consumptive and distributive forms. Therefore, an increase in aggregate demand is concurrently followed by an uptrend in aggregate supply. An increase in aggregate supply will raise the output (Q ↑) and pull the price
(P) down. This corresponds to the law of demand and supply: the more goods are produced, the lower their price. Conversely, the less goods are produced, the higher their price. The impact of zakat on price stability is depicted in Figure 7:

![Figure 7: Impact of Zakat on Price Stability](source: Authors)

Figure 7 illustrates the effect of zakat on a macro scale. The initial equilibrium (meeting point between AD and AS) is indicated at a₁, where the zakat instrument does not function optimally. Under the influence of zakat, the equilibrium point shifts to a₂ (where the role of zakat is still not optimal) with the increase of AD₁ to AD₂. At this point, it appears that prices hike from P₁ to P₂. However, from the perspective of zakat, a rise in aggregate demand is followed by an increase in aggregate supply. Thus, the rise of aggregate supply from AS₁ to AS₂ moves the equilibrium point from a₂ to a₃ (where zakat works optimally). In this final equilibrium, a₃ pulls P down from P₂ to P₁. From this we can conclude that the optimal application of zakat maintains price stability with an increase in Q (production quantity) from Q₁ to Q₃ at the highest level.

![Figure 8: Impact of Zakat on Price Stability](source: Authors)
Turning to qualitative analysis, this uses a socio-normative approach to overcome inflation due to human factors, such as corruption, poor administration, excessive tax collection, and printing money to generate excessive profits. Zakat plays an important role in overcoming inflation due to human factors based on the following arguments:

1. The collection and distribution of zakat is based on obedience to Allah. This serves as an internal control, avoiding corruption and mismanagement among administrators.

2. Zakat avoids poor administration via its spirit of efficiency, as reflected in the stipulation of a nishab and a clear set of zakat rates.

3. The rate of zakat is stipulated by the Lawgiver. As a result, the use of zakat as a fiscal policy instrument and source of state revenue does not create excessive taxation, which might cause inflation.

4. Printing money to attain profit is not supported by zakat, which stimulates economic growth via productivity and effectiveness.

5. Human error inflation is due to incompetence and lack of integrity. Zakat, on the other hand, encourages skillful human resources, professionalism, and integrity. The state also serves as amil (zakat manager) to manage zakat funds. Important requirements for the amil include competence, professionalism, and high integrity.

The Role of Zakat in Addressing Unemployment

Unemployment arises when demand for labour is lower than the size of the existing workforce. This might be due to a lack of skilled workers or an economic downturn that shrinks production by creating low demand. Zakat could address the issue of unemployment through the following aspects.

1. Increased labour supply
   Labour plays a critical role in producing goods and services. Enhancing labour expertise eventually increases labour supply, which in turn increases national output. Figure 9 illustrates the relationship between labour supply and national output:
Figure 9: The Relationship between Labour Supply and National Output
Source: Sukirno (2000)

This paradigm relates to how assets can be equally distributed, including how zakat can shift the status of mustahiq to muzakki. In this respect, the concept of zakat promotes productivity. For example, self-irrigated agriculture is subject to 5 per cent zakat, while rain-fed agriculture (with no productive activity) is subject to 10 per cent zakat. Additionally, zakat in the Prophet’s time and under Caliph ‘Umar bin ‘Abdul Aziz was not only distributed in the form of basic needs, but also as productive capital.47

If the labour supply exceeds demand, increased expertise will eventually recreate demand. This is consistent with the law of Say, which states that supply will create demand.48 From the perspective of zakat, increased supply will always be followed by an increase in demand, and vice versa.

2. Increased labour demand

As a fiscal policy instrument, zakat could be partly allocated to infrastructure development and social facilities. Some contemporary scholars like al-Qaradawi include this objective under the category of fi sabilillah. Infrastructure development will create new employment and increased national income. This can be analysed using the following mathematical equation:

\[
Y_0 = \frac{1}{1-b (1-t)} = (a + I_0 + G_0) \quad \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots \ldots (5)
\]

where \(Y\) is national income, \(I\) Investment, and \(G\) government expenditure. Increases in government expenditure (\(\Delta G\)) will increase national income to:
$Y_0 = \frac{1}{1-b (1-t)} = (a + I_0 + G_0 + \Delta G) \quad \ldots \quad (6)$

Increases in real national income ($\Delta Y$), from as much as $Y_1 - Y_0 = \Delta Y$, can be calculated as follows:

$Y_0 = \frac{1}{1-b (1-t)} (a + I_0 + G_0 + \Delta G) - \ldots = (a + I_0 + G_0)$

Or

$\Delta Y = \frac{1}{1-b (1-t)} (\Delta G) \quad \ldots \quad (7)$

The effect of an increase in government expenditure on fiscal policy can be further explained using the following consumption function curve:

**Figure 10: Consumption Function**
Source: Sukirno (2000)

As indicated in Figure 10, aggregate expenditure is initially reflected by $AE_0$, with the original equilibrium point at $E_0$ and national income at $Y_0$. An increase in government expenditure of the amount $\Delta G$ will raise $AE_0$ to $AE_1$. Thus, the new equilibrium point is $E_1$ and the new national income is $Y_1$.

Based on this analysis, zakat expenditure for government infrastructure will increase national output. The national output signifies an increase in productivity that will ultimately increase demand for labour.

3. **Maintaining the balance between labour supply and labour demand.**

As stated earlier, unemployment emerges partly due to an imbalance between labour supply and labour demand. This issue can be overcome by increasing labour demand via incentives to create new jobs. This will reintroduce a
balance between labour demand and labour supply. To analyse this balance, we use the following labour market graph:

![Labour Market Graph](image)

**Figure 11**: The Aggregate Labour Market and Effect of Minimum Wages

Source: Sukirno (2000)

Here, curve $N^D$ represents labour demand, while $N^S$ is labour supply. The equilibrium point of the labour market can be realised if labour demand is at par with labour supply. This condition occurs at point $E_0$, where wage rate = $W_0$ and job level = $N_0$. If the wage rate increases to $W_1$, there will be labour oversupply, which means that some of the workforce will be unemployed. According to classical economists, this unemployment will decrease wage rates. This decrease in wage level will then increase labour demand, reducing labour supply. This adjustment process stops if both demand and supply for labour again reach their equilibrium point at $E_0$. Conversely, if the wage rate is at $W_2$, labour demand will rise. This will lead to an increase in wage levels, which in turn leads to an increase in labour supply while reducing labour demand. Eventually, the demand and supply for labour will likewise return to the equilibrium point at $E_0$.

If we fuse this labour market law with *zakat*, we find that the latter will always pull conditions to the equilibrium point by increasing both aggregate demand and aggregate supply. This is true since *zakat* is distributed in two forms: consumptive and productive. The former will increase aggregate demand while the latter raises aggregate supply. High aggregate demand encourages producers to increase their productivity. The higher their productivity, the greater the demand for production factors, including labour. This will pull down $W_1$ to $W_0$. Thus, an excess in labour supply can be minimised. On the other hand, *zakat* will also push up aggregate supply. This increase in goods and services signifies a rise in production, which in turn increases labour demand. This will pull down $W_2$ to $W_0$ (equilibrium point).
Revisiting the Trade-off Theory via Zakat

According to the trade-off theory, unemployment and inflation cannot be solved simultaneously. A country can achieve lower unemployment only if it is willing to face higher inflation rates, and vice versa. This theory is illustrated by the Phillips Curve, as shown in Figure 2 (above). The Phillips Curve illustrates a negative relationship between unemployment and inflation. But, how does this happen? In conventional economics, the Phillips Curve can be rationalised through labour market theory, as follows:

The Phillips Curve concludes that the lower the unemployment rate, the higher the increase in wage prices. The WN (wage-employment) curve illustrates the nature of this relationship: the higher the level of employment, the higher the wage level. When this happens, the $N_f$ in Graph (a) illustrates how increased labour costs makes production more expensive. As companies are established to make profit, higher production costs will force an increase in the price of goods, which in turn effects real GDP. In other words, if employment opportunities increase, real national production also increases, which inflates wages. A rise in wages increases production costs, which in turn raises the price of goods, as illustrated in Graph (b).

The response to this situation is as follows: if an increase in wages also increases price levels, this signifies that, although the nominal income of workers is higher, their real income is not. This is particularly true if the increase in nominal wage is smaller than the rate of inflation. In an Islamic economy, when zakat is implemented optimally, this situation should not exist because an increase in productivity follows an increase in wages. This conclusion is further substantiated by productivity analysis, where price ($P$) is a function of total cost.
(TC) divided by total production (Q), as follows:

\[ P = \frac{TC}{Q} \] .......................... (8)

If TC increases without a rise in Q, P will inflate. However, since under zakat an increase in Q follows a rise in TC, P remains stable. This increase in Q is the ultimate objective of zakat. An increase in Q via zakat will be due either to cost efficiency or improved labour expertise, thus increasing productivity. Additionally, Q will reach its optimal point because it is followed by an increase in aggregate demand. This indicates an increase in real wages, reflecting better welfare.

Furthermore, because price levels are associated with aggregate goods and services, we can employ Irving Fisher’s assumption that \( MV = PQ = Y \), where \( M \) is money supply, \( V \) the speed of money circulation, \( P \) price level, \( Q \) the quantity of goods and services, and \( Y \) real GDP. Based on this equation, we can conclude that \( P \) will not rise when \( Q \) increases. This is because \( M \) also rises, while \( V \) remains unchanged.\(^5\)

On the other hand, the Phillips Curve says that decreased unemployment will increase income. An increase in income will increase aggregate demand, thus creating inflation. Figure 13 illustrates the impact of aggregate demand on inflation:

As discussed, zakat can resolve inflation due to an increase in aggregate demand. This is because the distribution of zakat raises aggregate demand while also pushing up aggregate supply. The distribution of zakat in a consumptive form will raise aggregate demand, while the allocation of zakat as productive capital
will boost aggregate supply. A rise in both aggregate demand and aggregate supply will establish an equilibrium point, rendering price levels stable. In other words, when the implementation of zakat is optimal, prices remain stable and $Q$ (production quantities) shifts from $Q_1$ to $Q_3$ at its highest equilibrium point, as illustrated in Figure 14:

![Figure 14: Impact of Zakat on Inflation](image)

Based on the above analysis, we can conclude that zakat could become the anti-thesis of Phillips’ trade-off theory, with the optimal distribution of zakat overcoming both unemployment and inflation simultaneously.

**Conclusion and Recommendations**

Inflation and unemployment are the two main problems facing both developed and developing countries. On the basis of A. W. Phillips’ work linking these two issues, conventional economic theory argues that these two problems cannot be solved concurrently.

This paper has argued that zakat could serve as the anti-thesis to Phillips’ trade-off theory. The optimal distribution of zakat could resolve both inflation and unemployment by addressing the latter via increases in both labour supply and demand, while also maintaining a balance between these two things. Zakat can also control natural inflation because it is distributed in both consumptive and distributive forms, meaning an increase in aggregate supply will be followed by a rise in aggregate demand. An increase in aggregate supply raises output ($Q \uparrow$) and pulls prices ($P$) down. In addition, zakat addresses inflation due to human factors because it is based on obedience to Allah and efficiency. The system also stimulates economic growth by inspiring productivity and effectiveness. It also
encourages skillful human resources, professionalism, and integrity.

To assist zakat in addressing the above issues, the paper recommends the following:

1. *Zakat* be managed by the state as an integral instrument of fiscal policy.

2. *Zakat* be obligatory. In this respect, *zakat* should be administered by a dedicated ministry as a deductible variable for tax.

3. *Zakat* institutions be managed by qualified, professional, and accountable ‘amil for effective functioning.

4. *Zakat* institutions need to explore the possibility of allocating *zakat* funds for productive purposes and job creation. For example, a portion of *zakat* should be designated for development, especially in disadvantaged or remote areas. This will eventually open up more employment opportunities.

Notes

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