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Wage Differential in an Islamic Framework

Syed Kanwar Abbas*

Abstract : The establishment of an Islamic society can itself remove many social and economic evils. Although differences between the poor and the rich generate a 'balanced economic society', they do not affect the glory of man. The departure of the Islamic economic agents from non-Islamic economic agents is due to the motivation behind economic decisions. The utility function of an Islamic employee consists of Divine will, Master pleasure, Wages and Effort level. The degree of Aman matters in worship and economic decisions and leads to wage differential in the labour market.

I. Introduction :

The present article analyses the motivation behind economic decisions of the Islamic economic agents and secular economic agents. This paper presents an employee's utility function in an Islamic framework. We point out that it is the degree of *Aman* (which varies from heart to heart) that matters in economic decisions as well as in *Ebadah* and leads to the wage differentials in the labour market. Moreover, we also discuss the secular economic point of view on the existence of wage differentials.

Man is elevated to the status of vicegerent by God on earth. God Himself has created some differences in the form of the poor and the rich in this world because it is only He Who knows well the mechanical existence of life and the system related to it. Allah (Subhanahu) orders:

"Mankind! We created you from a single (pair) of a male and a female, and made you into nations and tribes, that ye may know each other (not that ye may despise (each other). Verily the most honoured of you, in the sight of God, is (he who is) the most righteous of you. And God has full knowledge and is well acquainted (with all things)". (Surah Hujurat, 13)

In another place, He says in the holy Quran:

"Gracious is God to His servants: He gives sustenance to whom He pleases. And He has Power and can carry out His Will". (Surah Al-Shura; 19)

Man is respectable and honourable in all forms despite differences of like a slave or a master. All men are equal in all respects and one who is 'Muttaqi' is worth seeing in the eyes of Allah. In fact, differences seen in society in the form of the poor and the rich do not affect the glory of man.

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These differences are important to identify man and generate a 'balanced economic society' because positive and negative elements exist together like day with night, light with dark, life with death etc. Life will be meaningful if death exists.

Islam rejects all forms of inequality because they create barbarism and despotism in the society. Every one is given safeguard, proper honour and respect in Islamic society. The establishment of this society itself removes many social evils in general and economic evil in particular. Many economic problems, which arise in the non-Islamic systems, i.e., secular, capitalistic, socialistic and communistic are removed in the Islamic society. The secular system suffers from many critical economic problems like lockouts, strikes, (Tabakoglo, pp. 77-91) and shirking problems (Akhtar 1992, pp. 207). which have no place in the Islamic economic system.

Islam stresses an employer to be kind-hearted, loving, generous and honest with the employee in particular and with every member of the society in general. There is no room for fraud and cheating in business dealings. Allah (Sub' hanahu) orders:

"O Ye who believe! Eat not up your property, among yourselves in vanities. But let there be amongst you traffic and trade, by mutual goodwill. Nor kill (destroy) yourselves; for verily God hath been to you Most Merciful!". (Surah an Nisaa; 29)

The messenger of Allah said:

"A true and honest businessman will be with the prophets, the truthful and the martyrs on the Day of Judgment". [Al Tirmidhi, (B-4), 1209. pp. 515]

On another occasion, the prophet (peace be upon him) said:

"The best among you is the one who treats his servant with kindness and charity". (Kanz-Al Ammal, Vol. 5, 18)

Islam demands purity of economic dealings. It also allows free-market forces to determine wages and prices and avoids market intervention from state except whenever it is necessary. (S.Tahir 1997)

II. Islamic Point of View on Wage Differentials

The main departure of the Islamic economic agents from other agents is due to the intention behind economic decisions. The motivation of the secular economic agents is material while the Islamic economic agents believe in 'Falah' both in this world and the hereafter (al Akhirah). Moreover, the eternal success only matters.

Akhter (1992) reports:

“When an employer pays his/her employees, one part of the compensation may be to seek labour and another part of it may be to seek Allah’s pleasure by meeting his/her employer’s needs for his sake alone”. (Akhtar 1992).

This statement defines an employer’s profit function in an Islamic framework while we can define an employee’s utility function as given below:

$$U = (\text{Divine will, Master pleasure, Wages, Effort}) \text{ and} \\ e \geq e^{\wedge} \text{ (No concept of shirking)}$$

Where e is Effort level of the employee, e^{\wedge} is the required level from employer.

Utility of an employee is a function of Allah’s will, master’s pleasure, wages and effort level.

The first two variables are omitted in secular utility maximizing agent. He does not behave sincerely with his master as per maximization propositions. He shirks on the job whenever he finds opportunity while an Islamic economic agent is always sincere with his master and asks for his favour. He takes care of his master’s property instead of shirking on the job.

The Apostle of Allah said:

“The slave is responsible for the property of his master”. (Quoted from Akram Khan 1989)

Abdullah reported that the Apostle of Allah (May peace be upon him) said, “When a slave sincerely works for his master and worships well, there is for him double reward”. (Quoted from Akram Khan 1998)

All believers have not the same degree of Amana (Faith). The degree of Amana varies from heart to heart. This degree impacts the character of a person. Amana not only matters in Ebadah (prayers) but also in daily dealings. Some are more trustworthy, dutiful, honest and kindhearted in their matters. Trustworthiness, honesty etc. are important in business dealings. The secular economic agents have almost the same motivation of material maximization in their economic decisions. Here, Amana does not involve in decisions. Although difference in economic decisions exists, the larger variation in motives is not found. Therefore, it is pertinent in an Islamic system to have wage differentials. The degree of Amana leads to difference in wages. The more trustworthy and honest employee will get a higher remuneration package than his colleagues.

III. Secular Economic Point of View on Wage Differentials

The law of one salary propagates the notion that workers with the same attributes receive the same compensation package as per the law of one price, which states that one object cannot be sold at two different prices postulating the absence of transaction and transportation cost. However, the persistent existence of wage differential is observed in the labour market and workers having the same attributes (i.e. age, education, experience etc.) and performing the same works in the same locality receive different wages. Economists have consensus on the existence of wage differentials but consensus on the explanation of wage differentials has not been developed yet.

Wage differential has become a practice of the present era. Economists do not deny this phenomenal fact but its explanation is a 'puzzle' between the competitive vs. non-competitive approaches.

IV. Competitive Vs. Non-Competitive Theories

The competitive theory offers two interpretations of the existence of wage differentials for workers with identical characteristics.

- Labour demand is determined by the value of marginal productivity (VMP). Wage differentials must correspond to productivity differentials (Neo-classical explanation).
- The competitive theory hypothesizes that, with free market forces, observed wages compensate for unobserved abilities or working conditions. Refutation of this idea is evident in the presence of stable wage differentials even after allowing for measured and unmeasured labor qualities, working conditions, fringe benefits, transitory demand shocks, firm size and other factors.

The competitive model in the scenario of three interpretations can explain the existence of wage differentials.

1. Transitory Differentials
2. Compensating Differentials
3. Unmeasured labor quality

1. Transitory Differentials

It is the change in the labour demand, which produces transitory wage differential across industries for equally skilled workers, but this pattern of wage dispersion will narrow as labour market converges to the equilibrium state in times to come.

2. Compensating Differentials

The compensating wage differential explanation is that higher wages compensate workers for job attributes for the industry. Krueger and Summers (1988) provide

evidences against compensating differentials that high wage industries have lower quit rate than low wage industries.

3. Unmeasured Labour Quality

Wage differentials may reflect the existence of unmeasured labour characteristics. It is pertinent to point out that the worker's ability is known by the worker and the firm but is unobserved to econometricians.

Non-Competitive Theory

The non-competitive theory presents the efficiency wage models. The idea behind efficiency wage models is the hypothesis that the effort per worker is a function of real wage. This hypothesis explains the reasons of wage rigidity in the presence of involuntary unemployment.

Efficiency wage models have primary concern about the factors which play an important role to determine wages of a worker. These models provide logical insight that the industry affiliation causes wage differentials.

Therefore, it is possible that, with similar attributes, a worker can receive different wages within different industries despite performing similar work. The empirical work of efficiency wage models has primarily focused inter-industry wage structure. Large differences in wages for the same work in the same locality have been empirically proved.

The implication of efficiency wage models is that if the relationship between wage and productivity differs across different industries, the optimal wage paid to the similar workers for the same work in the same locality will be different among industries.

Numerous reasons for the existence of wage differentials are associated with the different flavours of the efficiency wage hypothesis. Of them, the sensitive reason behind the existence of wage differentials is the wage effort hypothesis (Akerlof 1982) which differs across firms and determines different optimal wages for each firm leading to wage differentials in the labor market.

Moreover, firms pay wages above the market clearing wage, which affects their output in the form of lowering quits, improving worker morale, lowering incentives to shirk etc.

V. Conclusion

Differentials in the form of the poor and the rich do not affect the glory of man. These differences establish a 'balanced economic society', which itself removes many social and economic evils like lockouts, strikes, shirking etc. because Islam demands purity of economic dealings.

The departure of the Islamic economic agents from other economic agents is due to the motivation behind economic decisions. Islamic economic agents believe in 'Falah' both in and after life (al Akhirah) while secular economic agents behave according to the materialist proposition. In an Islamic framework, an employee's utility function constitutes Allah's will, master's pleasure, wages and effort level while the first two elements do not exist in secular utility maximizing agents. Thus variation in Aman should reflect in wage differential in an Islamic economy.

The degree of Aman (faith) is an important factor which varies from heart to heart because all believers have not the same degree of Aman. This degree matters in Ebadah (prayers) and economic dealings. This degree leads to wage differentials in the labour market. The secular economic agents do not have this 'element'. Therefore, we find no larger variations in their economic motives. The secular economic framework provides competitive and non-competitive theories to explain wage differentials. The competitive theory offers two interpretations of the existence of wage differentials.

The non-competitive theory (Efficiency Wage Models) hypothesizes that firms themselves willingly pay higher wages more than competitive wage in the labour market, which results in high morale, lower quits, reducing shirking etc. These models also interpret that if the relationship between wage and productivity differs across different industries, the optimal, the optimal wage paid to the similar workers will be different among industries.

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