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Islamic Perspectives on Market Prices and Allocation

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As the title suggests, the paper deals with Islamic perspectives on market prices and resource allocation. Market prices and allocation are two independent, but related, and important aspects of an economy. It is rightly observed by the author that the production of goods and services, in a free market economy, is guided by price signals. Resource ownership in such an economy is usually highly skewed. The resulting inability of the low-income group to pay for basic needs and the ability of the rich to pay for even luxuries distort demand conditions in a free market economy. Consequently, the production of basic needs turns out to be less profitable than that of luxuries. This phenomena non leads to the production of economically profitable, but socially undesirable or less desirable goods and services. Thus market prices in a free market economy cannot be treated as a true guide to social welfare because of income distribution effects.

It is therefore important to elevate the income level of the poor by making appropriate institutional arrangements. This would tend to even out distortions in market prices through the improvement of the ability of the worse-off population to pay enough for basic needs. In this context, it is important to analyze Islamic perspectives on market prices and allocation. The author deserves credit for his attempt in this direction.

With this overall appreciation, I would like to make specific comments on some particular aspects of the paper. In analyzing Islamic perspectives of market prices, the approach taken by the author is to provide a good critique of market prices in a free economy. It would be very appropriate and instructive to provide some positive and objective analysis of market prices in Islam. (Although Section 4 is on the 'Islamic Approach to Market Prices', it is mainly a critique of market prices under a capitalistic system).

The author has not specified whether he is dealing with a model of an Islamic economy or with some ad-hoc issues within the framework of a non-Islamic economy directed by free market forces. Although the framework is unspecified, the paper clearly attempts to address the issues from an Islamic viewpoint within a system unacceptable to Islam. It would seem more appropriate to analyze the problem of market prices and allocation as a part of the total economic system presented by Islam.

The author tends to argue against a free market mechanism. To my knowledge Islam does not deny market mechanism per se; rather it rejects the absolutely free operation of Market forces without moral restraints, because this usually leads to distortions in resource ownership and to other undesirable outcome. Instead, Islam advocates a market mechanism under which economic agents are free to chose economic activities and to maximize their objective functions subject to norms laid down by Islam for social as well as individual welfare, rather than maximizing social welfare by sacrificing individual welfare, or maximizing individual welfare by sacrificing social welfare as the two contemporary major economic systems tend to advocate. As mentioned earlier, the author has rightly pointed out that resource endowment under a free market economy is usually highly inequitable which leads to distortions of market prices. Islam ideally denies the existence of such high inequality and assures, through its mechanism of size and functional distribution of income, a reasonably equitable distribution of resources in the society. In such an Islamic economy, market prices would be considered as a guide to social desirability and welfare. It is therefore useful to qualify one's statement by saying that "market prices of a free market economy" cannot be accepted as a true guide to welfare, instead of saying without qualification that there is an "Islamic reluctance to accept a market price as a true guide to social and community welfare..." (p.20). In addition, if the author is considering price under a free market economy, such a reluctance is not specific to Islam and, if an Islamic economy is under consideration, some support from Islamic sources would be instructive. It appears to me that Islam does not hesitate to accept market prices per se, except for the cases where market prices are artificially distorted by hoarding, etc.

It is rightly stated by the author that Islam treats distribution as a key to productive activities, rather than emphasizing transfer payments. However, the citations in the paper from the Quran and Hadith refer only to transfer payments in the form of some compulsory and optional charity. It would be inadequate to present Islamic principles of distributive equity and justice by merely citing something on transfer payments (pp.1-3) and by suggesting something about the proper distribution of bank credits and the provision of public utilities (p.12). It would be instructive to analyze the Islamic viewpoint as well on the functional distribution of income (distribution of produced goods and services among the factors of production).

Islam, as I understand it, is interested in protecting the human right, among others, to wealth and income generated in the process of production where this is consistent and compatible with efficiency as well as equity. Ideally, Islam provides a systematic mechanism through which economic agents, as well as the disabled, receive their due share in the wealth and income of a community. This mechanism has provisions for reasonable equity, but it does not deny, rather it advocates, efficiency. It is, therefore, "equity along with efficiency" in stead of the author's position of "equity rather than efficiency" (p.11) which is important in allocating resources in an Islamic economy. Islam advocates a beautiful balance between growth and distribution based on justice and efficiency, instead of only growth as under capitalism or only equity rather than efficiency as under socialism.

The author hypothesizes that 'equilibrium may not be unique' in an Islamic economic analysis (p.4). This can also be true in other, non-Islamic, systems. The importance, therefore, of this hypothesis is less clear. It is, however, obvious that the set of constraints and the nature of objective functions would be different in an Islamic economy. One may even suspect that the range of the set of equilibrium would be less in an Islamic economy because the set of normative constraints laid down by Islam would be the same for all.

Some standard diagrams have been used in the paper for the purpose of criticizing policy decisions on the basis of these analytical tools. Some minor errors can, however, be noticed in their use. For example, 'C' in Figure IV is not economically efficient (although it is mentioned by the author to be so) because this point does not satisfy marginal conditions for equilibrium (geometrically, a tangency situation between the two indifference curves) because a consumer "can" (instead of "cannot") attain a higher indifference curve through a movement from 'C' without causing the other consumer to move on to a lower indifference curve. For instance, a movement from 'C' to 'G' would keep individual Y on the same indifference curve F1 F1, while individual X would move on to a higher indifference curve K2 K2 from K1 K1. In Figure III, it cannot be said that the producers to the left of CL are under-privileged be cause a point on a market supply curve does not represent an individual supplier or a particular group of suppliers; instead, it shows the quantity that will be supplied by all producers at the corresponding price, even if all of them are over-privileged. A quantity beyond OL would not be supplied because this would not be profitable under existing cost and revenue conditions. A similar comment is applicable to consumers as well; a point to the right of CL on the market demand curve simply means that the consumers as a whole will increase quantity demanded beyond OL only when the price is lower than OQ, even if all of them may be quite rich. (Also the equilibrium price in Figure III is OQ, rather than QQ). The demand and supply curves in Figure VI do not correspond to the given demand and supply functions[(1)] in terms of both intercepts and slopes (the supply curve would start from the origin, the demand curve would have quantity intercept at Q=100 instead of at more than Q=140, and the price intercept would be at P=200 instead of at less than P=100). In Figure VII, demand curves have little to do with ability to pay. A lower demand curve for individual X does not necessarily imply that he is poorer than individual A. In reality, it may be the other way around. If B is more addicted to tea, for example, his demand curve will be higher than that of X (if X is less addicted) even if X is richer than A.

In conclusion, the subject of the paper is interesting and important and the analysis useful. However, the analysis could be more complete and useful if appropriate changes are made. (May Allah reward the author for his efforts).

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(1) The demand and supply functions are Qd=100 - .5 (P) and Qs=2 (P) respectively (p. 15).