

ASSESSING THE CONTRIBUTION OF ZAKAH FUND IN THE MALAYSIAN ECONOMY

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ABSTRACT

Background – Zakat is considered as one of strategic pillars in Islam. Significant improvements in Malaysia's zakat administration started when PPZ -Pusat Pungutan Zakat (Zakat Collection Centre)- was established in 1991. Afterwards, the collection and disbursement of zakat fund have shown a positive trend over the years and have played a certain role for socioeconomic betterment of the country.

Problem – Since the contribution of zakat to economic growth has received attention recently and been debatable, the present paper will deliberately focus on the impact of zakat in spurring economic growth in Malaysia. Such that, there are three possible enquiries as entry point to obviously explore above mentioned topic, namely (1) what is the contribution of the zakat fund towards promoting economic growth in Malaysia? (2) What is nature of the relationship between zakat fund and economic growth in Malaysia? (3) What are the relationships between zakat fund and Malaysian economic growth in the short and long-run?

Design/methodology/approach – The present paper used time series approach to trace out the behavior of selected variables during the period 1991-2009. Vector Auto Regression approach was utilized to elucidate on what variables which is endogeneity significant for capturing movements each variable observed. Variance decomposition, impulse response function, and Granger causality also were incorporated to empirically describe time series behavior.

Findings – The paper found some evidences, as follows. (1) Zakat implementation in Malaysia is not yet used to advocate zakat as the major fiscal policy instrument and stabilize macroeconomic fluctuations. (2) Empirically, zakat could be significantly effect to the economy if the government is able to raise the economic growth. As Granger causality results perform the evidence that there is bi-directional relationship between LnGDP and LnCOL, LNDIS. In other words, the zakat collection and disbursement would be increasing as economy expanding, (3) The contribution of LnCOL and LnDIS towards economic growth just give 19%, and 11% respectively as their amount are yet relied upon heavily on income of zakat payers which are dependent on the phase of business cycle in the economy.

Keywords: Zakat fund, Economic growth, VAR, Malaysian Economy

1. INTRODUCTION

Zakat is a unique ingredient of Islam which is multidimensional in nature. It is both a value as well as an institution, beneficial for the giver as well as the recipient; both moral and socioeconomic; a redistributive measure, its acceptance a sign of faith, and its rejection a source of peril; an individual act of piety and a collective source of benefit; both otherworldly and this worldly (Haq, 1996).

The administration of zakat in Malaysia has its long history. It can be traced back to the colonial era when zakat formally administered under the Council of Religion and Malay Customs which was established by the British in each state of the country. It was the council which governed Islamic affairs and Malay customs, including the zakat administration (Wahab, et.al, 1995). This type of management seems to be the basis for current management in which the administration of zakat is under respective states. There are 14 Islamic Councils, one for each of the 13 states and one for the Federal Territory Wilayah Persekutuan of Kuala Lumpur.

However, significant changes and improvements in zakat administration started when PPZ - Pusat Pungutan Zakat (Zakat Collection Centre)- was set up in 1991 by passing bureaucratic procedures and a customer oriented approach as well as a pro-active approach in tackling customers complaints. PPZ is being the first zakat office to operate in a new corporate style so that the administration made more professional and systematic, including computerization. Afterwards, the collection and disbursement of zakat fund have shown a positive trend over the years and have played important role for socioeconomic betterment of the country.

Since the contribution of zakat to economic growth has received attention recently and been debatable, the present paper will deliberately focus on the significant impacts of zakat in spurring economic growth in Malaysia. Such that, there are three possible enquiries as entry point to obviously explore above mentioned topic, namely (1) what is the contribution of the zakat fund towards promoting economic growth in Malaysia? (2) What is nature of the relationship between zakat fund and economic growth in Malaysia? (3) What are the relationships between zakat fund and Malaysian economic growth in the short and long-run?

The structures of the paper are organized as follows. The first section constitutes an introduction. The second section provides a literature review containing a brief elucidation on the zakat and its economic impacts. Methodology of the paper will be presented at the third section followed by discussion on result and analysis at the fourth section. Finally, the paper is ended by conclusion and policy recommendation.

2. LITERATURE REVIEW

2.1. Economic Impacts of Zakat

Zakat, the compulsory levy on the income and wealth of Muslims, is the most widely subject in Islamic public finance. It is the religious obligation of a Muslim, in the same way as regular prayer (*salah*). While prayer functions as the pole of religion (*'imad al-din*), zakat serves as the pole of society. This is not astonishing given that after declaration of faith, *salah* and zakat represent the two most important fundamentals of Islam.

Apart from its religious status for Muslims, zakat has certainly significant roles in the economic world. There were a lot of studies conducted by a number of Islamic economists

discussing the effects of zakat and its several developmental implications on the economy (Nik Hassan, 1987; Sadeq, 1990; Sadeq, 1996; Haq, 1996, and Kahf, 1997).

To begin with, zakat increases income level of the worse-off population at the grass root level in society to meet their basic needs and to be promoted to the category of zakat payers. Ahmed (2004) studied the role of zakat and macroeconomic policies aimed at growth of income and providing opportunities to the poor in eliminating poverty. Simulation of various macroregimes and zakat schemes for Bangladesh indicate that while macroeconomic policies play an important role in reducing poverty, poverty cannot be eliminated without using zakat in an effective way.

Hassan (2007) showed that zakat funds can replace government budgetary expenditures in amounts ranging from 21 percent of Annual Development Plan (ADP) in 1983/1984 to 43 percent of ADP in 2004/2005.

Zakat is also closely associated with increasing level of aggregate consumption. The relationship between zakat and aggregate consumption has been considered by some researchers such as Metwally (1997) and Khan (1997). Metwally found that zakat increases both the marginal and the average propensities to consume. Meanwhile, Khan (1997) indicated that if zakat is injected in an economy without any additional charitable spending, it will slightly increase the marginal propensity to consume. However, if consumers behave in a restrained manner and observe the Islamic pattern of modesty and moderation, this reduces the marginal propensity to consume to a level lower than that of a secular economy. He further suggested that the policy to impose zakat system in a country should be accompanied with the policies to reduce *israf* in consumption both in public and private sector.

Zakat plays a vital role to redistribution income and wealth within society so that each and every individual is assured of minimum means of livelihood. Part of the zakat transfers could be assigned for the recipients to participate directly and actively in productive activities, relevant to their capacities. This in turn builds self-employment and independence. Ahmad (1984) observed that the institution of zakat was incorporated in the Kaldor-Pasinetti framework showing that an Islamic economy possesses a strong redistributive instrument in the scheme of distribution.

Meanwhile, zakat would increase effective demand for basic needs and thus helps production of socially desirable goods and services through market forces. The institution of zakat furthers aggregate demand in a macro-economic sense which should lead to higher investment and economic growth (Sadeq, 1990).

It is evident that zakat could motivate savers for investment, since they have to pay zakat on their hoarded and saved resources. If not invested, successive payments of zakat will eat up their saved resources at some point in time. Nik Hassan (1987) and Metwally (1997) asserted that zakat encourages investment as it penalizes idle resources. By imposing a penalty for keeping resources idle, zakat helps push resources into productive sector that generate income for individuals and community. Similarly, Faridi (1976) conveyed that a certain amount of zakat funds, invested according to the overall production priorities of an economy, would benefit the poor, in particular, and the economy, in general, through its multiplier effect on employment and incomes.

Al-Suhaibani (1997) found that the first effect of zakat on investment can be negative since it increases consumption. This is true in a static analysis, but in the latter passage of time, the

positive effect of zakat on aggregate demand and its discouragement of leaving funds idle would enhance investment.

In addition, the satisfaction of basic needs of the zakat receivers will upgrade their health care, education, food intake and so on which in turn will increase their productivity. Sadeq (1990) argued that zakat increases the standard of living of the poor, improves their health and skill and hence boosts the productivity of the workforce. Yusoff (2011) showed zakat spending and school enrollment to be important determinants of economic growth in Malaysia. The zakat spending and student enrollment could significantly explain the variation in the growth of real output represented by the growth in real GDP.

The zakat system which is endowed with an incentive structure provides a positive stimulus to economic growth. Rashed and Abdelhafid (1992) who developed an optimal economic growth model by explicitly incorporating zakat into the utility index found that under reasonable assumptions, the optimal growth path at the stationary state corresponds to the golden rule of capital accumulation. This implies that zakat can create a dynamic equilibrium system yielding a level of economic growth that is also attributed to the maximum national well-being.

Many Islamic economists have advocated zakat as fiscal policy instrument in an Islamic state. Yusoff (2006) pointed out that zakat could be used as a counter-cyclical policy through discretionary and non-discretionary fiscal policy. Discretionary fiscal policy is carried out by varying the disbursement of zakat to the recipients. During the expansion phase of the business cycle, the government reduces zakat expenditure to close the inflationary gap. This action helps increase the zakat surplus, in the *Baitul-Mal*. Likewise, zakat expenditure could be increased by using the zakat surplus accumulated during the boom periods, when the economy is in the down-swing to spur aggregate spending and economic activities. Therefore, zakat could complement taxation and government spending as tools of stabilization policy.

Yusoff (2009) opined that the built-in stabilizer mechanism occurs when zakat collection is automatically reduced during recession providing more money for the people to spend which tends to stimulate the economy. However, during the boom period more zakat is collected reducing the ability of the people to spend which tends to dampen economic activities. These reduce macroeconomic fluctuations. He then showed empirical evidence using Malaysian data to support the hypothesis that zakat spending is a potent fiscal instrument to improve the economic performance. The results of panel data regression analysis indicate that zakat expenditure could significantly explain the variation in the real output. This suggests that Muslim countries should make serious effort to improve the efficiency of zakat collection and spending to generate growth and the development of *ummah*.

2.2. The Contribution of Zakat in Malaysian Economy

Malaysia at the moment, practices a mixed economic system which is consistent with nation's philosophy of *Rukun Negara* (National Ideology). Nevertheless, in line with the Malaysian Constitution which places Islam as the official religion, the country provides certain provisions for a number of Islamic practices, including zakat (Nik Hassan, 1987).

However, it seems that zakat institution still has not played a significant role in the country's economy. As an illustration, zakat only accumulated a few amount about RM 408 Million in 2003 compared to the revenue of the government which was about RM 89.2 billion from tax and other revenues. Zakat is such a small portion while the economic, educational and social

needs of the community are financed almost wholly from government revenue (Halal Journal Team, 2009).

Even though zakat is a religiously economic institution, it is regarded as a pure religious institution which does not have a strong relationship with nation's economic and fiscal policies. One of the reasons is apparently because the administration of zakat in Malaysia is a state religious affair (through its respective State Islamic Religious Councils). Under its current system and management, zakat becomes just as a voluntary payment system, unlike taxation that is a highly regulated system enforced by the Federal government (Bakar and Rahman, 2007). The law enforcement is of the significant issues behind ineffectiveness of zakat management. This is certainly not only the special case for Malaysia, but also for the rest of the Islamic world. Nonetheless, Malaysia is so far considered among the best countries around the world in managing zakat system. The country's experience on this particular system is often made a referral by other Muslim countries.

2.3. Financial Sector Development and Economic Growth

It was since the seminal work by Schumpeter (1911) that has stressed the positive effects of finance on growth and its mechanism underlying the long run relations between finance and growth. The other fact has substantiated, for instance, King and Levine (1993a) using data from 80 countries, document strong and positive correlation between measures of financial development and per capita output growth. Xu (2000) further illustrated that there is strong evidence whereby financial development is important to economic growth both in the short-run and the long-term. Moreover, in the context of Islamic banks which tie to closely associate with financial intermediaries, particularly into real economy. However, the severe aspect in financial system may have desperately impacted into real economy as well. Several evidences had taken place through incidences of economic crises such as Mexican crisis, Indonesian crisis, and current global financial crisis in USA, which described a potential disequilibrium to real economy. Therefore, the role of financial sector cannot be excluded in developing an economic growth of a nation. This is because financial sector has a function as financial intermediaries that accumulate capital from household sector or savers to business sector, in which the capital will be used to generating real sector which will absorb available labor in a market, and also realize profit.

To deliberate deeply on such relationship between financial sector development and economic growth, the causality directional approach is equipped to finally fall into three categories, namely (1) the "finance led growth" (the supply-leading), (2) the "growth led finance" (the demand-lending), and (3) the "feedback". The first category argues that the existence of financial sector, as well-functioning financial intermediation in channeling the limited resources from surplus unit to deficit, would provide efficient allocation resources to fuel the other economic sector in their growth process. Schumpeter (1912) and Levine (1997) have argued that this approach is considered as the significant method in promoting economic development. The second category hypothesizes that a high economic growth may create demand for certain financial instrument and arrangements. Robinson (1952) and Romer (1990) have documented that this approach impacted economic growth. Finally, the feedback departs from an argument that a country with a well-developed financial system could promote high economic expansion through technological changes, product and services innovation, and in turn it will attract higher demand on the financial instrument. Since financial system is actively responsive on such development, a higher economic performance could be attained. In brief, both financial sector development and economic growth are

heavily interdependent and feedback relationship. Luintel and Khan (1999) have proved above condition empirically.

3. METHODOLOGY

3.1. Method of Estimation

The analytical tool used in this research is Vector Auto Regression (VAR). VAR approach which was developed by Sims (1980) is a system of equations that show each variable as a linear function of the constant and *lag* values of the variable itself and *lag* values of other variables that exist in the system. In VAR, separation of exogenous and endogenous variables is neglected and assumes that all variables used in the analysis are potential to be endogenous variables.

VAR model specifications in accordance with Sim's criteria (1980) include selection of variables which is suited with the relevant economic theory and suited with the *lag* selection that is used in the model. In the selection of the optimal interval used, this research utilizes Schwarz Information Criterion (SC).

VAR model was developed as a solution to the criticism of simultaneous equations models (Amisano and Gianini, 1997), namely:

- a. The specification of simultaneous system is too based on the aggregation of partial equilibrium model, regardless of the result of the lost relationship (omitted interrelation).
- b. Dynamic structure on the model often specified in order to provide necessary restrictions in obtaining identification of structural form.

According to McCoy (1997), to overcome the criticism was mainly to determine endogenous and exogenous variables; VAR approach tries to let the data speak by making all variables potential to be endogenous variable. Within the framework of VAR each variable, both in the level and the first difference, are treated symmetrically in system of equations that contain the same regressor set.

Enders (2004) formulates the traditional bivariate first-order system as follows:

$$y_t = b_{10} - b_{12}z_t + \gamma_{11}z_{t-1} + \gamma_{12}z_{t-1} + \varepsilon_{yt} \quad (1)$$

$$z_t = b_{20} - b_{21}y_t + \gamma_{21}y_{t-1} + \gamma_{22}z_{t-1} + \varepsilon_{zt} \quad (2)$$

By assuming both variables y_t and z_t stationer, ε_{yt} and ε_{zt} is *white noise disturbance* with standard deviation σ_y and σ_z , and ε_{yt} dan ε_{zt} are not correlated *white noise disturbance*.

Meanwhile, the standard form of above equation can be written as follows:

$$y_t = a_{10} + a_{11}y_{t-1} + a_{12}z_{t-1} + e_{yt} \quad (3)$$

$$z_t = a_{20} + a_{21}y_{t-1} + a_{22}z_{t-1} + e_{zt} \quad (4)$$

Where e_{yt} and e_{zt} is a combination of ε_{yt} and ε_{zt} .

Achsani *et al* (2005) represented general form of VAR as follows:

$$X_t = \mu_t + \sum_{i=1}^k A_i + X_{t-1} + \varepsilon_t \quad (5)$$

Where x_t is vector of endogenous variable with dimension of $(n \times 1)$, μ_t is a vector of exogenous variable, including the constant (intercept) and trend, A_t is matrix coefficient with dimension of $(n \times n)$, and ε_t is vector of residual. In simple bivariate system, y_t is affected by value of z_t in the previous period and current period, while z_t is affected by value of y_t in the previous period and current period.

3.2. Type and Source of Data

The data used in this research is categorized as secondary data of annually time series obtained from Pusat Pungutan Zakat (PPZ) data set and International Financial Statistic (IFS). The range period of study is 1990 to 2009. In addition, the variables used in this study and their operational definitions are stated as follows:

- a. GDP Real (LnGDPR) is a macroeconomic measure of the value of output economy adjusted for price change. Mathematically, it can be arranged as Real GDP = GDP Nominal/GDP Deflator.
- b. Zakat Colletion (LnCOL) is a certain fixed proportion of the wealth and of the each and every kind of the property liable to zakat of a Muslim to be paid yearly for the benefit of the asnaf in the Muslim community.
- c. Zakat Distribution (LnDIS) is a part of zakat amount which must be distributed or disbursed proportionally among 8 categories of people deserve receiving the zakat collected.

All data are expressed in logarithmic forms and in Ringgit Malaysia (MYR).

4. RESULTS AND ANALYSIS

4.1. Unit Root Test Results

Before we proceed, it is imperative to perform a priory analysis of the variables temporal properties. Two methods are used simultaneously to test the existence of root test or the stationary of the data. We subject each time series to the standard augmented Dickey-Fuller (ADF) unit root test. With 5% Mckinnon on critical value, meaning that if the value of t-ADF less than 1% Mckinnon critical value, then the data can be identified as stationer or has no unit root. According to below results, the table indicates that almost all data series under consideration are integrated of order 1, or I(1). In addition, the study implements the Philips-Perron (PP) test for all variables under consideration and the PP test confirms the stationarity in I(1) process. The important of stationary time series is in terms of shocks coming into the system. The shocks towards a stationary time series are considered necessarily temporarily; overtime. Therefore, the stationary time series enable the shocks will dissipate and will revert it to its long-run mean level.

Table 4.1
Unit Root Tests Results: ADF and PP Tests

Variable	ADF Test		PP Test	
	Level	First Difference	Level	First Difference
LnCol	-1.897039	-4.067221***	-1.886539	-7.110338
LnDis	-1.252289	-5.289560***	-1.251237	-6.041595
LnGDPR	-2.310210	-3.255286**	-2.732776*	-3.163526**

Note: *, **, *** denote significance at 10%, 5%, and 1%, respectively.

Source : Eviews, 4.1

4.2. Selection of Optimal Lag

One problem of the VAR system with time series data is autocorrelation. To cope with such problem, optimal lag length should be identified. Such thing can be obtained by using the test of optimal lag. The selection of optimal lag length in this paper will be referred to the shortest lag of Schwarz Information Criterion (SC). The below tables obviously describe that the optimal lag for LnDIS-LnGDPR is one (1) lag, meanwhile two (2) lag for LnCOL-LnGDPR.

Table 4.2
Selection of Optimal Lag: Endogenous variables: LnDIS-LnGDPR
and LnCOL-LnGDPR

Lag	LogL	LR	FPE	AIC	SC	HQ
0	-1.178984	NA	0.004791	0.334630	0.434045	0.351455
1	39.35041	68.26004*	0.000103*	-3.510570*	-3.212326*	-3.460095*
* indicates lag order selected by the criterion						
Endogenous variables: LNCOL LNGDPR						
Lag	LogL	LR	FPE	AIC	SC	HQ
0	6.189942	NA	0.002153	-0.465549	-0.366619	-0.451908
1	43.33437	61.90737	5.45E-05	-4.148263	-3.851472	-4.107339
2	52.62406	13.41844*	3.10E-05*	-4.736006*	-4.241355*	-4.667801*
* indicates lag order selected by the criterion						

Subsequently, we continue with a co-integration test, as suggested by Johansen (1992) and Johansen and Julius (1990). Essentially, the test of a VAR- based test, treating all variables as essentially endogenous. In implementing the test, we place emphasis on the pre-condition that the error terms need to be serially uncorrelated. Co-integration test based on trace statistics will be applied to determine the number of equation systems that can explain long term relationship.

As it can be observed from the table, we find evidences for the presence of a long run relationship between the variables in LnCOL and LnGDPR within a VAR system. Trace test of such model shows 2 cointegrating equation(s) at both 5% and 1% levels. Meanwhile, under LnDIS and LnGDPR show no longer for the presence of a long run relationship between the variables in a VAR system. Therefore, we can justify that zakat collection could be a measurement for indicating the foster of economic growth in Malaysian economy. The big amount of zakat collected would be a significant foundation that muzakki has been increasing their wealth, thus the road of economy is going ahead and accumulated into an increase numbers of zakat payment then. In brief, the existing of co-integration between LnCOL and LnGDPR is describing for the presence of moving together in long period and no longer dissipating each other in the process of interaction over long run period.

Meanwhile, in respect to LnDIS and LnGDPR relationship, the paper gives to understand that those above mentioned variables are no longer co-integrated in a VAR system estimate. Theoretically, a principal feature of co-integrated variables is that their time paths are influenced by the extent of any deviation from long-run equilibrium. After all, if the system is to return to the long-run equilibrium, the movements of at least some of the variables must respond to the magnitude of the disequilibrium. Taking to the case of LnDIS and LnGDPR, the relationship between long and short term relationship, if the gap between LnDIS and LnGDPR relationship is "large" relative to the long-run relationship, the LnDIS or LnGDPR must ultimately rise respectively to close the existed gap. Therefore, to threat the absence of

cointegrating vector, (1) it should increase the value of amount of LnDIS or LnGDPR in the long run, (2) an increase in the LnDIS but a commensurately larger rise in LnGDPR variable, (3) a fall in the LnGDPR but a smaller fall in the LnDIS variable. In short, under a VAR system, without a full dynamic specification of the model, it is not possible to determine which of the possibilities will occur. Nevertheless, commonly, VAR system exhibits that the presence of short-run dynamic must be empirically influenced by the deviation from the long-run relationship.

4.3. Cointegration Tests Results

Table 4.3
Cointegration Test Results: LnCOL and LnGDPR

Unrestricted Cointegration Rank Test

Hypothesized		Trace	5 Percent	1 Percent
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Critical Value
None **	0.623836	32.16922	18.17	23.46
At most 1 **	0.599314	15.54783	3.74	6.40
*(**) denotes rejection of the hypothesis at the 5%(1%) level				
Trace test indicates 2 cointegrating equation(s) at both 5% and 1% levels				

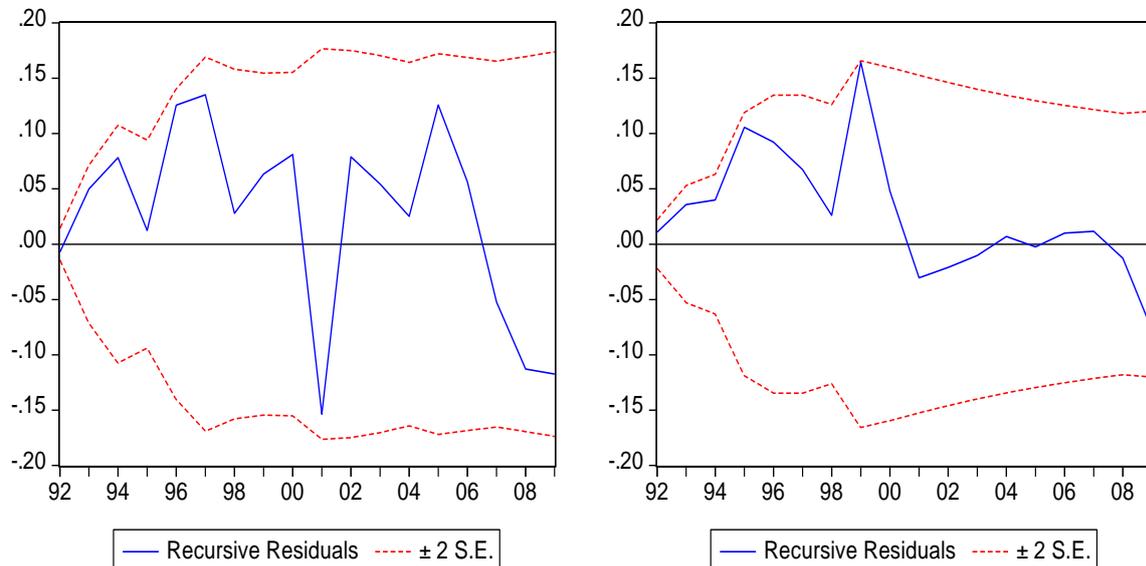
Table 4.4
Cointegrating Test Results : LnDIS and LnGDPR

Unrestricted Cointegration Rank Test				
Hypothesized		Trace	5 Percent	1 Percent
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Critical Value
None	0.473973	17.05193	18.17	23.46
At most 1 *	0.262823	5.488685	3.74	6.40
*(**) denotes rejection of the hypothesis at the 5%(1%) level				
Trace test indicates no cointegration at both 5% and 1% levels				

4.4. Stability Test

The VAR system at its optimal lag should be stable. Unstable VAR system will probably make the results of impulse response function (IRF) and forecast error variance (FEDC) are not empirically valid. The present paper uses the stability test through recursive estimation by emphasizing on recursive residuals. The graphs below outline the stability shown by residuals of two models in a VAR system. The LnDIS LnGDPR graphic tells us that over period of observation, the movement of residuals is no longer out spacing the red line, even though the residuals was shouting down severely during 2001 and 2009. Similarly, the graphic of LnCOL LnGDPR is also between red lines which indicate that the residuals are stable during the period of observation.

Figure 4.1
Stability Test between LnDis and LnGDPR and Stability Test between LnCol and LnGDPR



4.5. Granger Causality Test Results LnCOL and LnGDPR

In addition, the Granger causality results find out some striking outcomes. Firstly, LnGDPR does Granger cause LnCOL which means the increases amount of growth taking place in the country, Malaysia, will eventually make up the bigger zakat payers. It strengthens the notion that once economic growth takes place, the income collected for zakat will simultaneously rises up. Secondly, concerning the distribution side, the Granger results show that LnGDPR does cause LnDIS. It implies for the evidence that the zakat distribution in Malaysia is yet dependent heavily on the growth rate in its economy. Hence, it is quite worried during the recession since the distribution of zakat will decline and therefore share bad effect to mustahiq, mainly for the poor and destitute. Zakat recipients, particularly, the poor and needy, are getting desperate if they have no incomes since they totally depend on zakat and sadaqah for consumption purpose (Yusoff, 2009).

According to Granger causality results, some lessons can be grasped into account, namely (1) as described above that the amount of zakat disbursed to the recipients may be less or more to zakat fund depending on the economic condition, (2) zakat implementation in Malaysia is not yet used to advocate zakat as the major fiscal policy instrument and stabilize macroeconomic fluctuations. The two said statements refer to empirically evidences, namely although the zakat collected over two decades showed the co-integrated pattern with the economic growth, it does not impact similarly to its distribution side which does not support Malaysia economic growth. Theoretically, according to Metwally (1983), zakat disbursement has the ability to increase the aggregate consumption since the marginal propensity to consume of zakat payers is lower than that of zakat recipients. In other words, the zakat disbursement has a crux role in the national income determination; the higher the zakat expenditure the higher the increase in the equilibrium output. Therefore, concerning Malaysian case regarding the pattern of LnCOL and LnDIS variables towards economic growth (LnGDPR) could be explained as the existence of disintegrated policy between LnCOL and LnDIS in promoting economic growth or we may say that zakat policy imposed among Muslims in Malaysia does not have power to solve social diseases, such as poverty incident along with zakat policy implementation.

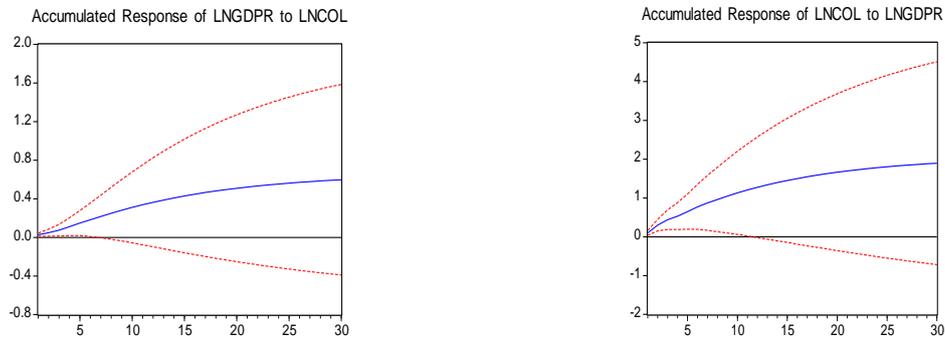
Table 4.5
Granger Causality Test Results: Series: LnCOL LnGDPR

Lags: 2			
Null Hypothesis:	Obs	F-Statistic	Probability
LNGDPR does not Granger Cause LNCOL	18	5.02126	0.02422
LNCOL does not Granger Cause LNGDPR		1.65400	0.22910

4.6. Impulse Response Function between LnCOL and LnGDPR

Figure 4.2
Accumulated Response of LnGDPR to LnCOL and LnCOL to LnGDPR

Accumulated Response to Generalized One S.D. Innovations ± 2 S.E. Accumulated Response to Generalized One S.D. Innovations ± 2 S.E.



In addition, the behavior of zakat policy towards promoting growth can be also described through impulse response function. The accumulated response of LnGDPR to LnCOL exhibits that the shocks coming to zakat collection will definitely trigger the spur of Malaysian economy. It also informs that the preference or behavior of zakat payers are mainly relied upon the economic fluctuation as perhaps the main source of zakat in Malaysia are coming from zakat income or income deduction for zakat. The accumulated response of LnCOL to LnGDPR is confirmed by looking up to the uprising the blue line over 30 period horizon which points out on any disturbing in the zakat collected will be responded positively to the decrease in the accumulated GDP in the country. In conclusion, zakat collection and accumulated GDP are closely intertwined and relied upon each other, even though statistically insignificant.

Table 4.6
Variance Decomposition Function of LnCOL and LnGDPR

Period	Variance Decomposition of LnCOL:	Variance Decomposition of LnGDPR:
	LNGDPR	LNCOL
2	17.53382	42.47832
4	21.42867	59.72958
8	20.04538	69.72791
12	19.63134	72.75257
16	19.45647	73.94113
20	19.37353	74.47020
24	19.33256	74.72199
28	19.31195	74.84629
30	19.30585	74.88285

According to Variance Decomposition Function table, (1) variation on LnCOL variable is attributable by shock LnGDPR is quite strong even though in period 2 was recorded 17.5%, and finally increases to 19.3% in 30 horizon period. Meanwhile, the accumulated in LnGDPR as the innovation is occurred by LnCOL was high, roughly 75% in 30 horizon period. This evident was confirming the previous finding and strengthening statement made by Metwally (1983) that the growth of Malaysian economy is essentially contributed by how huge are the zakat collected by government over a year lunar calendar.

Having looked at collection side as a part of zakat management policy, the present paper tries to also focus on distribution aspect of zakat management in Malaysia.

The Granger causality results below point out that (1) LnGDPR does cause the LnDIS in Malaysia during period of observation, (2) in contrast, LnDIS does not cause LnGDPR. These findings may imply two indications of facts, namely (1) the significant impact of economic growth towards zakat distribution has shown the government does not conduct fiscal policy action through zakat distribution. Once zakat collected, it was directly distributed to zakat recipients. The absence of fiscal policy through zakat was confirmed by second null hypothesis stated that the zakat distributed is no longer effect to economic growth. Hence, zakat management should be arranged differently according to the expansion phase of a business cycle. The zakat collection maybe more than the zakat disbursement as more people are employed and there would be less eligible zakat recipients, and therefore there should have the zakat surplus during the expansion phase of business cycle. In contrary, during recession, everyone would expect a fall in zakat collection and a rise in zakat disbursement as more people are unemployed, which proportionally leads to zakat deficit. However, the deficit would be covered by the zakat surplus accumulated from the previous years. Therefore, given assumption that every realized deficit is covered by every realized zakat surplus, it implies that zakat management might have always supported economic growth. In other words, distribution of zakat will have causal bi-rectional relationship towards economic growth.

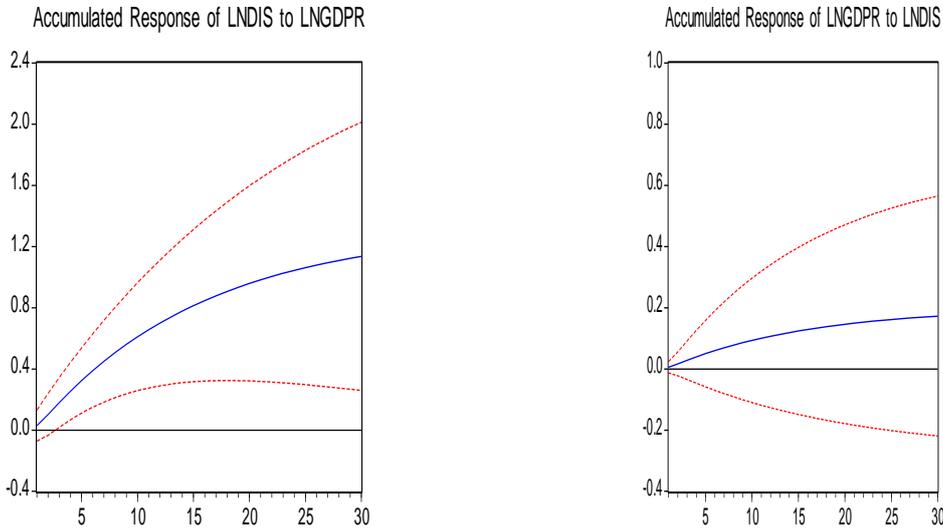
4.7. Granger Causality Results of LnDIS and LnGDPR

Table 4.7
Granger Causality Test Results: Series LNDIS and LNGDPR

Lags: 1			
Null Hypothesis:	Obs	F-Statistic	Probability
LNGDPR does not Granger Cause LNDIS	19	6.73545	0.01953
LNDIS does not Granger Cause LNGDPR		0.44902	0.51236

Figure 4.3
The Accumulated Response of LNDIS to LNGDPR and LNGDPR to LNDIS

Accumulated Response to Generalized One S.D. Innovations ± 2 S.E. Accumulated Response to Generalized One S.D. Innovations ± 2 S.E.



In addition, looking at the impulse response graphic above, they explain the similar behavior on what have described in Granger results. The accumulated response of LnDIS to LnGDPR outlines the positive and significant response of zakat distribution in reacting toward a shock coming in as GDPR is fluctuating. Therefore, the disbursement of zakat is heavily relied upon the increase of GDPR in the economy. Meanwhile, the accumulated response of LnGDPR was also positive as disbursement zakat was getting shocks even though it is statistically insignificant. Therefore, the impulse response does confirm that frankly the disbursement of zakat will be increasing as responding the positive shocks coming in from GDPR in a VAR system, and zakat will not bring the significant impact towards economic growth as there does not incorporate zakat as one of fiscal policy instrument in the economy.

Table 4.8
Variance Decomposition of LNDIS and LNGDPR

Variance Decomposition of LNDIS:		Variance Decomposition of LNGDPR:	
Period	LNGDPR	LNDIS	
2	7.307232	5.374514	
4	20.76058	8.464893	
8	33.57167	10.16230	
12	38.97220	10.68599	
16	41.63489	10.91462	
20	43.05013	11.06453	
24	43.83244	11.09067	
28	44.27427	11.12479	
30	44.41796	11.13580	

According to variance decomposition function, the results show that (1) variance decomposition of LnDIS is attributable in a relatively huge proportion from LnGDPR, increasing from 7% in second period to 44% in 30 horizon period. Such increase indicates that the disbursement of zakat is really dependent on the growth of economy as a whole, even

though zakat as a fiscal policy instrument is not yet prevailed in Malaysian economic system. In addition, the contribution of LnDIS towards economic growth seems to be recorded as a negligible portion, roughly 11% till 30 horizon period due to the small amount of zakat collected over a year compared to tax collection. However, yet zakat which can be considered as additional fiscal policy instrument could be powerful enough to underpin and fine tune the growth of Malaysian economy.

5. CONCLUSION AND POLICY RECOMMENDATION

5.1. Conclusion

The present paper focuses on looking at the contribution of zakat fund in the Malaysian economy. By utilizing Vector Auto Regressive (VAR) approach, finally some findings and lessons could be empirically reaped. The conclusion can be listed as follows:

- a. Zakat implementation in Malaysia is not yet used to advocate zakat as the major fiscal policy instrument and stabilize macroeconomic fluctuations.
- b. Empirically, zakat could be significantly effect to the economy if the government could raise the economic growth. As Granger causality results perform the evidence that there is bi-rectional relationship between LnGDP and LnCOL, LnDIS. In other words, the zakat disbursement and collection would be increasing as economy expanding.
- c. The contribution of LnCOL and LnDIS towards economic growth just give 19%, and 11% respectively as their amount are yet relied upon heavily on income of zakat payers which are dependent on the phase of business cycle in the economy.

5.2. Recommendation

Due to the collection of zakat and its disbursement are still relied upon economic growth, the integrating policy between the zakat policy and economic activities, in particular, its role for promoting growth by eliminating poverty incident across the country, should be addressed, as follows:

- a. Zakat proceeds are sufficient to cover needs. It means that the implementation of zakat shall be based upon the Shariah rule, namely it enables to be disbursed and allocated for poverty alleviation scheme.
- b. Government is highly responsible in collecting and distributing zakat, in such a way, by allowing government to directly supervise the mechanism and ratio of zakat distribution. It also includes the ability in instructing the zakat payers in terms of zakatable assets, whether it should be paid in cash, kinds, or by means of consumer goods in order to fulfil the desired objectives.
- c. The cost of zakat management is minimized as the amount collected is relatively small compared to nominal GDP.
- d. Zakat does not create economic distortion in terms of equity accumulated and eventually does not also reduce government budget collection.
- e. Lastly, zakat could be incorporated as one of the fiscal policy instrument to analyze the efficacy of fiscal policy to stabilize economic performance by non-discretionary policy integrated with the channel of transmission to the real sector.

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IPB International Convention Center, Bogor, July 19 - 21 2011

Number : 024/Papers/IZC-WZF/VI/2011 Jakarta, June 10, 2011
Attachment : List of Accepted Presenters
Subject : **Acceptance Letter**

To:
**Mochammad Arif Budiman, Dimas Bagus Wiranata Kusuma
and Qurroh Ayuniyyah**

Assalamu'alaikum Warahmatullah,

Hopefully this letter finds you in the best of health and high Islamic esteem.

We are pleased to inform you that after a thorough and careful review, your abstract has been accepted to be presented at the International Zakat Conference, which will be held in Bogor, Indonesia on July 19-21, 2011. Attached is the list of the accepted abstracts along with the authors and country of origin for your information.

We would like to remind you that your full paper must be submitted on June 30, 2011. As for the hotel accommodation, meals and local transportation during the conference, the committee will fully cover the expenses for one presenter only. In case you need visa to enter Indonesia, please send us your scanned passport which has validity of more than six months.

Thank you and we look forward to meeting you in Indonesia.

Wassalamu'alaikum Warahmatullahi Wabarakatuh,

ORGANIZING COMMITTEE OF THE CONFERENCE

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Chairman

Noor Aflah

Secretary

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