

# Keynes' Consumption Theory: A Reevaluation According to the Islamic Perspective

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## Abstract

Keynes Consumption Theory assumes that the household will increase its consumption if the income is increased and some of the income is saved. Although increased consumption will increase the household demand that can then contribute to economic growth, uncontrollable consumption increase spurred by increased income will lead to various negative implications, such as poverty, imbalanced income gap and deficit. The question is, does the household increase in consumption necessarily correlate with the increase in income? Next is, how does this theory square with the perspective of Islam particularly in terms of unused income? This paper carries two purposes. The first is that, it looks into Keynes' consumption theory and the function of the household consumption based on Islam. Secondly, it analyzes the difference between Keynes' consumption theory and the function of the Islamic consumption. The research for this paper relied on the qualitative approach using secondary data. The data were then analyzed using content analysis. The research outcome indicates that an increase in income does not automatically lead to an increase in consumption just as increase in consumption is not the direct result of income increase. Secondly, income increase provides for the opportunity to save and an opportunity to contribute to charity in the path of God rather than an increase in consumption. This is especially true for Muslim households.

**Keywords:** Consumption, Consumer, Keynes Theory, Debt, Household.

## Introduction

There are multiple theories, models and approaches that have been introduced by Western scholars in explaining and looking closely into consumer behavior. This includes Keynes' theory of consumption. Keynes' consumption theory makes the assumption that the consumption will increase if the income is increased and part of the unused income will be saved or put in a fund (Nor Asmat Ismail, 2013: 94-95). However, if this theory is reevaluated according to the Islamic standpoint, the theory will not be seen as accurate measured from the Ghazalian perspective that suggests that the increase in income should not be used to increase the consumption (Mat Hassan Abu Bakar, 2003:51-52). This is because according to al-Ghazali, any increase in an individual's financial means should be directed to spending in the path of God such as helping the family, neighbors, the poor, the orphans, travelers, Muslims in hardship, and also those who need help rather than increasing one's own consumption (Mat Hassan Abu Bakar, 2003:51-52).

In Malaysia, Keynes' consumption theory is generally included in the indicator of the Gross Domestic Production (GDP) or *Keluaran Dalam Negara Kasar (KDNK)* that is adopted to

measure the level of development of the national economy. If studied holistically, the assumptions developed by Keynes' consumption theory actually show negative implications towards the economic growth such as wastage issues, poverty, imbalanced income gap, and even deficit if the purpose of the consumption is not at par with the requirements of *shara'*, the Islamic legal parameter. According to Wan Norhaniza Wan Hassan and Mohd Shukri Hanapi (2014), the mold of regular development does not have to be used to create an Islamic-oriented development index. They argue that a pure Islamic-oriented development index can only be built based on the development mold that is purely grounded in Islam. However, the regular development mold may be used through modification by mixing it with an Islamic-oriented development mold. Nor Asmat Ismail (2013: 96) further argues that in the context of the national debt, Keynes' theory assumes that the household does not consider the total amount of debt and the repayment period. This clearly proves that Keynes' consumption theory has several weaknesses that are influenced by factors like utility or satisfaction, and it should be reevaluated through the perspective of Islam.

Thus, this paperwork seeks to reevaluate Keynes' consumption theory based on the Islamic perspective. Based on this purpose, this paper is divided into three sections. The first section explains Keynes' consumption theory that is adopted as one of the elements found in the KDNK indicator. In the second section, this study analyzes the concept of the consumption put forth in the Islamic economy. As for the third section, it analyzes Keynes' consumption theory following the Islamic perspective.

The search for knowledge and its acquisition has begun since the beginning of life. This continuing process of learning enhances further the development and transformation of a community (Brookfield, 2000). Learning transcends the borders of every level of life experienced within the community regardless of gender, age, race and social status. The growing

demand for learning not only encompasses the formal platform, but also the informal and non-formal learning ones.

This project focuses on the non-formal learning in religious classes that take place in a housing community. The term non-formal is known to refer to organized learning activities that are being conducted beyond the 'formal' education system. From Mazanah (2001), these are the learning activities which serve specific clientele, tend to be sponsored by community-based, non-governmental organizations, normally conducted in community meeting places and informal settings other than a 'classroom' setting. Hence, this paper projects the usage of a *musolla* in which the religious lesson is held.

### Keynes' consumption Theory

John Maynard Keynes was a British economist whose radical economic ideas contributed fundamentally to the transformation in the ways governments design their economic policies and in how the theory and practice of economics are generally understood. Keynes' theory of consumption assumes that the increase in income is used for the purpose of increased household consumption and that the part of unused consumption will be saved up. According to the theory, the total amount of savings and the actual savings depend on the household's marginal propensity to consume (MPC). The greater the MPC, the greater the amount of money used and the smaller the amount of savings (Nor Asmat Ismail, 2013: 95).

This theory can be better understood by justifying the Keynesian consumption function that can be expressed as

$$C = a + b Yd$$

where (**C**) refers to the total consumption, (**a**) the autonomous consumption, (**b**) the marginal propensity to use, and (**Yd**) the useable income, or the income that can be used by the household after taxes. The role of tax in the consumption

function acts as a fiscal tool.

Total savings also depends on the function of savings. The function can be expressed as

$$S = -a + (1-b) Yd$$

Where (**S**) refers to total savings, (**a**) is the constant, (**1-b**) the marginal propensity to save (MPS), and (**Yd**) the useable income. The total savings or funds depend on the MPS if the level of income for the household is increased. This function explains that, the greater the value of MPS, the greater the total savings.

According to Keynes' theory, other than saving up, the household also makes an investment based on the total savings done. This can be demonstrated through the following equation:

$$S = I$$

The equation shows that the total investment (**I**) is influenced by the total savings of the household. However, the investment spent by the household is in the form of materials with worldly purposes only, without involving the more spiritual aspect of wellbeing. Nonetheless, this is seen to be different from the concept of spiritual-oriented investment as stressed in the Islamic economy. Islam is not a stagnant way of life. The objectives that are to be achieved in Islam strike a balance between the importance of the economy and the non-economy in life.

### The Islamic Economy Consumption Function

Based on the consumption function in the Islamic economy, the determination of the level of income in the country in the Islamic economy includes the element of *zakat* in the consumption function. This consumption function explains two positions comprising of *zakat* payers and *zakat* recipients. This can be understood through the consumption function that can be shown as follows (Ausaf Ahmad, 2008:15):

$$C = C_1 + C_2$$

(**C**) refers to the total aggregate consumption spending for the rich and the poor. (**C<sub>1</sub>**) is the

consumption expenditure of *zakat* payers. (**C<sub>2</sub>**) is the consumption expenditure of the *zakat* recipients. The aggregate consumption function of tax payers is assumed to have depended on the gross income of individuals (useable income) after the *zakat* and *infaq* are deducted. This can be shown through the consumption function in the Islamic economy as follows:

$$C_1 = a + b [Y - Z - E]$$

The consumption function of the *zakat* payers above explains that the MPC value depends on the stipulation in Islam. Islam has put a high price on the practice of moderation. Individuals who have savings or excess funds to the point that there is asset freezing, or in other words, individuals who save up until their total savings are sufficient for the limit of *nisab* (the qualified *zakat*-able amount) to qualify them to pay *zakat*, but are not paying, then it is only reasonable for the individuals to pay taxes as a form of national punishment. The spending for *zakat* and *infaq* recipients depends on the total granting of *zakat* and *infaq* by the payers of both. This assumes that the *zakat* recipients no longer have other sources of income other than receiving *zakat* and *infaq* from the *zakat* payers. However, this assumption is limited and temporary in nature as it consistently changes according to the distribution of income in an Islamic country. This is because, it is unreasonable to assume that every source of income for *zakat* recipients only depends on the total *zakat* obtained from the *zakat* payers only. Based on this assumption, the consumption function of *zakat* recipients as explained earlier can be shown as follows:

$$C_2 = Z + E$$

Based on the above equation, it is assumed that *zakat* and *infaq* recipients spend all the income they receive on the consumption. In other words, MPC of *zakat* recipients is equal to elastic ones.

In the Islamic economy, *zakat* is imposed towards qualified adult individuals and those who own more than the minimal level. *Zakat* is imposed on accumulated wealth that serves to be the shares or acquisition coming from

agricultural yield. The function of *zakat* in the consumption function can be shown as follows:

$$Z = z Y$$

In the above *zakat* function, (**Z**) denotes the collection of *zakat* in the economy, (**z**) is the marginal rate and average of *zakat* and (**Y**) is the income. The rate of *zakat* is fixed but the level of wealth varies. Other than the *zakat* payment demanded by Islam, Islam also encourages spending on the path of God (*infaq*). The function of *infaq* can be shown below:

$$E = y Y$$

Based on the *infaq* above, (**E**) is the individual spending on the path of God and (**y**) is the propensity to spend on the path of the Creator. It is assumed that the spending on this path of God is always positive but less than one. Looking at the consumption function in the Islamic economy, the elements of *zakat* and *infaq* are included in the consumption function and play the role as a form of spiritual-oriented investment. The spending that goes beyond the charity for the society, which is greater than the minimum limit is something good and encouraged in Islam. One example is donation (Surtahman Kastin Hassan, 1990: 11).

### **Evaluating Keynes' Consumption Theory According to Islamic Perspective**

The evaluation of Keynes' consumption theory according to the Islamic perspective can be assessed based on three aspects namely, the concept of consumption, the concept of rationalism, and the function of *zakat* to the national economic development.

#### *The Concept of Consumption*

In general, the main aim of conventional economy is the achievement of the maximum level of satisfaction in allocating requirements from limited resources. This economic aim is typically emphasized in Western literatures such as the works of Robbins (1935), Sen (1988), Groenewegen (1996), and Peil and

Staveren (2009). Such an economic emphasis ultimately led to our economic theory where the consumers' level of fulfilled satisfaction does not weigh upon whether or not the issue is allowed in the laws of ethics.

Even more so, the philosophy behind this conventional economic wisdom has acknowledged rational consumers as consumers who have the desire to use anything he or she wants just to fulfill his or her satisfaction to the maximum (Surtahman Kastin Hassan, 1990:1). On the contrary, the philosophy of Islamic economy leans on the conviction that humans need to adhere to the laws of God so that our lusts and desires can be curbed. In this fashion, we move from the conventional mindset of fulfilling unlimited desires through limited resources to utilizing and appropriating our limited resources in order to fulfill the individual needs fairly. On this note, Islam has taught its *ummah* to become consumers that can reap happiness and prosperity in this world and in the Hereafter even in the face of limited shared resources (Mohd Zaid Mustafar & Joni Tamkin Borhan, 2013).

Consumers therefore have to consider the right method to spend their income and manage their daily consumption so that their basic needs can be fulfilled. Here, the best step that can be taken by consumers is to plan ahead the items or services that they need so that waste can be avoided. The consumerist culture based on the conventional economic philosophy is also able to encourage the culture of uncontrollable credit card consumption, excessive spending, purchasing branded, luxurious items that can further invite serious financial debt (Roza Hazli Zakaria, Radiah Abdul Kader, Noor Ismawati Mohd Jaafar & Sabitha Marican, 2012).

#### *The Concept of Rationalism*

The concept of rationalism understood by the Neo-Classic economists argues that individuals who achieve spiritual satisfaction (non-economic satisfaction) is regarded as an irrational act

(M.A Chaudhury, 1986:25). For the Muslim consumers, the concept of rationalism is related to the scope in life involving the two dimensions of life in this world, and life in the Hereafter (Muhammad Syukri Salleh, 2003: 34-35). In the context of Islamic economy, any action done by the consumer in his or her consumption, will give an impact to both the worlds especially when it comes to charitable consumption. Additionally, the combined goodness of this life and the next, is a form of consumption that enables a consumer to attain the highest level of satisfaction (Monzer Kahf, 1992:63).

Thus, a Muslim consumer can still act rationally when he or she releases part of his or her personal consumption or economic consumption for the sake of spending his or her asset to improve the satisfaction, which is the satisfaction that encompasses material and spiritual satisfaction (Tahir Ahmad Wani, 2013). A Muslim therefore believes that actual satisfaction would be satisfaction in this life and in the life of the Hereafter. Thus, for this worldly consumption, a Muslim consumer acts rationally because consumption is not only due to one's own need, but it also involves something greater in the form of the spiritual satisfaction.

### **The Function of Zakat in the National Economic Development**

Based on the Keynesian consumption function, taxes play the role as a source of government income that have to be paid by the household and firm sectors, whereas the Islamic economic consumption function suggests that not only are the taxes (*kharaj*) to be introduced, the element of *zakat* also plays an important role as the economic stabilizer among Muslims.

It is evident that the role of *zakat* is not only in the increase of the status of living of the Muslims, it also helps to eradicate poverty, avoid asset collection and freezing among certain groups. It also ensures the balance of the gap between the rich and the poor through the redistribution mechanism of wealth in the

society (Zulkefly A. Karim, Mohd Azlah Shah Zaidi & Hairunnizam Wahid, 2004; Patmawati Ibrahim, 2008). As such, *zakat* is able to become part of the national fiscal policy, generate the purchasing power of the society, and increase the national productivity (Hailani Muji Tahir, 2004).

For Hassan Ali (2003), poverty and income distribution are key issues to the development of developing countries. Although the eradication of poverty cannot be eliminated in total despite ongoing effort, Muhammad Syukri Salleh et. al. (2000) believe *zakat* is able to give a positive effect given the spiritual presence within the individuals.

Looking at the effort, not only is *zakat* found to be able to mitigate poverty and reduce the income gap, it also has the potential to boost the economic growth. *Zakat* is even able to lessen the burden of the people who cannot manage to settle their debts. Beyond that, *zakat* as an instrument for fiscal policy takes the most important place in the Islamic fiscal policy and operation because of its role as a natural fiscal tool provided by God and its role as a fair income distribution tool and stimulator to the national economic activity (Salama 1983 & Faridi 1983). In a study done by Zarina Kadri, Sanep Ahmad & Mohd Ali Mohd Noor (2012), the *zakat* distribution to low income groups is able to increase the demand for aggregate and boost the economic growth because the marginal propensity to consume is higher for the poor than for the rich, which will finally help expedite the status of high income countries. This enables Muslims to spend again to restore and breathe new life to the economic growth.

The theory of consumer behavior regarding the poor generally states that the poor have the higher marginal propensity to consume compared to their rich counterparts. Thus, the effect of *zakat* distribution can increase the demand for aggregate in the country through active economic activity and can finally be able to further generate the economic growth.

In terms of the aggregate demand, the *zakat* imposed on the rich people is distributed to the poor, causing the income of the rich people to take a dive and the income of the poor people to increase. This in turn increases the marginal propensity to consume and average by aggregate in the economy (Faridi, 1983).

Muhammad Fahim Khan (1984: 6) further observes that other than for urgent use, self-welfare and family use may also imply elements of savings and investment. It is only reasonable that the consumer uses part of the allocation for savings or investment for the sake of his or her future.

However, the spending between self-welfare and family and the spending for charity is placed on the consumers' rational behavior where it is influenced by the level of '*takwa*' (God-fearing attitude) (Muhammad Fahim Khan, 1984:7). In the Islamic economic scope, the consumption to fulfill these purposes is also encouraged, and Muslim consumers have the responsibility to spend for the charity and wellbeing of the society (Muhammad Fahim Khan, 1984: 3).

## Conclusion

The consumption function of the Islamic economy has several advantages compared to Keynes' theory of consumption. This is because Keynes' consumption theory clearly motivates individuals to over-consume and if the practice is continued without control it will lead to serious debt practice. The effect of this uncontrollable individual consumption will automatically lead to high debt levels, poverty issues, and imbalanced income distribution which will further stunt the national economic growth. In the case of the Islamic consumption theory, consumption at the minimal rate is seen to have a number of strengths or benefits because over-consumption will only be a form of distraction. Consumption at minimal rate seeks to safeguard the interests and wellbeing of the future generations.

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