*J.KAU: Islamic Econ.*, **Vol. 8**, pp. 41-48 (1416 A.H. / 1996 A.D.)

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*Distribution in Macroeconomic Framework: An Islamic Perspective*

The International Institute of Islamic Economics,
International Islamic University,
Islamabad, 1988, pp. I-XII + 1- 231.

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This book has resulted from a conference on Islamic Economics held at the Institute of Islamic Economics, Islamabad, the underlying theme of which was a study in income distribution. This is the second volume, the first already published under the title: *Distributive Justice and Need Fulfillment in an Islamic Economy* (also published by the Institute). Hence, some important aspects of the discussion are not to be assumed to have been neglected as one reads just this volume.

Some 155 scholars from 19 countries participated in this conference. It was a serious effort made by the Institute towards discovering what Islam has to offer on this fundamental subject. Moreover, the subject was not treated as a matter for rhetorics of the faithful, but that for an economic treatise by those who not only know the depth of Islam as only the believers could, but also economics as a scientific discipline. It is very refreshing to read discussions on the fundamental concepts in relation to different civilizations, even if at times one might not agree with their proponents. In this sense, the value of this book is enormous and, of course, not restricted to Muslims only.

The Quran which is the fundamental source of Islamic economics, claims that it is a complete guidance to human problems and that it would be understood more as knowledge increased. This book is a testimony to the Quranic claim made in the early part of the seventh century of the Christian era. The economic scholars -certainly those who have contributed to this book - become imbued with enthusiasm when they discover that the Quran opens up a further horizon of thinking and exploration from where they stand with their current knowledge of theory and reality derived from a different source altogether. Unfortunately, there is a side effect to this. When they see a light, they do not always give the restraint and care required for widening the focus, despite their familiarity with the scientific discipline. We find, for example, that often they compare the Quranic concepts and constructs with those in the current economic thinking in order to stress upon their significance and perhaps even their superiority. But in their enthusiasm to tell their discovery, many of these remain insufficiently or sometimes erroneously explained. In this book there are several such situations and therefore it would take too much space and diversion to try to correct or explain all of them here. In any event, the reader should appreciate the prolegomenous nature of the contributions in the fundamental direction of thinking and be not diverted from it by temporary technical irritations. The editor of the book, however, in realizing this problem, has included discussions and comments of a number of participants. The readers will be less troubled if they also read them carefully.

The editor has interestingly divided the book into four main chapters

[1] Macro Consumption Function in an Islamic Framework;
[2] Labour and Capital Concepts in Islamic Economics;
[3] A Macromodel of Distribution in an Islamic Economy; and
[4] Towards an Islamic Macromodel of Distribution: A Comparative Approach.

In the chapter on macro consumption function, M. Fahim Khan points out that the Quranic guidance is of two related types: (1) on individual value-system and character building, and (2) on establishment of a framework for an economic system and analysis. Unlike what economists do, the Quran does not leave the desired behavior to the competitive system alone. For example, a guidance to the consumer for spending is (Quran 17:29; 25:67): "Make not thy hand tied (like niggard's) to thy neck, nor stretch it forth to its utmost reach; so that you become blameworthy and destitute ... but hold a just (balance) between those (extremes)." There is a number of deep and quality guidance on the individual behavior. Khan has tried to incorporate some of them in the "utility" constructions which he then uses to discuss consumer decisions regarding expenditures on consumption and charity. Much more systematic work is still required here. There is also some confusion regarding zakah which is a levy and therefore its initial impact is on reducing total income to disposable income. Khan does not make use of this for his analysis with utility, although later in discussing the aggregate consumption function he does. Charity, of course, is different: the consumer has a choice. Khan puts much effort in analyzing this. He makes two significant points. In Islam, charity is an act of worship, and not just that of al truism. Secondly, it presents much more than just a marginal choice that can be substantially ignored in analyzing consumer behavior. Hence, the analysis of charitable behavior presents a considerable challenge to Islamic economists. Unfortunately, not much help is available from economic literature. Whatever little there is, it concentrates on compassion and altruism, and not as an act of worship. Khan has given a very interesting introduction by developing a concept of "God-consciousness". Also, the Quranic guidance on decision-making in the practice of charities is explicit; see, for example, Surah 2:219; 2:261-74. The further effort should therefore be to incorporate this guidance more thoroughly into the analysis.

The concept of utility is not extended by Khan to the macro level, where it be comes the usual Keynesian consumption function, but with a significant difference. In recognition of the transfer of income, in particular through zakah, from the higher income group to the lower income group. Khan divides the aggregate consumption function into two types in order to be able to show the impact on consumption, saving and growth. His one interesting even though a tentative conclusion is that in a dynamic process, the consumers would move more and more from the lower income group into the higher income group.

There is an aspect that has not been sufficiently discussed by Khan. Islam forbids taking of "interest". This should have a significant impact on the consumer behavior as compared with situations where interests are allowed.

Ahmed Tabakoglu analyses the factors of production. He argues from the "fiqh" (decisions of the jurists), not directly from the Quran and the Hadiths, that the factors are to be classified into two groups only - human and physical, or as Khan explains it (p.8), those that can be owned (the physical factors) and those that cannot be (the human factors). He then gives the details of the views of the *fuqaha* (jurists), setting up a number of conclusions and differences from those in economic literature.

In view of this approach based on the historical nature of juristic decisions, I suspect the reader who is not familiar with Islam will find it difficult to shift the material of this chapter between what contains weak or particular arguments or conclusions and what strong or more general. Therefore it may be useful to readers to state briefly what I consider is the fundamental framework of discussion regarding factors of production.

In Islam God has created the universe and thus what is called at times the "natural" factors of production-virgin land, minerals, virgin forests, clouds, sun, cattle (technology), seeds (technology), etc. (see, for example, Surah 27:60, 36:71, 56:63). A human may participate in raising cattle or crops, but he cannot do so without the help of God, nor has he created cattle or seeds. That is, the labour theory of value, for example, is meaningless in the Islamic context: the human (labour) cannot possibly be the only prime or exogenous factor. Hence, Tabakoglu's classification of factors between physical and human only should be regarded as based on particular historical arguments. He explains that in his classification, the natural resources are placed with capital or physical factors. But first observe the insight of the *Quran* which includes among the created factors, for example, cattle and seeds - their technology aspect: this is an extended concept of natural resources. *Secondly*, in the *Quran*, the created physical factors are primary factors, i.e., not generated by human beings. Therefore they are distinct from secondary factors like capital, or current intermediate inputs, which are generated. To put the primary and secondary factors together will be seldom, if ever, meaningful. Thirdly, the created physical factors be long to God, not to any individual or government. The values generated from them (calculated as zakah) are to be spent in the Way of God, on the indigents, as defined in the Quran. Those using the concept of the "natural resources" have to determine to whom they belong.

But this is not all on factors. The framework of guidance includes the concept of social justice: the factors should receive the value that they generate in the production process-no more and no less-as their inalienable right. The Islamic economic institutions and practices are designed to ensure the attainment of social justice.

With this framework of the concepts of created, primary and secondary factors and social justice, a reader would be able to, I am sure, assess more properly Tabakoglu's arguments or conclusions on, for example, collective bargaining or land rentals.

Finally, the aggregation or disaggregation of factors depends not only upon the concepts (created, primary, secondary) but also on the requirement of the model (general - equilibrium, macro or micro). To restrict ourselves to any particular classification means that a choice is made for some particular arguments; that is all. It does not mean that other choices are prohibited if the argument changes, or that the argument itself cannot be changed.

The final two chapters are on the construction of a macro-model for assessing in come distribution.

First, Ausaf Abmad tries to adopt the Kaldor-Pasinetti macro-model of income distribution to the world of Islam. This is focussed on how to introduced zakah into the model. What he does is that he accepts the Kaldor-Pasinetti conclusions and assesses the impact of zakah on them. The question is whether it is a valid and helpful procedure.

There are two fundamental propositions of the Keynesian world in its setting of a basic competitive institutional structure: (1) the existence of hoarding (liquidity preference) and (2) the choice between consumption and saving being a "balancing" one - the stable Keynesian multiplier. The *Quran* also sets up the basic competitive structure and explicitly recognizes the hoarding behavior. Ahmad has seen this (p.124). We have observed above the *Quranic* guidance on consumption and saving: a balance between the two extremes. If the guidance was instead, that the more one saved, the more one would prosper, the Islamic world would have become different from the Keynesian world. So far so good: both worlds are consistent.

But then the *Quran* changes the conditions in the Islamic world. *First*, it prohibits interest. Ahmad knows this (p.119), but does not explain what it means to the Kaldor-Pasinetti model. Secondly, it strengthens very considerably the practice of charity whereby not only rich help the poor but also the poor help the other poor in a routines manner. Ahmad does not consider this at all.

Furthermore, the *Quran* turns the hoarding behavior into a "rational" one. This it does by imposing a *zakah*. First, it levies a *zakah* of 2.5% on the hoarded assets. Ahmad recognizes (pp. 122-3). But that is not all that the *Quran* does, and Ahmad has not realized its implication. It levies also a basic *zakah* of 2.5% on productive (capital) assets. Thus, in the Islamic world, because of *zakah*, if the savers find the (expected) profit greater or equal to zero, they will rationally invest and not hoard. If, on the other hand, they expect loss, they will hoard and pay *zakah*, or increase consumption. This is an absolutely rational behavior. If the savers invest on projects which have losses, they will start or hasten the decline of the economy; not expand it. If they do not invest on them and hoard or increases consumption, they will slow the decline, or not cause it. That is, in the Islamic world, if a positive profit exists, the hoarding behavior is nullified, thereby the intended saving would become less or equal to intended investment; i.e. the economy would be either expanding or on equilibrium; and not ever contracting. If there is no positive profit, the hoarding of saving will be rational.

There is some apprehension (p. 124) that the hoarding nullification condition is not, as said above, the expected positive profit but that it is the expected changes in positive profit, and that the rate of change be not positive. For the determination of nullification condition in a dynamic term, the time element will have to be brought in both for *zakah* payment and profit. In Islam the time unit is one year. Anything more than this would not be sensible. With this time unit, the above nullification condition must surely hold. For the steady state in which the rate of profit is constant and positive, there will be rationally no hoarding in the Islamic world. In the Keynesian world, hoarding can exist even when profit is positive. Here the rate of interest plays a significant role, apart from the fact that the tax system is differently arranged.

Solving the problem of hoarding does not, of course, automatically solve the problem of the level of investment required for full-employment or the steady state, at least in the Keynesian model. The *Quran* also introduces an amount of expenditure through *sadaqah* (which includes both charity and *zakah*). But the concept of this expenditures is very different from that of the Keynesian in the functional finance. First, it says that expenditure is for the indigents and as a matter of their right (Surah 70:24-25). A government cannot follow a compensatory budgetary policy with this expenditure. Secondly, it says that the *sadaqah* expenditure will prevent wealth circuiting among the rich only. (Surah 59:7). Ahmad does not explain this process at all. M. Fahim Khan, as said above, has attempted an explanation by showing how in his constructed model the lower income groups would move more and more to higher income groups. Thirdly, it says that the *sadaqah* would bring about an exponential growth (Surah 2:261-2). Again Ahmad has not realized this. The exponential growth in the Kaldor-Pasinetti model is caused by population growth and technical progress. One wonders what would happen to the Kaldor-Pasinetti model if a steady state was also caused by the *sadaqah* expenditure.

There are also technical difficulties arising out of different concepts. The *zakah* is a special tax on assets. It is quite different from income tax, which is easier to incorporate in income models. In incorporating *zakah* into the Keynesian income model, Ahmad uses asset-income ratio (p.123). However, he does not discuss the accuracy or the stability of this ratio. Indeed, I am surprised that he does not use perhaps the more accurate asset-profit ratio. Also he goes on to give a very curious reason for it, that the *zakah* would be paid out of income. The levying of *zakah* on assets cannot be dependent upon positive income or cash flow. If it does, it will destroy the vertical and horizontal equity rules of the *zakah* system. M. Fahim Khan, on the other hand, considers introduction of *zakah* differently. He estimates as (p.36): $Z = 0.025\ (A + S)$ where Z = *Zakah* revenue, A = Assets at the end of last year, and S = Saving in the current year. This is perhaps more accurate and stable than the asset-income ratio, since its larger element, the asset is more stable than income. Observe that Khan uses saving, rather than investment, as an addition to assets. But since saving and investment are always equal *expost* - the term relevant for levying a tax - each can be exchanged for the other, depending upon its suitability in the model. The estimating of *zakah* revenue in an income macromodel is not likely to be ever very accurate since sector exemptions and marketable value of assets are required. The revolutionary stock-flow concept of capital conceived by von Neumann and now also used in the Generalized Dynamic Input-Output models will be ideally suited for this purpose. But then one moves away from just macromodels to general equilibrium models. Fortunately, the general equilibrium models (especially the input-ouput models) can incorporate the fundamental equations of macromodels. And if one is really keen, like the steady state, there is the turnpike. The general-equilibrium models have moved quite ahead since Kaldor and Pasinetti discussed their models.

Therefore, although the basic Keynesian conditions are also found in the Islamic world, the changes to them and the solutions established by the *Quran* are quite different. We may use the Keynesian model to explore some analytical possibilities as a step towards a more complete understanding of the Islamic world or use just some concepts like the circular flow of income in constructing a model for the Islamic world. This type of usefulness of the Keynesian model and concepts is there and by all means we should take full advantage of it, as has been done in this book. At the same time, we must recognize that. the ultimate understanding of the Islamic world in terms of the constructed model or of civilization will be significantly different from what is accepted in the Keynesian world. This, I believe, is clear from some of the *Quranic* guidance discussed above.

The *Quran* also implies a difference in the approach for constructing models, or, if you would like, considering an economic problem. It considers the three aspects of social justice; efficiency and welfare as one perspective such that each is not only balancing with the other but also supportive. Thus there is no balancing or compromising of objectives. For instance, the *Quranic* concept of *zakah* is such that it is designed to bring about social justice to factors of production, but in doing so it acquires a capacity to bring about also justice to indigents and thereby an improved welfare and growth to the economy as a whole. The Keynesian approach, on the other hand, is restricted to the objectives of the model as a perspective of its own. Therefore, it may require balancing or compromising with other perspectives. For instance, a key Keynesian implication of its perspective of full-employment or the steady state is that of government compensatory investment program. Kaldor, Pasinetti and Ahmad have all made the assumption that government would carry out this function. For the Keynesian perspective it is not difficult to make this assumption, nor also that it would be dependent upon a tax system based on "ability to pay", or with a tax rate allowed to be varied. If it is found that the investment program is inconsistent with some other objective like stability in the money market, a balancing may be attempted between full-employment and, say, inflation. For the Islamic perspective, we have to show that the investment program or the tax system is not inconsistent with social justice, efficiency or welfare. A tax for expenditure on the unemployed based on ability to pay would be inconsistent with social justice, for instance. This tax system would be invalid, and so the dependent government program unless another financing source was found that would be consistent with the Islamic perspective.

Also, the most vital consideration in the construction of an Islamic model, as it is I believe also clear from the above discussion, is the *Quranic* guidance itself, and not any particular models we have. This is because the guidance given is positive, directional and complete. Take again its guidance on *zakah*. It gives its functions justice etc.), a mode of analysis (the circuiting of wealth), and consequences (economic growth etc). Whatever path is taken for constructing Islamic models incorporating *zakah*, we cannot be by-pass the understanding of the circuiting of wealth, because it is central to explaining how in making the expenditures for satisfying the right of the indigents, economic growth can also be achieved. In other words, as I understand the guidance, if the expenditure program on the indigents is not correct, then neither the rights will be satisfied nor economic growth will be achieved. the *Quranic's* guidance is not just that there should be expenditure on the indigents but that it should be such that the wealth does not circuit only among the wealthy in that economy. One must admire the depth of the *Quran* and the completeness of its guidance. Let us remind ourselves how many such programs have failed completely in their objectives because the implementation were not properly conceived.

This book therefore does not only initiate the excitement of new ideas and construction of models but also bring to it the challenge of how to do all this when the direction and framework are known.

We may now clear the Islamic perspective on income distribution. In this book, it has been constrained to that of the impact of the withdrawal and transfer of the *zakah* revenue on income distribution of different groups in the economy. This constrained perspective, nevertheless, has generated on its own a substantial study. The *Quran*, however, has given a much wider perspective. It directs this through social justice and charity. The rights are established not only in the factor market but also in commodity and money markets, plus for indigents, inheritors, etc.: i.e., in all various facets of the "competitive" civilization. Charity is very special and practiced by all for the benefit of indigents. The established rights and charitable practices do not, however, lead to a complete equality of income. Ahmad has discussed this (pp. 115-118), as well as the reason why it is neither attainable, nor desirable. But these rights and practices prevent the wealth from circulating only among the wealthy, and bring about economic growth, both of which will have a significant impact on income distribution.

In the last chapter, Mabid Ali Al-Jarhi sets up the perspective on income distribution by examining a number of models from the "Western" economic history. This must have been a very considerable undertaking. No less must have been the effort for summarizing it in a short chapter. Perhaps expanding this material more fully in a book will make it easier to follow and its importance more obvious.

Al-Jarhi also attempts to extend Ahmad's model to one that is closer to the *Quranic* guidance. In this respect, I am surprised that he thinks that a *zakah* can be levied on wages and salaries. I do not know of any *Quranic* Verses or a *Hadith* giving authority for this interpretation. Also, given the assumption of a competitive labour market in the framework of social justice described above, the factor labour will receive only that value that it generates. A *zakah* on this will violate social justice.

In this book and especially in this last chapter, it is very heartening to know that Islamic scholars show equal respect to knowledge from all different sources - Islamic and Non-Islamic. It is hoped that the other scholars despite their different belief would also view knowledge so, and participate not only in making contribution to Islamic economics but also in extending the *Quranic* knowledge for the benefit of all. From this book it is clear that the *Quranic* knowledge is for all, as it contains the common aspiration of social justice, economic efficiency, and welfare.