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A Comparative Study of Views and Role of Labor in Marxian, Mainstream and Islamic Economics

Salman Ahmed Shaikh¹

Abstract

In this paper, we comparatively analyze the views and role of labor in Marxian, mainstream and Islamic economics. We argue that Marxian view of labor undermines the role of entrepreneur. Indeed, the slave trade, industrialization and Colonialism resulted in exploitation of the labor. But, to correct matters, undermining the role of entrepreneur to the extent of abandoning private property rights is not the right solution either as it was also proved in the later part of the twentieth century. Nevertheless, mainstream economics too is unable to create an equitable balance between the capitalists and the labor class, especially in the presence of extractive institutions like interest based earnings on accumulated wealth and incapacitated wealth redistribution mechanisms. These extractive institutions perpetuate the dominance of wealthy capitalists by making their accumulated wealth immune to entrepreneurial risks. This also results in concentration of wealth, increase in income inequality and low levels of capital formation. Indeed, the recent evidence of jobless growth, high youth unemployment despite high per capita income and high income inequality supports this view. In Islamic economic framework, prohibition of interest encourages productive enterprise and capital formation. These factors boost the labor demanded by the firms. In the microeconomic decisions in consumption-leisure choice framework, Islamic institutions positively boost the labor supply. In an Islamic economy, wealth redistribution through Zakat and inheritance laws ensures circulation of wealth. Prohibition of interest closes the door for riskless non-labor income on money capital. This increases the cost of leisure and encourages the person to supply more labor and/or invest money capital in productive enterprise. Finally, we discuss the impact of Islamic work ethics on dealing with the problems of moral hazard, labor shirking and rigidity in the labor market due to efficiency wages and insider-outsider relationships.

Keywords *Labor Economics, Labor Market, Labor Value, Marxian Economics, Islamic Economics, Wage Inequality*

JEL Codes *J22, J23, J24, J31, J53*

1. Introduction

Labor is an important factor of production in any production process. In the classical literature, labor theory of value appears as a fundamental determinant of commodity price movements. In the middle of the industrial revolution, Marx observed the exploitation of labor by the capitalists. In his study of the production process, Marx argued that all value is created in the production process and by the labor effort while the capitalist extracts the surplus value in the exchange process. As a result, he advocated the denial of private property rights so that the labor cannot be exploited by the capitalists.

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Nevertheless, due to co-ordination and incentive problems, the radical policy suggested by Marx could not be fully implemented and wherever it was implemented to a small or large extent, it was eventually abandoned. The abolition of markets is no longer on the agenda in developed and developing countries (Arnold, 1987). The alternative mainstream neo-classical perspective rests on the market mechanism in which economic agents make self-centric economic choices based on marginal valuations of costs and benefits. Hence, the mainstream post-classical economics literature since the second half of the twentieth century focuses more on economic choices by households to decide about how much time endowment to allocate between leisure and labor supply. In addition, the mainstream literature also focuses on the labor market dynamics, agency conflicts, insider-outsider relationships, industrial organization and other frictions that hinder market clearing in labor market and results in persistence of unemployment.

In this backdrop, from an Islamic perspective, we do not fundamentally need to try and suggest a new positivist explanation of labor as a factor and explain labor market dynamics. However, it is vital to find a right balance between the two standard economic perspectives and suggest ways to overcome co-ordination and incentive failure as in Marxism and to avoid labor exploitation and systemic inequalities in income distribution between capitalists and labor in a capitalistic economy.

In this paper, we are interested to discuss the policy questions of how to achieve economic growth that is inclusive and that creates jobs. Indeed, jobless growth or growth which destroys jobs for masses and creates fewer new ones for a privileged group of skillful people is not desirable. Such an economic growth can result in exacerbating growing income inequalities. In fact, income inequality has increased in the developed part of the world in the last half century or so (Piketty, 2014) despite the decline in productivity since the 1980s. We are also interested in this study to discuss how the frictions caused by the extractive institutions can be removed and hence how can we achieve circulation of capital and promote entrepreneurial culture. We want to analyze and suggest how labor exploitation can be removed without undermining innovation, private property rights and economic freedom. We explain how Islamic economics with its distinct worldview, work ethics and set of economic institutions solve these problems amicably in comparison to Marxian and mainstream economics.

We proceed as follows. In section 2, we critically evaluate the Marxian view of labor. In section 3, we discuss how labor is theorized in neo-classical economics. We note that provision of private property rights is crucial and fundamental in fostering innovation and capital formation. However, the resulting systemic inequalities can be checked by removing extractive institutions. In section 4, we compare the view and role of labor in Marxian, neo-Classical and Islamic economics framework. In section 5, we discuss how an Islamic economy achieves egalitarian income distribution between capitalists and labor. Finally, in section 6, we discuss labor supply choices in an Islamic economy vis-à-vis a conventional economy.

2. A Critique of Marxian View of Labor

In Marxian economics, it is argued that the labor creates surplus value in the production process and which the capitalists extract in exchange process. Marx said that the capitalist purchases the

use value of labor (service) and pays labor something equivalent to the exchange value of labor time (Weeks, 1984). But, when the capitalist sells products created by the 'labor power', these products command more exchange value and this excess is known as surplus value (Shaikh, 1982). The surplus accumulates and this is exploitation of labor by the capitalists (Hasan, 2007).

However, upon closer inquiry, it is clear that the payoffs to the labor and the capitalists are different in the production process. Labor gets fixed wage; whereas, the capitalists earn random profits from the sale of a good or service in the exchange process. Capitalists provide certain important functions to which Marx seemed to have given little importance. Capitalists provide employment to labor. Labor gets fixed wage irrespective of profit to the capitalists and which could be negative as well (Eubank, 2011). Tendency of losses to occur at the height of industrial revolution was rare, but that does not suggest that profits are the necessary outcome of every production process for the capitalists. Capitalists compete among themselves and their competition in theory may bring prices down to the level of marginal cost in competitive markets in the long run. If there is allocative efficiency in the market, then the producer price is only as much as the cost of production which only includes the normal profit for the entrepreneur.

Furthermore, in the same countries where labor was exploited during the industrial revolution, the per capita incomes have increased manifold. We know by experience and data that most of the new startup firms fail and all capitalists are not always able to reap greater value than labor from the production process. Hence, capitalists take the risk of random profits, prices and sales fluctuations and they must have an incentive to take the risk. The incentive is in the ability to make profit from the sale of products. But, profits can be negative as well. As long as they are earning profits from the sale of goods (with intrinsic value) sold to willing buyers at competitively set market prices, it is not regarded as exploitation by Islam.

Also, social relations are not mutually exclusive these days. Employee stock ownership plans, general and limited partnership and joint stock companies have modified factor relations. In a joint stock company, there is no one big capitalist. There are small shareholders in large numbers. These shareholders are workers in other organizations. Nowadays, scientists, programmers, and artists can have patents.

Cohen (1979) argues that the labor theory of value is not a suitable basis for the charge of exploitation laid against Capitalism by Marxists. It is correct to argue that actual labor time devoted to production may vary from one labor to the other and across firms. The effectiveness of each factor in the production process in turn depends on availability, quality and interaction with other factors in the production process. Marx coined the phrase 'socially necessary labor time' to provide a benchmark for measuring surplus value and analyzing exploitation (Folbre, 1982). However, it is next to impossible to arrive at a standard and consensus based measure of 'socially necessary labor time' given the intricacies of production processes and heterogeneous labor working in conjunction with variety of other input factors. As per Marx, labor has only one thing which he can use to earn income, i.e. labor power. However, why does he not become a capitalist? It can be said that lack of seed capital acts as a constraint. But, in most developed countries, there is much less borrowing constraint. Then, why the majority of people do not become entrepreneurs by choice? If the working class is always greater in number than the capitalists, then why most democracies do not overthrow market system? Fact of the matter is

that markets create incentives, encourage competition and that allows capital accumulation, technological change, economic growth and transaction of wide range of goods as well as services.

Bowles & Grintis (1975) argue that the neo-classical economists only treat labor as a commodity and labor markets are analyzed just like markets for other commodities. It is true that this mechanical outlook on labor and human beings can and has resulted in exploitation and neglect of the negative effects of extractive political, economic and financial institutions. However, the recent literature generates labor supply from the consumption-leisure utility maximizing framework where individuals themselves decide about how to allocate time endowment into leisure and labor supply in a self-centric utility maximization framework. A person can decide to supply less labor after a wage rise if the income effect dominates the substitution effect. Hence, the labor supply decision is taken to be independent in the modern micro-founded mainstream macroeconomics.

According to Islamic perspective, there is no harm if people specialize and engage in voluntary trade of goods in a legal and ethical way. Islam does not recommend an arbitrary equal distribution of income for all people with diverse work efforts and skills. The promise of equal wage and standard of living in communism is very attractive at its face value and especially to the masses that generally do not have highly employable and demanded skills, access to quality education and opportunistic circumstances. The argument that each person as a human being shall have equal rights and equal standard of living seems convincing.

However, it is a fact that people have different tolerance for risk, different innate abilities, different attitude towards progression in life and career, different levels of ambitions and as a result, they exert different levels of effort in acquiring education, skills set and as a result, their productivity levels are different. The difference in characteristics highlighted above may not necessarily be a result of discrimination or exploitation. Most of these could be controlled and determined by individuals and by their intertemporal choices. Equating everyone's compensation despite these factors would be unjustified.

3. Labor in Neo-Classical Theory

In classical economics, labor theory of value was used as a framework to explain why prices of some goods were higher than others. If the production of a commodity requires more labor effort, the price of such commodities will be higher than other commodities which require less labor hours to be produced. This theory remained in vogue in pre-industrial revolution era and Muslim thinkers like Ibn-e-Khuldun also explained it in their works much before Adam Smith, Ricardo and Marx used it to explain the production processes and determination of prices (Azid, 2010). Later on, this theory was replaced by marginal value and marginal cost principle as a foundation for demand and supply behavior in the marketplace.

Another stream of literature in labor economics focuses on labor market itself and how wages are determined in the labor market. Frictionless labor market equilibrium is simple and a useful framework to analyze comparative static results of supply shocks and technological advancement on equilibrium wage and employment. However, the frictionless model is not able to explain the

presence of unemployment and vacancies at the same time (Rogerson et al, 2005). Then, search models tried to fill the gap by adding frictions in the model to incorporate the empirical realities of the labor markets. Peter Diamond, Dale Mortensen and Christopher Pissarides are some of the prominent contributors in this strand of literature. Diamond (1982) and Mortensen and Pissarides (1994) explain wage determination in search models and how jobs are destroyed and created with frictions. This brand of literature is focused on positive explanation of empirical realities of the labor market dynamics.

Another brand of literature in labor economics has tried to explain labor market rigidity, especially the wage rigidity to explain short run business cycle fluctuations. The wage rigidity is explained on the basis of differential work effort by the labor and tendency by firms to pay above-market clearing wages, i.e. efficiency wages to retain the talent pool and reduce tendency of labor shirking. New Keynesian and other economists have also focused on industrial organization and bring labor unions in the models to explain how insider-outsider relationships also result in wage rigidity.

Still, another stream of literature has focused on explaining the micro foundations of labor supply and labor demand. To explain labor supply decisions at the micro level, mainstream microeconomic theory uses consumption-leisure framework for explaining the time allocation between leisure and working. Using this framework as a foundation, later studies have tried to explain the labor supply dynamics of immigrants, women, and minorities etc.

While the provision of property rights and self-centric choices is a better alternative to overcome co-ordination and incentive problems in Marxian framework, the capitalistic economy has been unable to check extractive institutions which create systemic inequalities between capitalists and labor in income distribution. There are two reasons why wealth inequality may still persist in a capitalist society: i.e. 1) interest bearing capital accumulation and 2) incapacitated wealth redistribution mechanisms. Both the absence of broad based wealth taxes and the legal decree of allowing compound interest on money capital are the prime sources of wealth concentration in a market economy. Das Capital, Volume III, Chapter 24 starts with this statement. 'The relations of capital assume their most externalized and most fetish-like form in interest-bearing capital.'

The disincentive to enter in entrepreneurial pursuits because of lack of willingness of capitalists to put capital at risk while having the opportunity to earn fixed interest income reduces investment in the economy. Decline in the potential investment in productive pursuits reduces real sector economic growth, raises unemployment and it adds burden on fiscal position of the government to expend on transfer payments. Then, if more money is printed, it increases national indebtedness and which can eventually result in a country paying major portion of its gross national income every year in the form of interest.

Islam removes the extractive institutions that perpetuate income and wealth inequality in an economy, especially the institution of interest and freedom to devise tax policy for elite interest groups in capitalistic democracies that put the welfare of future generations in jeopardy by excessive deficit financing and inflation tax. A uniform Zakat levy on wealth and produce can result in tax rate smoothing, automatic stabilization of business cycle and hence encourage long

term investments and decision making without leaving the long term planner in the private sector to worry about fiscal policy reversals (i.e. Ricardian equivalence).

4. Labor in Islamic Perspective: A Comparative Review

As a factor of production, labor refers to provision of physical or mental exertion by way of contract for consideration in the form of wage or salary (Sadeq, 1987). From an Islamic standpoint, there is no fundamental problem from this mainstream definition of labor and its role in the production process. Nevertheless, the key difference in an Islamic framework comes with regards to moral injunctions as filter and ethical check on defining various legal as well as moral imperatives on economic behavior of both capitalists and labor.

In an Islamic economy, the principle of ‘risk based productive enterprise’ and ‘interest free financial intermediation’ can result in growth which is inclusive and not hierarchical in its distributional effects. The principle of risk based productive enterprise can foster capital formation and entrepreneurship in an Islamic economy that disallows fixed return on money capital in the form of interest. Increase in investment through entrepreneurial activities will increase the labor demand and wages. Increase in wages will improve the standard of living of poor labor class and enable them to improve their productivity further. Productivity may also rise with the increase in capital per worker.

In table 1, we provide a brief comparison of how Marxian, neo-classical and Islamic economics view and define the role of labor and labor related issues.

Table 1: Comparative View of Labor Related Issues in Different Economic Systems

Ideas	Marxian	Capitalism	Islamic Perspective
Private Property Rights	No. All property belongs to the community as a whole. It is held, used and managed centrally.	Yes. Beyond codified law, there is no responsibility and accountability for the acquisition, use and disposal of private property.	Yes. But the acquisition and use is subject to the concept that all things belong to Allah and humans hold them as trustees.
Creation of Value	Only labor effort creates value.	Value is determined in exchange based on marginal valuation.	Value is determined in exchange for lawful tradable commodities. For instance, money is not a tradable commodity.
Capitalists' Share in Income Distribution	Nothing. Profit earned by capitalists is surplus value extracted in exchange.	Risk based profits in exchange. It motivates entrepreneurial risk taking, innovations and creation of ideas.	Risk based profits in exchange through trade in lawful goods and by strict adherence to laws and spirit of ethical injunctions.
Income & Wealth Redistribution	No need as the central planner without private property rights would eventually result in perfect equality.	Inequality tolerated and considered as necessary. Redistribution is through progressive taxes. No other moral imperative for sharing and giving.	Extractive institutions like interest based financial intermediation are denied. Redistribution is by way of Zakat, Infaq, Waqf and inheritance distribution.
Reward to Entrepreneurial Risk	No reward. All value is created by labor effort in the production process. Capitalist extracts surplus value in exchange.	Expected positive profits. Not much normative compulsions beyond laws that only regulate liberty and rights in direct relations.	Expected positive profits from lawful trade of commodities that can be traded as per Islamic moral injunctions and filter.
Wage Inequality	Not permitted despite difference in ability, effort, work nature and marginal productivity differences.	Permitted with regards to difference in ability, effort, work nature and marginal productivity differences. But, no ethical imperative to deal with insider-outsider and agency conflicts.	Permitted, but additionally, the impact of extractive and inequity-prone institutions is minimized to provide equitable access to harness skills for upward mobility.

Second, we look at the specific institutions of Islam, especially Islamic work ethics which resolve labor market imperfections, asymmetric information and conflicting incentives. Islamic work ethics does not originate from the material incentive or legal requirement of engaging in righteous behavior, but from the concept of Tawheed and afterlife accountability. This results in a unique and distinct responsibility based concept of private property rights and socio-economic liberty within the bounds of responsibility set by Allah. Azid (2010) explains that the labor market in Islam is governed by the Islamic laws of fairness and justice.

This set of beliefs gives shape to the Islamic work ethics and which can have tremendous impact on the economic choices. For instance, in modern labor economics, it is suggested to pay premium wage to prevent people from shirking (underperformance). But, the belief of afterlife accountability will compel the person to use his skills in the just manner since if deliberate underperformance cannot be identified in this world, it will be brought for justice in afterlife.

Islam encourages people to avoid indebtedness and dependency. It can have positive impact on labor supply with decline in reservation wage and it will result in less people depending on transfer payments. A Hadith says:

“Narrated Hakim bin Hizam: The Prophet said, “The upper hand is better than the lower hand (i.e. he who gives in charity is better than him who takes it). One should start giving first to his dependents. And the best object of charity is that which is given by a wealthy person (from the money which is left after his expenses). And whoever abstains from asking others for some financial help, Allah will give him and save him from asking others, Allah will make him self-sufficient.” (Sahih-Al-Bukhari: Book 24, No. 508)

Likewise, the Islamic concept of ‘brotherhood’ and ‘justice’ can help in avoiding the ‘insider-outsider’ problem in which the people already employed in the organization do not allow a change in policy which hurt their private incentive but which can bring a positive social change by increasing employment to the outsiders. Hence, the externalities are internalized in the decision making process by a person who believes in afterlife accountability and who regard his private property, social and professional authority and physical and mental faculties as a trust. Imbued with values of Adl (justice), Ihsan (benevolence) and Ukhuwwah (brotherhood), the relationships between the employee and the employer will be congenial, peaceful and harmonious (Akhtar, 1992).

Islamic work ethics also affect the behavior of employer. Employers are directed to not overburden their employee, help them in work if necessary and pay them their due salaries without any delay. Prophet Muhammad (pbuh) said: “Give the labor his wage before his sweat dries”. [Ibn-e-Majah]. In another Hadith, Prophet Muhammad (pbuh) said: “I will be foe to three persons on the Last Day: one of them being the one who, when he employs a person that has accomplished his duty, does not give him his due.” [Bukhari, No: 2109]

In another Hadith, employers are asked to treat their subordinates fairly and look after them. Prophet Muhammad (pbuh) said: “Those are your brothers [workers under you] who are around you; Allah has placed them under you. So, if anyone of you has someone under him, he should feed him out of what he himself eats, clothe him like what he himself puts on, and not put so

much burden on him that he is not able to bear, [and if that be the case], then lend your help to him.” [Bukhari, No: 2359]

Lastly, we look at the emphasis of Islam on education and developing human capital for productive work. It is an empirical fact that most developing countries have lower labor productivity. Some of the reasons why people are not able to increase their productivity include: lack of education and hence lack of employable skills, poor health and malnutrition. Islam has made it obligatory for every Muslim - men and women - to educate themselves. Islam has made it obligatory for Muslims to seek permissible source of income through entrepreneurship or offering their labor in productive enterprise. Hence, this will increase the effective and more productive labor supply and entrepreneurial capital at the same time.

5. Achieving Egalitarian Income Distribution in an Islamic Economy

In this section, we see how income is earned by households in an Islamic economy. Income function of an individual can be represented by:

$$I_t = wL_t + E(\pi_t) + rA \quad \text{--- (i)}$$

Where,

‘r’ is the rent on physical asset holdings ‘A’. Market wage is ‘w’ and labor supply is L_t . L_t is expected to be higher in an Islamic economy than in a capitalist economy. The reason is that the feasible income sources in an Islamic economy will not allow a perpetual income source which is a direct function of past accumulated wealth.

$E(\pi_t)$ is income from direct and indirect participation in entrepreneurial activities for individual in time period ‘t’. $E(\pi_t)$ can be represented in equation (ii):

$$E(\pi_t) = \sum_{j=1}^k p_j \pi_j \quad \text{--- (ii)}$$

Provided that $0 < p_j \leq 1$.

Where

p_j is the profit sharing ratio in project ‘j’ agreed for time period ‘t’ at time period ‘t-1’.

π_j is the profit in project ‘j’.

If a person is the sole entrepreneur in some project ‘j’, then, p_j will be equal to unity.

It can be seen that in an Islamic economy, there is no provision for risk-free income. The legitimate sources to earn include income from providing factor services like labor, land in ownership, possession and risk and any other income from entrepreneurial undertakings in investment opportunities in the real sector of the economy.

If the average ex post realized return from investment opportunities is low, the household will have to increase labor supply to compensate for the lower income from entrepreneurial

investments. Increase in labor supply will reduce wage bill for the production sector and hence it will increase the ex post realized rate of return from entrepreneurial investments. Hence, this adjustment process of capital mobility and labor market transitions will lead to an equilibrium state where the share in income of the workers and the capitalists will be closer to each other except for differences in risk tolerance, risk preference, efforts and skills.

6. Labor Supply Choices & Market Equilibrium in an Islamic Economy

In this section, we present a simple model that explains how the labor allocates time between leisure and working for generating enough income to purchase a given amount of consumption goods. Suppose a person wants to consume goods and services and he can generate purchasing power by earning labor and non-labor income. In a capitalist economy, the person can earn interest on accumulated wealth. In an Islamic economy, this source of non-labor income is not allowed.

The total time can be spent on either working (n) or in leisure (l). Total time can be normalized to 1. So,

$$n + l = 1 \quad \text{--- (iii)}$$

Total income is given by the equation (iv):

$$I = nW + rC \quad \text{--- (iv)}$$

Where 'I' is total income, 'C' is accumulated wealth which can be invested to earn interest income and 'r' is the rate of interest offered in a conventional economy. 'W' is the nominal wage. In an Islamic economy, 'r' will be zero and hence the second term in the income function will disappear. For the purpose of highlighting the difference between interest free and capitalist economy, we ignore other legitimate means of earning non-labor income like rental income and profit on equity investments.

The person can consume this income on buying consumption goods. Hence, the budget constraint is given in equation (v):

$$Pc + Wl = nW + rC \quad \text{--- (v)}$$

Where 'P' is the price of composite consumption good and 'c' is the consumption expenditure. The left hand is the expenditure and right hand side shows the income. Here, the cost of leisure is the nominal wage 'W' forgone.

Solving (v) for 'c', we get equation (vi):

$$c = \frac{(n-l)W}{P} + \frac{rC}{P} \quad \text{--- (vi)}$$

Since the $\frac{rC}{P}$ term will disappear in an Islamic framework, the person will have to either supply more labor or invest more capital in entrepreneurial investments either directly or through financial markets or intermediaries in order to achieve the same level of consumption. Both decisions will increase market employment with rightward shifts in labor supply and labor demand curves. Hence, in an Islamic economic framework, not only the employment opportunities increase, but there is also a simultaneous increase in self-employment and entrepreneurial pursuits (Khan, M. Faheem, 1992).

Next, we show the labor market equilibrium in an Islamic economy. Let the labor supply function be represented by equation (vii):

$$NS = a_0 - NW + w - TR \quad \text{--- (vii)}$$

Where,

NS is the labor supply.

NW is the net wealth after Zakat payment.

w is the market wage per unit of labor employed.

TR is the transfer receipts.

a_0 is the catch all term for all other variables.

We can see that $\frac{\partial NS}{\partial NW}$ is negative. Hence, increase in wealth will decrease labor supply. With the institution of Zakat, NW will be decreasing function overtime. Hence, the labor supply is expected to be positively influenced by Zakat. Increase in labor force participation will also increase the total income accruing to laborers.

Let the labor demand function be represented by equation (viii):

$$ND = a_1 - w \quad \text{--- (viii)}$$

Where,

ND is the labor demand.

w is the market wage per unit of labor employed.

a_1 is the catch all term for all other variables like productivity, capital stock etc.

In equilibrium, $ND = NS$.

$$a_0 - NW + w - TR = a_1 - w$$

$$2w = a_1 - a_0 + NW + TR$$

$$w = \frac{1}{2} \{a_1 - a_0 + NW + TR\}$$

Equation for equilibrium level of employment is obtained by:

$$N = a_1 - w$$

$$N = a_1 - \frac{1}{2}\{a_1 - a_0 + NW + TR\}$$

$$N = \frac{2a_1 - \{a_1 - a_0 + NW + TR\}}{2}$$

$$N = \frac{a_1 + a_0 - NW - TR}{2}$$

It can be seen that $\frac{\partial N}{\partial NW}$ is negative. Hence, decrease in wealth will increase the equilibrium level of employment. While $\frac{\partial N}{\partial a_1}$ is positive. Hence, increase in productivity and capital stock will increase the equilibrium employment as well. Also note that $\frac{\partial w}{\partial a_1}$ is positive.

Conclusion

In this paper, we comparatively analyzed the views and role of labor in Marxian, mainstream and Islamic economics. We argued that Marxian view of labor undermines the role of entrepreneur. We also discussed that mainstream economics too is unable to create an equitable balance between the capitalists and the labor class, especially in the presence of extractive institutions like interest based earnings of accumulated wealth and incapacitated wealth redistribution mechanisms. We argued that in an Islamic economy, prohibition of interest encourages productive enterprise and capital formation. We showed that these factors boost the labor demanded by the firms. In the microeconomic decisions in consumption-leisure choice framework, the Islamic institutions positively boost the labor supply. We showed that in an Islamic economy, the wealth redistribution through Zakat and inheritance laws ensures circulation of wealth. In addition to that, prohibition of interest closes the door for riskless income on money capital. This increases the cost of leisure and encourages the person to supply more labor and/or invest money capital in productive enterprise. Finally, we also discussed the impact of Islamic work ethics on dealing with the problems of moral hazard, labor shirking and rigidity in the labor market due to efficiency wages and insider-outsider relationships.

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