Allocation of output to factors of production and the implicit Islamic concept of market Justice

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Contents

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Introduction

Economics of income distribution gained new grounds in the 1990s as a result of assessing the effects of the collapse of the Soviet Union and the transition of East Europe and Central Asia to a newly re-spirited market economy. The 1990s also witnessed the publication of a new specialized journal on income distribution called.

This paper aims at reviewing the theory of income distribution and its critiques and attempting to formulate an Islamic outlook or quasi theory on income distribution, especially in the light of Research and practice in the field of Islamic economic and banking over the last three decades.

The paper shall begin with a summary of the conventional theory of income distribution as conceived in the Marxist and Neo classical traditions. Section I will therefore review the Marxist theory of surplus value from the point of view of being an income distribution theory, then the neo classical marginal theory of distribution and lastly the theory of bargaining. I shall focus on the basic ideas and landmarks of these theories without going in any detailed arguments because they are very familiar in the literature. Section II shall briefly present some of the main critiques addressed to these theories from both economic and Islamic points of view and Section III will attempt to argue for an alternative theory of distribution derived from the Islamic Shari'ah and Islamic Economics. Then I will submit the Conclusion of the paper.

Finally, Since the paper focuses on relating output to the factors of its production, what is known as the functional distribution of income, I shall avoid any discussion of the redistribution of income, that is usually called the personal distribution, including the issues of basic needs and other welfare economics' subject in both the conventional and the Islamic income distribution systems.

Section I:
Conventional theories of income distribution

Marx's Income Distribution Theory

The Carl Marx theory of income distribution is generally known as the theory of exploitation because it is based on a dogmatic idea that workers are exploited by the capitalist. This theory of income distributions is derived from Marx's labor theory of value and it made the cornerstone of the now outdated international communist slogan that calls for a world workers' revolution.

Following the Recardian tradition, Marx believed that any value added is the result of labor effort exerted on the previously accumulated labor that takes the form of capital goods, or for the sake of understanding the analysis of current production is expressed in terms of intermediate goods. On the other hand, because of the structure of the capitalist market and the power of the capitalist, the latter knows that it takes the worker less than the value of the output of her labor for reproducing herself for another labor day, and by the same token another laborer when the present one expires. Hence, while the capitalist sells the output for a lucrative price, certainly valued at the amount of the worker's efforts put into it, he only pays, as wages, the amount necessary to reproduce new human-hours in replacement of the ones used up in the production process, and the capitalist obviously reaps up all the difference that Marx called the Surplus Value.

The Same argument can be expressed in terms of the labor market and the commodity market. In the labor market, labor supply is infinitely elastic, a horizontal line because there are many workers who will accept as wage rate a minimum amount that is merely sufficient for survival, i.e., only reproduction. Shifts in the supply of labor can only be caused by changes in the cost of subsistence living. On the other hand, the demand for labor by the capitalist is downward sloping, and shifts in labor demand can be caused by the amount of output the capitalist can sell in the commodity market.

While the price of labor is determined by the cost of subsistence living, the price of output is determined in the commodity market by the amount of labor used in production regardless of the shape of any commodity demand curve, because the amount of labor is the only producer, and determinant of value. The surplus value, that is the difference between the wage rate and the price of output, is grabbed by the capitalist.

Hence, while Marx built on a classical tradition of Ricardo, by arguing that labor is the only contributor to value, or the only factor of production, he did not recognize any effect on wages or prices of the demand side in either the labor market or the commodity market. For Marx, labor is the only element that has a legitimate claim on the output and any share extracted by the capitalist is simply a rip off that deserves to be eliminated and abolished. To do that, the only way is for the workers of the world to unite and revolt against the capitalist system so that they can create a Proletarian system that eliminates the capitalist and substitutes him by a totalitarian rule of the workers.

We must notice that, within the Marginalist tradition and without any revolutionary sentiments, a similar form of exploitation can take place in the case of monopsony in the labor market. While a perfect competitor firm has a fully wage-elastic derived demand for labor that the marginal productivity of labor and its average are always equal, a monopsonist is able to impose a wage rate at the level of marginal productivity while the average productivity is still higher than marginal productivity and then reaps the positive difference between average productivity of labor and its marginal productivity.

When the workers and peasants of certain parts of the world got united, revolted and created their utopia, the result was seventy years of miseries for every one, especially the peasants and workers, in addition to thirty million lives sacrificed. During the life of communism in the formerly communist countries, wages have come to be determined by a Polit-bureau or a central planning commission that was as alien to workers as the capitalist! Whence the iron curtain was torn down, the revelation came to be devastating exploitation of workers and distressing lack of respect of human rights. Even the pan internationalism slogans did not help as it was revealed that minorities in the former USSR were the most to suffer.

The Neo classical Theory of Income Distribution

While Marx recognizes only one factor of production, labor, and did not worry about explaining the returns to land, capital and entrepreneurship except that the capitalist profit is the surplus value ripped off from workers, the Neo classical theory is founded on the premises of the capitalist economy. Hence, it attempts to provide a comprehensive explanation of the whole capitalist economy and interrelations between the different variables that play within its context. Consequently, the Neo Classical theory begins with a market and a supply and demand functions for each commodity and for each factor of production. Income distribution is explained in terms of the famous marginalist analysis as the formal expression of the Neo Classical theory. This obviously requires us to search for the components of the theory of income distribution in the sub-theories of wage, profit, rent and interest.

However, the assumption of perfect competition is used to simplify the marginalist analysis as it provides it with the ability to deal with all factors of production in a similar manner through perfectly competitive supply and demand functions for each factor of production. Let us assume that all the known conditions of perfect competition are satisfied, the production function is linear and homogeneous and every body is a maximizer (this maximization behavior is necessary for the firm to find its equilibrium at the point when marginal cost equals marginal revenue, it is also necessary for the consumer and for suppliers of factors of production so that perfect competition can produce equality between price and marginal utility for consumer in the commodity market and between marginal and average productivities and the earnings of the factors of production in the factors' markets), then at equilibrium output shall exclusively be distributed to the factors of production at a price rate for each factor that equals its marginal productivity. This is known as the Euler's theorem or the add-up theorem. The argument assumes a production function of the form:[1]

$$x = f(a, b, c, \ldots),$$

in which x = f(….) is a linear and homogeneous function, and a, b, and c are competitive factors with perfect elasticity of substitution.

The conclusion of the marginalist theory is that x is determined by the equation that satisfies the condition of equality between the values of factors' marginal productivities and factor prices. At that point, the equilibrium of the competitive firm, the value of marginal productivity of each factor equals its price, and equals the factor's average productivity at the same time.

The Moral outcome of this theorem is very important: whence a factor's price equals the value of its marginal productivity, the distribution is fair and ethical, and there will be no economic profit left to the perfectly competitive firm. Moreover, the Neo Classical theory normally extends this morality by adding that any inequality in the factor price with the value of its marginal productivity must be caused by certain rigidity in the factor's market. This is especially applied to unemployment, so that whenever unemployment exists, it is always attributed to high and rigid wage rate.

The Price of Capital

While the Marginalist analysis, with all the above-mentioned loaded assumptions that we will come to later, goes on smoothly to explain the determination of the wage rate as the price of labor, it runs in difficulties in theorizing the rewards of all other factors of production, capital, land and entrepreneurship. Had the theory suffices itself with the same equality between the values of the factors' marginal productivities and applied it to all factors, Neo Classists would have kept a tradition of consistency, they would have then discussed the price of capital as per time/unit of physical capital and come up with a rental rate per unit of a presumed homogeneous capital. The same also applies of the rent of land. Instead, the Neo-Classists equate capital with security and the discussion is carried to a monetary level from a physical one. In other words, although the new classical theory argues that physical, not monetary, capital is the factor of production, it thinks of the price of capital in monetary terms, as a security, not in real terms as machines.

Although the Neo Classical capital theory is the formal and most widely acceptable explanation of the distribution to capital owners, capital and investment theory remains one of the most troublesome theories in the Neo Classical economics and one of its major problems arises from definitional matters.

[1] Bronfenbrenner, Income Distribution Theory, Aldine Atherton, Chicago and New York 1971, pp 120 - 125.

In its simplified version, the Neo Classical capital theory argues that firms demand for capital is paid for by securities and IOUs offered by the firms in exchange. While capital is assigned the normal definition of 'goods used to produce other goods and services,' the theory looks at the supply side as capital being offered by individuals against securities that produce a "certain," assured and perpetual stream of income, interest. Hence, according to the Neo Classical jargon capital and securities become the same and rent per unit of capital and interest per unit of securities become the same too.

The price of a security is obviously the present value of its income stream, i. e.,

$$p = y/r$$

This equation can be expressed as the equation of the price of capital:

$$r = y/p ,$$

which is the same as the price of securities.

Neo classical theory dismisses any differentiation between rent per unit of capital and interest rate as irrelevant. Bronfenbrenner dismisses any Zero interest rate, though "promoted in the Bible and the Qur'an" as he said, as being unreasonable because it requires an added assumption that the amount of capital be diminishing and when you apply it to money you need to add an element like "stamped money." [2]

On the other hand, the Monetarists, Neo Monetarists and Post Keynesians all converge on a point of commonality, and of common sense too! That is: interest is a monetary variable and a tool of economic policy.[3] Interest rate, or a structure of rates, equates the demand for loanable funds with their supply. That is: they bring the rate of interest back to its monetary sphere, as a monetary phenomenon that relates to funds exchanging hands and can be used by monetary authorities to influence the quantities of supply and demand of such funds as "loanable" in a given economy.

The theory of profit

The theory of profit is the most interesting theory of distribution the Neo Classical economics ever has. While Neo Classists deal with labor, capital, and land on the basis of their physical quantum and their respective physical productivity, be it marginal for the sake of input price determination, they find themselves forced to create imaginary inputs such as uncertainty, risk when they discuss entrepreneurship. Interestingly, when entrepreneurship is discussed as a factor of production, we find no more talk about marginal or average productivities; instead, there is a new and equally imaginary vocabulary such as *normal profit* and *extra normal* or monopolistic profit.

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[2] Bronfenbrenner, pp 298-315.

[3] Bronfenbrenner, pp 320-327.

The Neo Classical theory of profit begins by deviating from the accounting profit that every business and every economic agent knows. Such profit, usually called the accounting profit, becomes irrelevant to the Neo Classical theory. It jumps over it to claim that a "normal profit" is a compensation of a factor of production called entrepreneurship. This input is manifested in the form of risk and uncertainty.[4] This normal profit continues to exist under conditions of perfect competition as the normal compensation of the entrepreneurial undertaking of risk and uncertainty. The other part of profit, the extra normal profit, is a Schumpeterian profit that results from monopolistic elements introduced by the innovative effort of the entrepreneur. Monopolistic profit disappears under the long-run perfect competition conditions because the pecuniarity of information is then assumed away.

In brief, normal profit is not determined by the same equality of the values of marginal productivities, like any other factor of production, it is just there as normal as it ever can be, and with this normal profit all output becomes exhausted in distributions to the factors of production!

The Theory of Rent

The Neo classical theory of land rent is yet another imaginary product. It is based on the old classical heritage that took land as an abundant and consequently priceless gift of nature; land only gained an "economic" rent because of scarcity that is caused by metropolitan and demographic development. Hence, there is no reward to land, per se, as a factor contributing to the production process. Rather the Neo Classical theory of rent tailored it to the size of scarcity and "economic rent."

The idea of scarcity has been extended to other factors of production too, but because there is an obvious element of cost of production, or re-production with regard to labor, capital and entrepreneurship, their remunerations could not be exclusively attributed to scarcity. This led to a distinction between "normal" and "economic" portions of the reward of each of these factors of production too. We now find terminology like normal and economic wages, normal interest and normal profit; along with new definitions as those portions of compensations the factors get under perfect competition, full substitutability, and complete supply elasticity. This is in contrast with the economic portions that are the scarcity-related components of these rewards.

The Theory of Collective Bargaining

Refinement in the Neo classical theory started with the relaxation of the conditions of perfect competition. The theories of monopoly and monopolistic competition produced a new equilibrium. Hence, while the equilibrium of a monopolist still maintains equality between marginal cost and marginal revenue as well as equality between the values of marginal productivities of the different factors of production, the commodity market marks a price, i.e., average revenue, that is much higher than the marginal revenue = marginal

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[4] Bronfenbrenner, pp 367-368 as quoted from Knight.

cost point. And a firm that monopolizes its factor(s) of production markets can really affect a price of such factor(s) to go below the value of its (their) marginal productivity. The other name of a monopsonic behavior is simply exploitation.

Collective bargaining came as an off shoot of monopoly and monopolistic conditions. It was a natural development that resulted from the concentration of wealth and production and consequently demand for employment, in the hands of few. There is no doubt that unionism is heavily affected by socialist and communist view points of the world, but there is no doubt too that unionism and labor organizations came as a result of the monopsonistic behavior and exploitation, of the Western firms as monopsonic employers.

While a reaction to monopolies, the very presence of labor unions and their activities are themselves a monopolistic expression too. They speak on behalf of their members in a way that presents unionized workers as one front with one decision maker. This is a form of monopoly by agency or by proxy rather than simply a market share monopoly.

The theory of collective bargaining studies the behavior of negotiators on the bargaining table. It is an extension of the game theory where each of two parties draws its strategy with less than perfect information about the amount of power the other party has and consequently about the reaction strategy of the opponent. Fellner assumes that the union leaders are interested in two types of gains for their members, either a wage rate increase or an improvement in employment benefits and conditions. Using the marginal theory tools on a two dimensional map of wage and employment benefits, Fellner expressed the different possible solutions of collective bargaining as the points at which the different indifference curves of the union management and the curves that represent the average and marginal revenues of the firm, meet either as tangents or at intersections. He came up with eight potential solutions, four of them are in favor of each bargaining side.

An interesting point arises from the theory of collective bargaining. This is the study that traces of the incidence of a bargained agreement on non-union workers and consumers. The incidence analysis usually follows the same lines of tax incidence in a fiscal system. Several theories are offered that I will only mention without discussion because they are irrelevant to the present paper: A redistribution theory, A reallocation theory, inflation theory, illusion theory, consumption theory and productivity theory. Interesting in these theories is the argument that a phillips curve of inflation and employment may have a positive relation that features an increase in employment with the increase of wage rate, if a wage increase can positively affect labor productivity, and several reasons may be offered why such an effect might actually happened.

Section II:
Critiques of the Conventional Theory of Income Distribution

Several issues are raised with the conventional analysis of income distribution, especially the marginal theory, both on ethical grounds as well as on economic grounds. **First**, the marginalist theory overlooks the bargaining power of the firm vis a vis its labor force to the extent that it has been accused of being "antiunionist." This is especially true if we take into consideration the fact that it is too simplistic to assume the prevalence of the conditions of perfect competition in real life markets of commodities and of labor. This is emphasized in the labor market whereby the demand for labor by the firm is normally a derived one rather than direct demand. **Second**, the marginal theory equates the productivity of inputs with the productivity of their suppliers. This brings in issues related to the received distribution of wealth that affect not only the ownership of capital but also the amount of accumulated human capital that influences present factor supply both on quantitative as well as qualitative levels. **Third**, the measured productivity in the marginalist theory is productivity that accrues to the employer not to the society. The latter does not always coincide with the output derived by the firm from its factors of production. Societal productivity is emphasized in the studies of social cost/benefit analysis of new projects. For instance, when the environmental protection regulations are loose societal productivity may be much lower than the productivity to the producing firm. Similarly when the income distribution is highly skewed and the firm is involved in the production of luxury goods that use, as inputs, considerable amount of natural resources that could otherwise be used to produce goods that satisfy basic needs. **Fourth**, the marginal analysis depicts the demand side of the factors' market. It is argued that the price of the factor depends also on its supply and on the supply of other factors too. This means that complimentarity and competitiveness of factors are somehwo overlooked. **Fifth**, if we focus on the demand side of the factors' market, we are bound to loose the general picture that leads to adapting a factor's potentiality and services to the pecuniarity of demand in a given time and space. For instance, a sport star may be worthless to an African Sub-Saharan under-nutritioned society while it may be very valuable and highly paid to the American society. **Sixth**, the focus of the marginalist theory on profit maximization makes it redundant in interpreting factor prices in the public sector and in the non-profit sector. In most countries government is the largest factor user, both of labor and of capital, and the charitable sector is sizeable enough to be reckoned with. **Seventh**, there is some kind of circularity in the marginalist argument especially in the labor market, which is the cause and which is the effect? An increase in the price of labor increases labor productivity, and a rise in productivity increases wages. The question is which of them is the explanatory factor?

The ethical argument against the Marxist theory is even stronger. It begins with human rights issues, especially of the owners of the so-called previously accumulated man-hours, i. e., capital and intermediate goods. Then we have the lack of touch with reality, can production be done without capital and intermediate goods? If not, why is labor alone the producer of value? And lastly, the inadequacy and circularity of its solution, who is the Napoleon (of George Orwell's Anima Farm)?

On the other hand, The collective bargaining theory expresses a form of mutual coercion, it does not make functional use of the institutions that surround the bargaining, such as law, government, property, entitlements and existing claims, legitimization, etc. Lastly like the marginal theory the collective bargaining theory does not provide operational tools to the real life bargains.

On pure economic grounds, the argument against the marginal analysis centers on its unrealistic assumptions as well as on its definition of profit as a "rental" profit that is deviant from the accounting profit. The assumptions of linearity, homogeneity and perfect competitions are hardly realistic as real life has always been something different. This creates always a residual in the "adding up" equation of the form of:

$$x = f(a, b, c, \ldots) + u$$

The explanation given by the marginalists of this residual as being caused by other circumstances is not satisfactory. They sometimes like to sum up these circumstances as a lack of certain conditions that are presumed in the marginal theory, but this really adds up more deviation from reality.

Additionally, without denying the importance of profit as a motive that drives production and innovation there is a need to explain it under all circumstances, including normal situations, rather than making the unrealistic and unquantifiable distinction between normal and economic profits. Profit is known in accounting and to all women and men as the leftover or residual after paying all other factors of production. This profit is the one that needs explanation rather than the imaginary economic and normal profits.

Moreover, when one looks at the production function in the marginalist theory of income distribution, even after we add entrepreneurship as a fourth factor, we find some lack of homogeneity in the definitions of the different factors of production. While labor, land and capital can stand on their own as tangible factors that can be obtained, transacted and contracted in their own market separate of other factors, entrepreneurship can only be associated with one or the other of other factors. In the marginalist analysis entrepreneurship does not stand by itself on its own. It has to be associated either with capital, land or labor. Because risk and uncertainly in the final analysis can only be born by the owner of another factor of production. Even in corporate creation and merger a capital share is assigned to the entrepreneurs as if they have contributed a given amount of corporate capital paid for in kind. Henceforth, risk and uncertainly are born by the shareholders all together, whether they provided money principals or entrepreneurial capital. Even if the marginal theory intends to treat entrepreneurial skills as an independent factor of production the market structure of the marginalist creation does not accommodate a market for entrepreneurship, a market that can treat profit, all profit, as a price of this factor of production independent of other factors instead of treating it as a residual.

The serious problem that faces this imaginary analysis of profit is simple. While we have markets for land, labor and capital, where in the world there exists such a market for risk and uncertainty? Risk and uncertainty are implicit in the risk taker that may be the owner of capital, land, or entrepreneurial or non-entrepreneurial labor. Risk and uncertainty do not exist alone, simple and clear.

Furthermore, there is another aspect of unrealism in the marginal analysis, and for that reason the same applies to the Marxist theory of surplus value. It is manifested in its going back to dig in history from the beginning of creation when God created land and there were no humans on earth, then the first human came in and found the land free because there were no claims on it. All that is for the sake of arguing the case of land rent. We all know that rent is paid for land and we all know that you cannot get this natural resource free because it is no more abundant and as we do not live any more the age of the Homosapiens or Neandertals we need to worry only about rent that is paid in our age. We don't need to argue that the Homosapiens did not pay rent, who knows? Probably they did! Hence the whole argument for "economic" rent becomes irrelevant to us and to our societies and economies.

Rent is simply paid because land is needed for production; it needed exactly as we need labor and machines. By the same token, labor is not the only value producer because we know for sure that for any production process we nee capital and land in addition to labor.

Finally, it seems that the most outrageous deviation from reality is that we find in the Neo-Classical interpretation of interest: *As firms demand capital goods, they pay for them with IOU's and securities. Therefore the price of securities is the price of capital.* Can't this be extended to other factors of production too since land, labor and entrepreneurship can also be paid by IOU's and securities? And they actually are paid by IOU's and securities more often than we usually think. Would interest be then the price of these factors too?! How about the non-bonds securities that represent a share in the ownership of the firm and get dividends instead of interest? And how if capital is paid for with money the same way, we argue, labor is paid? Lastly how about if capital is leased for a rent per machine unit, assuming it is homogeneous as we usually assume labor to be homogeneous? Interest is a monetary phenomenon that can be understood in the light of demand and supply of loanable funds as the monetarists emphasize and there is a need to break the circle of old jargon that equates rent per machine with interest per unit of loan! There certainly is a need for a better theory of explaining both the reward of capital as a factor of production and the phenomenon of interest as a cost or a charge of loans. This is what I will try to do in Section III, but before we reach Section III we need to have a quick look at the Institutionalist criticism of the Neo classical theory of income distribution.

Institutional economists usually argue that the marginalist approach to income distribution lacks the main factor that determines the functional distribution of income, that is the institutions that create the market itself, set up its framework and work out the relationships within it. It is the institutions that in reality determine factor productivities and the values of the marginal products.

Furthermore, the marginal productivity theory, Institutional economists argue, can explain factor rewards at equilibrium only that is when marginal revenue equals the marginal cost for the firm. But the marginal theory cannot go beyond equilibrium in its explanation of wages and interest. This makes it trivial and deviant from real life. Are workers given, in reality, the value of their marginal products, no more and no less? What explains the differences between wage earnings? And how incremental wages are allocated? All these and similar questions cannot be answered by the marginal theory. Additionally, the marginal theory is so abstract from reality to the extent that it cannot be operationalized under all and any circumstances.[5]

Institutional economists also argue that any set of income distribution at time t is itself an outcome not only of the output of time t but of the claims that already exist on the output of time t. Hence, to understand income distribution at any period of time we need to study the entitlements or the rights to make legitimate claims. Entitlements are a function of law and of the distribution of power in a given society. Every society has its own "regularized arrangements" for establishing legitimate claims. There are formal entitlements such as property rights and tenured jobs and informal entitlements such as the entitlements that exist in the informal sector in developing countries. Each economic paradigm has its own system of formal and informal entitlements that allow its members to have claims or legitimate accesses to acquire shares of output. Finally, the entitlements system determines the acquirement not only with regard to functional distribution but also with regard to personal distribution of income.[6]

Section III:
The Islamic Approach to Income Distribution

> "What then is the right course as regards the distribution of income? There can be no fixed rule, no acceptable multiple as between what is received by the rich and what goes to the poor. Or indeed, as between what is earned by management at the top and what is earned on the shop floor. The basic character of the system is here involved. It does not lend itself to arbitrary rules. What is necessary are strong ameliorating actions that reflect and address the inherent and damaging inequality."[7]

The Islamic Approach to income distribution is comprehensive, detailed and realistic. It is **comprehensive** because it begins from an earlier

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[5] Warren J. Samuels, "an Institutionalist Approach to Income distribution" in The economics of Income distribution, edited by Joep T. J. M. Van der Linden and Andre J. C. Manders, Edward Elgar Publishing, Northampton, MA, USA 1999.

[6] Bas de Caay Fortman, "Beyond Income Distribution: An Entitlement Systems Approach to the Acquirement Problem" in The economics of Income distribution.

[7] John Kenneth Galbraith, The good society, Houghton Mifflin company, Boston 1996, p. 63.

point of distribution, distribution of wealth and human rights. It's **detailed** because it deals with every aspect of income distribution on its own merit and for its own sake. And it is **realistic** because: first, it takes the actual market as it is without any previous presumption about its development; second, it looks at the variables and market forces as they are without "fantasizing" them with psychological variables; and third because it recognizes the limitedness of the market in producing a "desired" income distribution and consequently it leaves a good-size room for institutionalized personal distribution or redistribution and for government intervention as well.

Distribution of Wealth

Property rights

Let us take it from the beginning. The late Baqer al Sadr argued that the Islamic approach to the functional distribution of income begins from the distribution of the means of production, wealth. This he called "the distribution before production."[8] The basic set of distributive rules of wealth is given in the form of a legal framework known as Shari'ah or Islamic Law. These rules can be summarized in the following:

While property rights make a cornerstone of the Islamic legal system, its basic definition is not the same as we find in the Western legal systems. Ownership in Shari'ah is a grant from God, to all members of the human race, to societies, and to individual persons. God created the earth and the universe and made them subject to the human race; societies are given large segment of natural resources within their boundaries; and individuals are given, by God too, personal property rights over owned land and other items. It is very important to notice that according to Shari'ah the right to personal ownership is granted by God, not by societies nor through the society.[9] The implication of this distinction is obvious. While some legal systems consider personal property rights as a gift from societies, The Shari'ah takes them as a gift from God protected by the sources of Shari'ah, i. e., the Qur'an and the Sunnah that make the de facto constitution of the Islamic System and Society. In other words, personal property rights are regulated and protected by the Shari'ah, as a law derived from the Qur'an and the Sunnah, rather than by man-made laws. Additionally, since the right to personal property is God-given and God regulated, it is limited to the life span of individuals. Consequently, whence a person expires God redistributes the estate, not government nor the deceased through an after-death action as manifested in a personal last will. This understanding of personal property makes the foundation of the Islamic inheritance system that will be mentioned soon.

Furthermore, personal property rights are also limited in their scope. There are items that the Shari'ah left to be owned solely by the society, either on community basis or as being represented by its government. Hence, in

[8] Muhammad Baqir al Sadr, Iqtisaduna, Dar al Fikr Publishing, Beirut, Lebanon 1961, V. II.

[9] Abd al Salam al 'Abbadi, Al Milkiyyah fi al Shari'ah al Islamiyyah, 1974.

addition to personal ownership The Shari'ah institutes two kinds of public ownership: social community ownership and government public ownership. Social community properties cover water, non-privately-owned grazing land and natural forests that are close to villages and towns. Government public properties include underground and aboveground minerals whether they are in public or private land, energy sources, big water streams and open land.[10]

In conclusion, private properties are not restricted in Shari'ah to personal and consumer goods. They cover land, capital goods and means of production and the ownership rights allot huge amount of authority of disposition and decision making to the private owners, a point that led certain writers to view the Islamic economic system as a sort of "Islamic capitalism." I believe that this classification is incorrect although the basic idea of a market with free play of its forces is common to both the Islamic economic system and the Capitalist system. However, because of differences in the definition and the scope of private property, the existence, in the Islamic economic system, of a substantial role - supported by substantial amount of resources as public property - assigned to the government, its emphasis, both moral and economic, on the inadequacy of market to achieve desired objectives of equity, efficiency and growth that characterizes the Islamic system with the existence of an inherent redistribution mechanism in the form of establishing a sizable third sector, and finally its intrinsic interrelations and interaction between the moral values, legal rules and economic behavior, the Islamic economic system is, in my opinion, significantly different from the Capitalist system.

Land Ownership

Although land ownership is generally covered under the principles mention in the previous sub-section, I feel it is rather important to dwell on it separately because there is a lot of discussion on this subject in the literature, both Islamic and Classical, in addition to its significance as a determinant of rent in the income distribution theory.

According to Shari'ah, Land can be owned privately, it can contribute in the production process on the basis of fixed return contracts of rent/lease or on the basis of crop sharing with the farming agent or the business firm. There is, among the Islamists, certain lyrics on prohibition against renting land, but non of these opinions are supported in the Shari'ah and the position of all

[10] It is worth mentioning that there is a fourth kind of ownership, the endowment or Awqaf. Awqaf (singular Waqf) are properties donated and designated by private owners for the use of non-profit institutions. The Shari'ah gives special attention to the activities of the third non-profit sector and properties assigned as infrastructure and revenue sources for this sector are owned by no personal entity including the entities of the third sector itself. Such endowments are considered 'as if they are owned by God.' The reason I did not include them in the text is because, according to Shari'ah, Awqaf properties come from the private sector. Individuals can create Awqaf that become owned by no body, but assigned to the benefit of a third sector entity.

schools of jurisprudence is on supporting the permissibility of both land renting and crop sharing.[11]

On the basis of a historical approach that goes back to the moment a society was established, the Shari'ah divides land in a country into four categories as follows:[12]

1. Privately owned land: lands inherited, purchased, bequeathed, reclaimed and revivicated, etc. this category of land remains in the private sector unless willfully given as endowment (Awqaf);
2. Community/society public property land: It covers all lands used by a village/town communities for the common use of people such as non-privately owned grazing land and natural forests located in the neighborhood of villages and towns, public parks designated for community ventilation and recreation, etc. If a land in this category turns no more needed for community purposes it is transferred into category No. 3;
3. Government owned land: lands assigned for use of government facilities and projects. They come through purchase, abandoned lands of category No.2 or appropriation form category No. 4;
4. Plain land: This category covers un-owned lands of mountains, valleys, deserts, natural forests and grazing lands not related to category No. 2. This land is under the general overall control of the government but not exactly owned by the government.

On this fourth category of land, the Shari'ah establishes two very important segments of land ownership laws. One: any person can claim ownership by "bringing life into a piece of plain land." This is what is called "the law of reclamation/revivication." It is a way to gain private claim of ownership on a lot of land, it may be regulated by the government but this is a right given to the citizenry of a county that Shari'ah does not authorize any government to abolish; and two: Mere reservation of a plain land by any person, other than the government for public use, does not generate a right of ownership.

Inheritance

The bulk of the Islamic inheritance system is given in the Qur'an to its very minute details. Its essential characteristics are: 1) It distributes wealth to several persons in a way that makes of it a long term legal process of continuous fragmentation of large wealth and an anti-wealth-concentration mechanism. 2) it is obligatory that individuals and governments both have no right to change any part of it. 3) it can be explained or rationalized on the

[11] All the restrictions mentioned by the Fuqaha (Shari'ah scholars) center around contracts that contain certain vagueness, imbalance between obligations and rights, and conditions that may turn impossible to deliver. I don't think we need examples of such restrictions because they are known in the literature.

[12] Islamic writers usually tend to qualify a society by "Islamic." This is true because Shari'ah only applies to an Islamic society. But a careful look at the rules themselves indicates that they rally apply to any society.

grounds of assigning the estates to close relatives, especially children, parents and spouses with consideration of an heir's financial responsibility toward others in his/her family as stipulated in the Shari'ah family laws.

Distribution of Output to the Factors of Production

Factors of Production

This is what al Sadr called " distribution after production." As the Shari'ah looks at the actual things as they are in the market without fantasizing on them or tracing their anthropological roots, it recognizes at least all four factors of production discussed in the conventional economic theory. Land, capital, and labor are clearly mentioned in most Shari'ah texts that relate to contractual productive relationships such as contracts to establish partnerships and companies and Ijarah (lease/rent/hire) contract.[13] But when we study the Shari'ah literature's chapters on Mudharabah and Muzar'ah, that translate as partnerships between owners of capital or land respectively and risk-taking managerial labor, we notice that the Shari'ah in fact distinguishes between two kinds of labor: 1) Skilled or unskilled shop floor and/or managerial labor. This kind of labor can only be hired for an agreed reward, and it carries no risk of the production process. And, 2) Risk-taking managerial executive labor. This kind of labor can only be contracted on risk-taking basis, that is, on the basis of distributing the residual of a production process between owner of capital or land and risk-taking management. According to the Shari'ah literature, this second kind of labor can also be the sole owner of a productive enterprise, in such a case risk-taking management may contract land, capital and shop floor labor on Ijarah (hiring) basis, i. e., on the basis of pre-fixed rewards. Capital is defined in the context of production, in the same lines it is defined in the conventional economics' text books, as goods used to produce other goods and services.

A few early Islamic economics' writers may be understood as arguing for a labor-based value theory and as thinking of capital as merely accumulated or stored labor. For instance, Abu Sa'ud defined capital as a stored labor embodied in a commodity that is used to produce other commodities.[14] This is sometimes confusingly derived from an attempt to deny any role for capital in order to justify the prohibition of interest in Shari'ah.[15] This line of thinking goes as follows: If the price of capital, interest, is not recognized in Shari'ah, then capital must be of no contribution to production, and what we see as machines and equipment is only accumulated labor! Al Sadr seems to support this line of thinking too, because he argued that only

[13] The issues of rent, lease and hire are discussed under one title, the chapter of Ijarah, in all Islamic jurisprudence literature. This chapter normally covers long-term and short-term renting/leasing of land and machines, and per-piece or per-time unit hiring of labor.

[14] Mahmud Abu Sa'ud, Khutut Ra'isiyyah fi al Iqtisad al Islami, Matba'at Ma'tuq Ikhwan Publication, Beirut 1965, p. 55.

[15] M. A. Mannan, Islamic Economics, Ashraf Publications, Karachi 1970, p. 126.

labor can extract utility/ productivity from natural resources.[16] Fortunately, a closer look at these writings indicates that they did not expand on this argument in the direction of the Marxist theory of distribution, instead they kept their labor value theory at an anthropological non-operational level and when it comes the distribution of output, they reverted to an exchange theory of value that includes on the one hand cost elements that affect the supply function and these elements include the cost of land, capital and labor; and demand elements that affect the demand function and these include, consumer preferences and size of population etc. Al Sadr adds in the supply side a value for the gift of natural resources bestowed By the Creator/Nourisher on women and men.[17]

In conclusion, from an operational and factual point of view, there are four factors of production: labor, land, capital and risk taking managerial executive labor.

Rewards of the Factors of Production

Now, since the Shari'ah does not deal with pure abstracts, the owners of these factors of production are all what matters. As production projects incorporate certain risk, there ought to be in any enterprise at least one risk taker. Shari'ah accommodates the principle that any of the owners of land, capital and managerial labor may enter a production process on the basis of contractual fixed income or on the basis risk taking; and if the owners of more than one factor want to contribute on the basis of risk taking they have to agree on a fixed risk sharing ratio. It must be pointed out that none of these three factors is permitted to exist in an enterprise on both bases together, that is to receive a fixed contractual reward and at the same time shares the risks of the enterprise. The Argument given in Shari'ah is that such a double-based relationship may lead to eliminating one another under certain circumstance, e. g., the case when profit after deducting the fixed reward turns out to be less than that fixed reward given to one of the two risk-sharing factors of production. Thus making the fixed earning factor a non-sharer of risk. Non-managerial labor, however, can only contribute to production on the basis of contracted fixed reward.[18]

At this point, let us call the risk taker in a production process "the owner of the enterprise." The owner of the enterprise can be either of the owner of managerial labor, capital or land or any combination of these three factors. Let us also call the reward of the owner of the enterprise profit and define it as the residual after paying the compensations of all rented/hired factors of production. If the owner of the enterprise is at the same time an owner of capital, she hires/rents the other three factors and she takes all the profit, that of course may be positive or negative. She also carries all the risks of the enterprise keeping in mind that risk is nothing more than the probability of

[16] Muhammad Baqir al Sadr, Iqtisaduna, Dar al Fikr Publishing, Beirut 1968, p. 573.

[17] See Abu Sa'ud, al Sadr and Mannan, op. cit. and following pages.

[18] If a laborer wants to enter a production process on the basis of risk taking,, she/he must have a role in decision making as risk bearing must be related to authority. Hence it becomes a "managerial risk taking labor" by definition.

having negative profit.. By the same token, if the enterprise owner consists of owners of more that one factor of production, they must have a sharing contract between themselves in addition to rent/hire contracts between the owner of the enterprise and the owners of fixed-reward factors.

Let us simplify the case by assuming that only one sharing contract is signed between managerial labor and capital owner. The sharing contract is negotiated in a special market that determines a distribution ratio of the realized factual profit that will be distributed to the owner of capital and the owner of managerial labor at the end of each accounting period or at the end of the enterprise. This sharing contract does not set a price as known in the rent/hire factors' markets. The assumption of perfect elasticity of factor substitution helps us analyze this market.

At a given amount of risk-taking managerial labor a high ratio is associated with relative scarcity of capital and a low ratio is associated with capital abundance. This provides for a downward sloping to the right demand for capital. The supply of risk-sharing capital can easily be explained as an increasing function of the capital-sharing ratio. However, there is a point on this curve where capital owners will cease offering their capital on risk basis because after that point it becomes better for them to give it on rental basis. That point is where the rental per machine plus the risk premium equals the profit sharing ratio multiplied by the amount of expected profit. That is the point of indifference of capital owners between giving capital on profit sharing basis or on rental basis.

Because the total of the ratio determined in the risk-sharing capital market and the ratio of profit sharing of risk-sharing managerial labor equals unity, we can think of the market of the risk-taking managerial labor as the other side of the coin of the risk sharing capital market. In fact they are only one market because once r is determined 1-r becomes known. By applying the same argument to the risk-sharing managerial labor, we notice that an increase in the supply of this labor increases r and a decline in this labor reduces r.

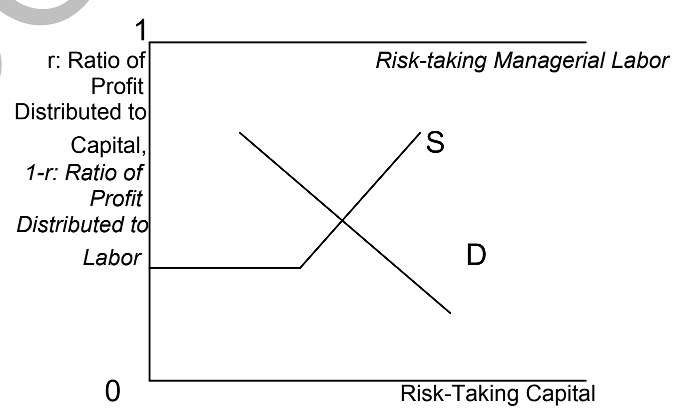

Figure 1

Figure 1 can be perceived as representing the market of risk-taking capital in which r, the ratio of the residual distributed to capital is determined. By the same token, it can also represent the market of managerial labor whereby the supply and demand schedules refer to the supply of and demand for managerial labor and 1-r depicts the market-determined share of profit distributed to the managerial labor.

Two observations are due at this point: 1) The market of profit-sharing capital, by determining a ratio instead of a price, allows to subject both risk-taking capital and risk-taking managerial labor to market forces. Consequently while the profit itself, i. e., the reward of the owner of the enterprise, is a residual or a left over after other factors are rewarded on the basis of prices determined in their respective markets, the profit sharing approach creates an intrinsic market-based mechanism to determine the shares of each of risk-taking capital and risk-taking managerial labor. 2) The ratios of profit distribution between risk-taking factors of production always have floors that are indicated by the horizontal segment of the supply curve. These floors represent the always-available rentals that can be obtained in the rent/hire markets of the same factors had they chosen to go on the basis of pre-fixed reward of hiring contract. Naturally, factor owners do not have the same degree of risk taking/averting. Risk-averter factor owners will always tend to go to the hire/rent markets of their factors. Therefore the hire/rent factor markets always exist and produce factor rental prices that serve as norms towards which the equilibrium profit sharing ratios tend to move.

Land rent, capital goods rental and labor wage are all determined in the hire/rent factor markets. If we take for a moment the whole set of the Neo Classical Marginal theory assumptions, we may conclude that under such assumptions, and within the Islamic-institutions-determined inherited distribution of wealth and production capabilities, and within the legal framework stipulated in the Shari'ah, output will be exhausted in distributions to the owners of land, labor, capital and the enterprise. This is in fact a mere tautology because the share distributed to the owner of the enterprise is simply the residual. In other words, as long as profit is treated as residual, and it is in fact residual, the Euler's or Add-up theorem always holds as a tautology. As we knew it in the marginalist theory, this residual is the difference between market-determined revenues and market-determined fixed cost of the other three factors of production. While running its analysis in real physical terms, as we did until this moment with the Islamic approach, the Neo Classical theory makes a quick jump from physical capital to monetary capital by substituting securities, only in the form of interest earning bonds, for physical capital. This turns the entrepreneur into a lord of capitalism, as he is the one who negotiates with consumers on one hand and with other factors owners on the other hand and comes up with the difference for himself with no body subjecting his residual itself to market forces. In the Islamic theory of income distribution, the distribution of this residual is made subject to market forces by introducing the risk-sharing concept as we've seen above.

Interestingly, the distinction between economic and normal profits, economic and normal land rent, economic and normal machine rentals and economic and normal wages becomes irrelevant to the Islamic approach to income distribution except from the point of view of the exercise of an exploitative monopolistic power. This is because the Islamic framework, as defined by the Shari'ah, focuses of the present reality and pays little attention to definitional fantasies that digress from it or cannot be substantiated on its ground. By the same token, the origin of value and origin of rent and accumulation or storage of labor have little to offer in explaining interrelations in today's economies, they are consequently irrelevant to the Islamic approach to income distribution.

On the other hand, there are several Sayings of the Prophet Muhammad, pbuh, that pronounce a prohibition against monopolies, and monopolistic practices. The Shari'ah despises monopoly and the exercise of monopolistic powers in both the commodity markets and the factors markets. If for any reason monopolistic practices exist, The Shari'ah calls on the government to interfere to dismantle monopolies and/or impose fines and pricing.

Prohibition of Interest

Until this moment, the Islamic approach to income distribution is discussed in physical terms. We are now ready to introduce money, credit and securities.

There is no doubt that Riba is prohibited. This is a matter of Unanimous agreement between all Muslim scholars. Although there is a minority that does not equate Riba with the interest of the banking system, an overwhelming Majority Muslim scholars and masses go along with the simplest definition of Riba that it is any increment conditioned in a loan contract. This definition is in fact implied in Verse 2: 279 that translates as follows: "**if ye repent, ye shall have your principals; neither shall you make (the debtor) suffer injustice (loss), nor shall you be made to suffer injustice (loss).**"

Does the ban on interest abolish money or credit or both? The answer is: No. Islamic banks came into existence on the basis of "no interest." They are multiplying in size and assets over the years and they provide financing and credit. Also, money has existed in the Muslim societies since the time of the Prophet, pbuh. Interest is the price of neither money nor capital. This is in spite of the teaching of conventional intermediate economics. Capital, as a physical factor of production is priced at rental per machine, assuming homogeneity the same way we assume it for labor; and the demand for capital is essentially driven by the demand for output produced in enterprises that use the machines and equipment. The presumed relationship between capital and financing is derived from a hastened substitution between capital and securities.

Venture capital, in money form, is poured in enterprises as risk-taking capital. Its owner remains the owner of the enterprise, solely or on sharing basis. Although this ownership is represented in venture securities, it actually belongs to and rests on the enterprise, itself, as the security is a mere representative or certificate of ownership. The Shari'ah holds to this reality and carries it to its fullest extent. The profit is deserved on the basis of owning the enterprise to the owners of the enterprise, of which the security is a mere representative, On its own, the security is only a piece of paper or a record on books and its ownership means nothing other than representing the ownership of the enterprise; and any and all transactions effected on a security are legitimized, justified and always measured to the extent of the real physical properties the security represents, i. e., the enterprise. This is the reason why financial ownership in the Shari'ah is always judged by the real things it represents. On its own, the security deserves no distribution at all, profit or otherwise. Profits procured by risk-taking capital owners, in terms of both dividends and capital gains, are related to the value of the enterprise and its output rather than to interest rate.

In conventional economies, non-risk-taking money is provided to enterprises for interest as a price of lending. Securities obtained take the form of indebtedness, IOU's. This financing is substituted in the Islamic economic system by commodity/service–bound monetary financing against a price that is marked-up over the cash price. Although markup looks similar to interest, it avoids the "monetary spill over" interest has. This is because markup does not make room for three kinds of transactions that add up to make the majority of interest-based financial assets' transactions: 1) Markup does not accommodate increasing the amount of a debt in case of rescheduling its payment to a farther maturity date; 2) It does not accommodate discounting debts and consequently the bulk of wholesale financing; and 3) it puts a ceiling to financing, the value of the quantity exchanged. This, obviously, also means denying the provision of credit facilities to all other purposes except commodity/services transactions. In other words, while the markup is a real phenomenon intrinsic to commodities/services market valuation, interest is a financial phenomenon that is very often expressed as a pure monetary transaction. Interest is the price of waiting in a loan, flat, plain and simple. Shari'ah seems to take the position that unless the modality of financing is changed and restructured in the form of a pure sale contract, interest will inevitably intermingle with markup. Consequently, Commodity-bound financing is defined according to Shari'ah only in the folds of sale transactions, i. e., Murabahah and Ijarah contracts that are sale contracts of goods and services respectively. The immediate result is that Islamic banks are traders specialized in buying cash and selling deferred.

The Role of Money

No body doubts that the invention of money was a blessing, because it saved the humanity huge resources that are needed to perform transactions in a barter economy. This service is made possible by the general acceptance of money as a medium of exchange. Even at the micro level of the firm money, as real balances, is also needed to smooth and perform transactions. Hence, it is not easy to claim that money is not useful. However, if we take a closer look at the services rendered by real balances we notice that they are not a contribution to production but rather a reduction of obstacles that hinder it. We can imagine a firm that needs zero real balances, if it has perfect planning in terms of quantities and timing of all inputs and outputs and their financial obligations. That is why writers on Islamic economics maintain that "Money in Islam is a non-income generating claim of real assets."[19]

In the chapters on Zakah in the Fiqh literature one always find Muslim scholars emphatically arguing that money is "potentially" a generator of income. A simplistic reader may be quick to refute such statements on the ground that the prohibition of interest abolishes any possibility that money may generate income. A close investigation of the Fiqh discussion on this "potentiality" reveals that for Shari'ah scholars it means that money may be "turned" into real assets that may again be turned into larger sums of money.[20] Implicit in this explanation is an important principle: the ownership of physical assets money is turned into remains in the hands of the owner of the initial money used to buy them. This ownership of the physical assets establishes a legitimate claim on the market value of physical assets; in financing, this larger sum equals principal plus its markup. It must be kept in mind that an I B operates, in a way, as a trading firm that buys goods and sells them for profit.

Islamic banks mobilize funds through their deposit schemes. Let us for a moment hang on to the scheme that allows depositors to receive income. In the I B jargon, it is called investment or Mudarabah scheme. The Shari'ah foundation of this scheme is that depositors give the I B a power of attorney to buy commodities, on behalf of the funds' owners, and resell them at marked-up deferred prices. While the ownership of these commodities, along with any associated intrinsic risks, continues to rest in the hands of depositors, the I B, as an agent takes a contractual percentage of the stake. Thus, money is effecting or realizing its potentiality without the existence of interest. Let us note here that the contract used for these investment deposits is the same as in the case of risk-sharing capital.

Should money be distributed a portion of the output? The question itself seems inconsistent not only with the Islamic approach to income distribution but also with the Neo Classical theory. In the Neo Classical theory, money is not one of the factors of production and both the ethics and the economics of the Euler's theorem prevents giving any portion of the output to other than the factors of production. In the Islamic approach, while money does not share any contribution to production it acts through the two principles of "continuation of ownership" and "turn over" as a risk-taking factor of production. Once funds are used for the purchase/hire of land, labor and/or capital, the owner of money becomes owner of these factors purchased with her money. In the Islamic system, these two principles create a claim or an entitlement to the owner of money on factors that actually contribute to the production process and consequently a claim on the output. This claim is measured only by the actually realized output produced by use of the physical

[19] Ahmad H. Mustafa and Hossein G. Askari, " Economic Implications of Land Ownership and Land Cultivation in Islam," in Munawar Iqbal ed. Distributive Justice and Need Fulfillment in an Islamic Economy, International Institute of Islamic Economics, International Islamic University, Islamabad, Pakistan, no date. It is partial Proceedings of the Second International Conference on Islamic Economics, Islamabad, March, 19-23 1983.

[20] This is called in Islamic Jurisprudence (Fiqh) al Taqlib. It means "turn over"

inputs the money owner has come to own. From the point of view of the legality of the Shari'ah, it doesn't really matter whether a market-forces-motivated contract distributes physical output or it distributes the value of this output after selling it in the market.

In contrast, should the money owner give it on loan basis, the lending contract creates a claim to the owner of money on the person of the borrower, not on the assets the borrower might hold for use in production. Liability is an abstract inter-personal matter not a production input. Although the borrower may have used borrowed money to buy factors of production she alone is the owner of what she bought. Consequently, the borrower/owner of factors of production gains an entitlement to the output while she owes a liability to the lender.

The Islamic approach to income distribution does not welcome, within the framework of the Islamic system, a market for loanable funds nor a market for debts/debts exchange as both markets are interest based.

Finally, to complete our discussion of the role of money we need to say a few words about the Islamic alternative to money markets in the Islamic economic system, i. e., the Islamic finance market. The players in this market are the Islamic banks that deal with investment depositors on one hand and with owners of enterprises on the other hand. As agents of depositors the I B's trade commodities/ services through time and make profit from the price/time differential, the markup. They collect the funds they use in their financing operations from risk-taking owners of money. The markup market, with its corollary the Mudarabah deposits market, creates for monetary assets a situation similar to the situation we've seen in physical capital, characterized by the side-by-side co-existence of two markets for financing each one of them provides an "opportunity price" for the other. The markup market that is characterized by minimum-risk establishes a norm around which the alternative risk-taking usage of monetary assets always move, with the risk premiums taken into consideration. There is an important difference between loanable funds market and Islamic finance market because the principles of "continuation of ownership" and "turn over" do not afford eliminating all risk, risks that are particularly intrinsic to ownership of physical commodities. The only risk-free transformation of monetary assets is to exchange them for secured debts and this substitution deprives them from earning any income.

Conclusion

I attempted to run quickly and very briefly through the theories of functional income distribution and to present the Islamic approach. We discussed the Marxist theory of labor exploitation and the Neo Classical marginal theory. Although both theories are market based, each one of them, on its own side of the human spectrum, has received both in the literature and in real human societies ethical and moral loads and connotations. I also gave a highlights of the collective bargaining theory. With even more brief synopsis-type abridgment I went through some of the criticisms of these theories. Then, I went on to summarily explain the Islamic approach to functional income distribution, which I don't call a theory because it is still in a formative stage as only a few writers pay sufficient attention to this branch of the Islamic economic study.

I pointed out that the Islamic approach to the distribution of output to its factors of production begins from the distribution of wealth and property rights. Although the Islamic economic system is market based like the Neo classical system, it does not attribute any moral merit to the distribution effected by market forces. In fact the Islamic economic system begins from a point that implicitly recognizes the deficiency of market plays and their outcome since it assigns the government a big segment of the economy and institutes re-distributive mechanisms to bring the functional distribution in line with the objective of human rights to basic needs' fulfillment and to social, economic and political equity. Equity-oriented mechanisms of functional distribution begin from the pre-production distribution of wealth through personal/public property rights, inheritance and the role assigned to the government to play in production and employment.

The functional distribution of income, within the above mentioned institutional framework runs through the market and its forces. Interest is prohibited on equity grounds. The argument for its prohibition relies simply on the principle of balance of contractual obligations as an interest-based loan exchange an amount of money – the interest – for an imaginary utility – the utility of real balances. With the prohibition of interest functional market income distribution falls back on the physical output.

Money poured in productive enterprises is certainly not a factor of production and as such does not deserve any distribution in the process of the functional distribution of income. However, with the help of the principles of "continuation of ownership" and "turn over, " money, as a claim on assets, that contribute to enterprises on risk-taking basis gets the share the real factors of production money is transformed into; and by virtue of the Turn over principle money can be used in sale-based financing and share in the profit generated by the price/time differential, the mark up. Hence, the ban on interest does not do away with a market for financing. In this market, a floor rate of return is set up for the investment of money in the least risky transactions, while the ban on interest removes loaned assets from the list of recipients of the functional distribution of income.

Finally, the realistic characteristic of the Shari'ah implies that while market is recognized as the place for the determination of factor prices on consensual basis, cases in which market forced do not play fairly or the scope of market functioning becomes narrowed and limited are also recognized. Both issues call for interference with the market functioning and adjustment of its outcome. This means that ideas such as collective and mediated bargaining, minimum wage legislations, market arbitration by experts, discriminatory utilization of fiscal and monetary policies and other policy tools of indirect interference and finally occasional government direct determination of certain prices of commodities and/or factors are accommodated in the Shari'ah.

Additionally, the Shari'ah provides for a wide range of equity-oriented adjustment of the functional distribution through the functions of the Zakah and of the third sector that is based on Awqaf and voluntary donations and contributions, in addition to the legal redistribution institutionalized by the Islamic family and neighborhood laws and Morales.

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