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**CONCEPT OF WAGES FROM THE  
ISLAMIC PERSPECTIVE**

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This is to certify that Bro./Sis LATIFAH H. AZIZ  
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under my supervision. The relevant comments made on the paper during its presentation have been incorporated in the present version of the paper to my full satisfaction.

I have pleasure in recommending that the graduate committee may approve the paper in partial fulfilment of the requirements for the degree of Master of Economics.

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Date: 19th. JULY, 1993

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## SYNOPSIS

This study focuses on the issue of wages from an Islamic perspective. The topic is related to human resource which is different from non-human resources in the sense that considerations of justice, humanity, and fairness dominate the scene here. An equitable distribution system, should ensure freedom of the individual and that each will get what is rightfully due to him according to his contribution. The system should also be able to close or narrow down the gap between the rich and the poor if and when it becomes undesirable.

In traditional economics, the reward to a factor depends upon its marginal product. This view has been under attack from its very inception. The main criticism has been that market is imperfect, the theory cannot explain the reward to factors which are used in fixed proportions, it is circular in reasoning etc. In short, it is valid only under very restrictive unrealistic circumstances.

Labour represents human effort in the form of mental or physical exertions in return to a fixed payment i.e wage. Labour being a human factor, the relationship between the employer and the employee must be just and fair. It cannot just be a mechanical sort of relationship. The employer should treat the employee with justice and fairness and the employee also should work honestly, under all conditions. There should be no adverse feelings between them.

It was agreed by Ulama' that the wage rate may be set in advance through an agreement between the parties. The supply and demand are the best mechanism to determine the wage if market is fairly competitive, otherwise government should interfere. There should be no fixed wage rate, it should be a range of wages i.e. the minimum wage-rate should cover the basic necessities as long as the wage rate does not exceed the contribution of labour.

Otherwise, it will cause the employer to suffer loss. The upper limit is based on the concept of justice and equity and must equal labour's contribution to output. Therefore, the actual wage rate should be between these two limits.

Another opinion is that the wage rate should not be a fixed one. The labour should face the risk of uncertainty in productive activity. The reward to workers will be divided into two parts, first a fixed minimum wage which is regular and second a flexible wage or bonus will be paid based on the profit and by mutual agreement about the sharing ratio.

## INTRODUCTION

Islamic Economic system is different from other systems in its nature, principles and operation modes. It is based on the fact that man is God's best creation on the earth. Man is a vicegerent of God and the purpose of his creation is to worship or serve God only.<sup>1</sup>

This study deals with the issue of wages essentially at a microeconomic level. It examines how the returns to labour are determined in a just way. In section A we deal with the background of the study, philosophy and objective of the topic. The definition of labour will be discussed in part B. In part C, the discussion will be on the relationship between the employers and employees. The concept of wage, we shall take up in part D. The linkage between wages and profits will be discussed in part E. Lastly, in part F we present the summary of the work and some concluding remarks.

### A. Philosophical Base:

In a discussion of labour its human aspect cannot be neglected. Labour as one of the economic resources is used in the production process. Human-beings need special considerations in dealing with them compared to

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<sup>1</sup> Al-Azariyat : 56.

a non-human resource, especially in fixing the wage rate. We cannot treat labour as a non-human resource or commodity.

Islam, also places a great value on work in human life; every individual is urged to work in one way or another to earn his living. Each individual who can work must do so and should not become a burden on society. Hadith puts emphasis on the importance of work.<sup>2</sup> Islam condemns begging and those who shy away from work.

It is narrated by Al-Miqdam r.a. The Prophet said "Nobody has ever eaten a better meal than that which he has earned by working with his own hands. The Prophet of Allah, Daud A.S. used to eat from the earning of his manual labour".<sup>3</sup>

Furthermore, to work in order to earn income to support oneself and one's family is highly appreciated. Narrated by Abu Hurairah r.a. the Prophet (s.a.w.) said:

"One would rather cut and carry a bundle of wood on his back than ask somebody who may or may not give him".<sup>4</sup>

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<sup>2</sup> Sahih Bukhari, V. III, p. 163.

<sup>3</sup> Sahih Bukhari, V.III, p. 162.

<sup>4</sup> Sahih Bukhari, V.III, p. 163.

Islam also gives special consideration to the reward for work or labour. It is mentioned in the Islamic teachings which always put stress on the concept of equity, justice, fairness and prohibits the wealth to be circulated among a few people.<sup>5</sup> Furthermore, the Prophet (Peace be upon him) commended the immediate payment of wage even before the sweat of the worker dries up. (Ibn Majah).

Some of the objectives that are to be achieved in functional distribution with regard to wages or reward to labour are as follows:-

First, to establish a system which could ensure the freedom of individual to use his ability, his aptitude, his own choice and liking. The freedom of his activities within a certain limit will be more fruitful and productive and it will create a healthy working environment.

Second, the system should ensure that everyone will get what is rightfully due to him according to his contribution to output. The right on the produce could be divided into two that is primary right and secondary right. The former is the right of individual who has

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<sup>5</sup> Q. 5 : 7.



directly participated in the production and which we will discuss in this study. The later is the right of the members of society who do not contribute to the production process. However in this study, the focus will be on the former only. It does not mean the former is more important than the latter.

Third, the system should have ability to close or narrow down the gap between the rich and the poor, to eradicate or to reduce the concentration of wealth in a few hands. However, the system can accommodate economic inequality within limits. Islam recognises economic inequality within reasonable and natural limits because Allah S.W.T. created human beings with different abilities, physical structure and in terms of intelligence and efficiency. In principle, economic inequality is permissible as long as it does not lead to the emergence of a class system.

Fourth, the system should be able to establish justice. The employer has to pay the right amount of wages to employees he hires.

These are some of the elements of the philosophy that lies behind the system of remunerating labor in Islam.

Marginal Productivity Theory

Marginal productivity theory states that under perfect competition the price (reward) of each factor, supplies of other factors remaining constant, is determined by its marginal productivity and the price of a factor in various uses will tend to be equal to it. However there is some serious criticism of this theory:

1. This theory is subject to many assumptions which are unrealistic such as the economy is in a condition of stationery state, the market has perfect competition, perfect mobility of factor, equal bargaining power of buyers and/or sellers, and each individual has a perfect knowledge about the economy. All these assumptions are clearly unrealistic.
2. This theory is valid only in a perfectly competitive market and it cannot be applied to imperfect conditions in the factors' market and product market. In perfect competition the wage paid equals the marginal revenue product of labour, while in imperfect market, if marginal productivity wage is paid to the worker it will be lower than average revenue of the firm which in fact is the

contribution of the marginal worker to the total revenue product.

3. This theory cannot explain the reward to factors which are used in fixed proportions. While one factor is constant, and the other changes, the additional output will be zero. Therefore according to this theory wage rate must be zero which is just impossible.
4. One rigid version of the theory says that trade union or collective bargaining cannot raise the wages of labour without creating unemployment. But in reality, under condition of monopsony, increase in wages rate may be accompanied by increase in employment.
5. It ignores the positive relationship between higher wages and efficiency or productivity of labour. With higher wages, workers shall be able to have higher standard of living and better health which will contribute to increase in productivity.
6. This theory is valid only with the assumption that the entrepreneur seeks to maximize profits, otherwise it is invalid. This may not be always

the case in Islamic economics.

7. This theory is based on the assumption that the entrepreneurs are fully aware of their production function. In reality many of them even do not know about production function in their firms before they set up the wage rate.
8. Another reason that challenges this theory is that in the production process, all inputs have been employed in a combination for producing certain good. It is impossible to estimate their productivities separately.
9. Another question is whether the payment according to their marginal product does or does not exactly exhaust the total product. With the help of Euler's theorem, it is shown that the payments to factors equal to the marginal product will exhaust the total product only if the production function is homogeneously linear or constant returns to scale prevail, otherwise not.
10. Marginal productivity theory neglects the supply side of factors. Wages or interest must equal the marginal product of these factors. It does not

discuss how the wage and interest have been determined.

11. This theory does not explain how the remuneration to entrepreneur should be determined because it is impossible to analyse this factor because in each firm, there is only one entrepreneur.<sup>6</sup>

#### B. Definition

1. Labour represents human service inputs used in the production process. It is in the form of mental or physical service rendered to earn a living. As long as it is based on the contract that gives the worker a fixed return that is wage the service rendered is labour. By this criterion, any human service which is not based on a contract for fixed return should be excluded from labour.
2. From other angle, labour could be seen as an agent to the principal or employer with the contract to do a certain job on the materials or resources which are already owned by the principal or employer. This definition is taken from the concept of agent in which the principal can appoint

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<sup>6</sup> Ahuja, H.L, Modern Economics, S. Chand, Company, New Delhi, 1988, pg. 391.

anybody to be his/her agent to do some work with a fixed payment. Furthermore, from the Shariah viewpoint, it is lawful to hire a worker to do some work with the condition that the employer will pay him the fixed wages agreed upon by both parties.

3. Some Islamic Economists, however, defined labour as human exertion, physical or mental for an earning. It includes organisation and planning too. On this definition, therefore, they desist from entrepreneurship creating as a separate factor of production. In other word, the concept of entrepreneurship has been included in the concept of labour.<sup>1</sup> The definition of labour in this way becomes very wide and may cause some problem in discussion of factor returns later because both in fact have different rewards that is profit and wages.

In this study, we will adopt the narrower definition of labour that is a human service either mental or physical rendered for a fixed return. The return will be determined by the forces of supply and demand in the market. In other words, the labourer is an agent to the

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<sup>1</sup> Mufti Muhammad Shafi, *Distribution of Wealth in Islam*, Begum Aisha Bawany Wakf, Pakistan, 197, pg. 11.

principal to do certain work for a certain period of time with the rate of payment agreed to by both parties. We choose this definition because the return is fixed return and the workers are not subject to any risk. In contrast, the entrepreneur bears the risk and the return to him i.e. profit is not fixed. However, in reality it is quite difficult to differentiate between labourer and entrepreneur. Many workers are involved in doing planning and managing part but are getting fixed return. For the simplicity, however, in this study worker who is getting fixed return and is not subject to any risk is considered performing labour.

### C. The Relationship Between Employer and Employee

Before we discuss in detail the concept of wage, it is better for us to see the relationship between the employer and employee. At the same time, we will state

some basic rights and obligations of the employers and employee from an Islamic perspective.

In a capitalistic system, the relationship between employer and employee based on supply and demand, is only mechanical and it is solely based on the self- interest

of both the parties. The employer respects the humanity of the employee as long as the employee could fulfil the employer's need or his self-interest. If his interest is for instance to maximize profit the human relationship will cease and the employer will start to practice all kinds of exploitation in order to achieve this interest. Labour, on the other hand, has their own interest too, for example to maximize his satisfaction. If this goal cannot be achieved, then he may indulge in unethical practices such as cheating, power abuse etc. in order to achieve his goal.

Based on the above reasons, we will now see what kind of relationship between the employer and employee should there be in an Islamic perspective. There are two dimensions of relationship in the life of every human-being, that is the relationship between the Creator and the men and the relationship among men themselves.

This fact is considered as a basic foundation for the relationship between the employers and employees. Therefore, this relationship should be a man-to-man brotherly relationship in an overall employer-employee behaviour. In one tradition the Prophet (p.b.u.h) said:



"Select for your brother the thing that you will select for yourself". Explicitly this hadith focuses on goods, in the labour market also. It means that the employer should pay the same attention towards, the employee he needs for himself for instance good exploitation free working-environment.

Secondly the employer should give a fair and generous treatment to the worker including prompt payment, fair work load, and working condition should be humanly acceptable. It is mentioned in the Holy Quran, citing the words of Hazrat Shuaib (a.s.) who stood in the position of the employer for Hazrat Musa (a.s.) and said, "I do not desire to lay (an undue) burden of labour on you. If Allah wills, you will certainly find me to be one of the righteous".<sup>8</sup> The employer cannot be righteous until and unless he has a desire to protect his employee from exploitation and does not over burden him with work.

Therefore, to be a good Muslim the employer should treat the employee in a good manner devoid of any kind of exploitation. As regard to the wage there are two traditions: "Pay his wages to the worker before his sweat gets dried". This tradition shows the importance

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<sup>8</sup> Ibid, 28:27.

of prompt payment of wages of the employee and emphasises the right of wages that must be paid to the employee concerned.

D. Wage Concept

Wage rate is the rate of payment that an individual receives for the supply of the number of hours specified in the wage contract. In other word, wages are the price of labour paid for its services according to the contract. Wage rate is very important in the economy because it affects the purchasing power of the consumer and consequently the progress of the economy as a whole.

As far as the return to labour is concerned many Islamic Economists have an opinion that the wage rate can be set in advance with the condition that both parties agreed on that rate. Furthermore, it is permissible from Shariah point of view to pay labour with a fixed wage. Even they agree that the wage should be set before hand, but the wage rate should not be fixed at one point but within a certain range. The range is based on the principle of justice, humanity and altruism.<sup>9</sup> This approach will be discuss in this section.

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<sup>9</sup> Afzal-Ur-Rahman, Economic Doctrines of Islam, Vol. II, Islamic Publications LTD, Lahore, (Pakistan) 1980, pg. 242-273.

Another opinion is that the labour should share the uncertainty of business. It means the payment to labour will be based on the performance of the business which takes the Mudharaba concept into consideration. Workers as human beings, have to survive, therefore wage rate cannot fall to zero. To counter this problem, the provision of a minimum wage rate may be the right answer. Beyond this, to be fair and just, labour and capitalists should share the profit according to a pre-determined ratio.<sup>10</sup> This matter will be discussed at length in the next section.

In principle the market is the best mechanism to determine the wage rate. It is the free interplay of natural factors which is subject to the free operation of the natural law of supply and demand in the open market.

In other word, it means that both the parties are free to judge their interest and assess the need for exchange of labour for money. For instance, the individual knows what he can contribute and what amount of wage he could get corresponding to his contribution. Therefore, the wage level could be determined through the negotiation between the labourers and the employers. However the

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Zubair Hasan, Theory of Profit: The Islamic Viewpoint, Journal of Research in Islamic Economic, Vol. I, No. 1, 1983.

Islamic State has a duty to ensure that wages are fixed at a level that they are neither too low as to deprive labourers from their elementary needs of life, nor too high as to deprive the employer of his just share of the joint product in the shape of profits.

Regarding the range of wage rate, the lower limit is determined by market forces only, that is at the point where supply curve of labour intersects with the value of marginal product. Here, minimum wage-rate should cover the basic necessities of life, including food, clothing, shelter, education, and medical care subject to different conditions and environment factors. It is relative to the place and time. This requirement is, however, applicable only to the case where the contribution of the labour is above than the standard of living for that area.

While the upper limit or the maximum level is based on the concept of justice and equity, partly to maintain their standard of efficiency and partly to encourage and maintain the rate of investment at a reasonable level. The maximum wage that they may claim from employers should be equal to what they have contributed to the productive effort along with other factors. It will be the value of average product of labour, it cannot be

higher than that because the enterprise will suffer losses.<sup>11</sup> If at the upper level the amount of wage cannot still fulfil the basic needs it is the duty of the state to distribute the income by other methods.

In the light of the above discussion, the actual wage rate will be fixed somewhere between the minimum and the maximum level which will be determined by the customary standard of living and contribution of the labourers. If the labour union is weak and less effective and the employer's belief in God is not firm, wages will be nearer to the minimum level. On the other hand, if the union is strong, and the employer's belief is firm, wages will be nearer the upper limit for the wage rate. So, the wage level is not fixed at a certain point. In this respect, the pioussness of the employer will determine the actual level of wages. Second factor that will determine the wage level is the trade union. It is the power of employees to bargain for their right for a just wage. And lastly, the role of the state to ensure the healthy market mechanism is important. If market mechanism fails to provide a just wage, the Islamic state should regulate the market maybe by legislative approach or by strengthening the trade union.

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<sup>11</sup> Sadiq, p. 53-55.

### E. Linking wages To Profits

This is another method in pricing the labour. In this context, the labourers will be paid according to the performance of the firm. It means the wage level is not fixed and it will vary from time to time according to the fluctuation in profits earned by the business organization. The business will run on the concept of profit-sharing basis or mudharaba contract. However, in discussion of this matter, one issue is that the minimum wages should be given in order to provide for a guaranteed minimum level of standard of living for the employee. The profit may be distributed to the employee monthly, quarterly or yearly.

Among the objectives that may be achieved through this method of pricing is to improve the productivity of employees to reduce the operating cost, and to link labour costs to company performance that is decreasing liability during bad times and increasing liability in good times. With this method of pricing, the cooperation between employee and employer may enhance the performance of the firm. It will give more incentive to the worker to work hard because they know that they will share the fruit. In reality it is akin to the concept of bonus from some business organisation.

Now we go on to discuss on the sharing formula of the return to this factor according to this approach. The analogy from Mudharaba in which the working partners are allowed to draw expenses for food, clothing, house, that is basic needs, when doing so is already stipulated in the contract. These expenses are considered as part of the cost of business and not part of profit.<sup>12</sup> This opinion of some group of Islamic thinkers which includes Ibn Taimiyah, seems to be more reasonable. It is because the working partners as human-beings, need to survive through fulfilment of their basic needs. With regard to the return, there will be two parts. Part of the employee's wage will be affected by market prices and conditions of the economy and the productivity of the workers. In this context the wages will be flexible that is rising or falling according to the overall financial performance of the firm. The payment may be monthly, quarterly or yearly depending on the need and urgency of the workers as well as the position of the employer.

The second part is fixed minimum wages in order to provide for basic expenses of that individual. It is according to basic needs requirement of the employee. As regard to the payment for a fixed amount, it should be

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<sup>12</sup> Abdul Azim Islahi, *Economic Concepts of Ibn. Taimiyah*, The Islamic Foundation, London, United Kingdom, 1988, p. 159.

more frequent such as weekly or monthly.<sup>13</sup>

Thus the labourer will be paid by two portions, flexible wages that is the amount of profit share of the workers and fixed (minimum) wages.<sup>14</sup>

#### Model

This model is for macro-level income distribution and is based on a profit-sharing concept. The wage received by labour will be in two part that is the minimum wage to fulfil the basic needs and second the flexible wages which accrue from profit. Let Y be the value added in the production process. We assume there are only two factors that is capital and labour. So the outcome of the production will be shared between the two as:

$$Y = P + \bar{W} \dots\dots\dots(1)$$

where P = Profit

$\bar{W}$  = Minimum wage

$\bar{W}$  is only negotional for later adjustment.

Profit will be shared by the capital owners and the

<sup>13</sup> Syed Abul A'Ala Maududi, Economic System of Islam, Islamic Publication LTD, Lahore, Pakistan, 1984, pg. 286.

<sup>14</sup> Zubair Hasan, Distributional Equity in Islam Distributive Justice and Need Fulfilment in an Islamic Economy, Edited by Munawar Iqbal, International Institute of Islamic Economics, Islamabad and Islamic Foundation, Leicester, United Kingdom, 1988, pg. 4.