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## RESEARCH ARTICLE

## INCOME DISTRIBUTION MEASUREMENT IN ISLAMIC PERSPECTIVE

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**Key words:**Income distribution, *mudharabah*, profit sharing**\*Corresponding Author****Atih Rohaeti Dariah****Abstract**

The research aims to find a measurement method for functional income distribution in Islamic perspective, realized in the practice of *akad mudharabah* (business partnership contract) involving three actors, namely *shahibulmaal* (capital owner), *mudharib* (manager), and labor.

In order to understand in-depth the meaning of *mudharabah* and *ijarah* (employment contract), content analysis of Al-Qur'an and Hadith was conducted. Data were also taken from previous research results on the measurement of conventional income distribution and experts' views of the measurement which were obtained through interview and FGD. The analysis of the whole data resulted in the proposition of an idea to measure functional income distribution in Islamic perspective.

Research results show that the calculation method of income distribution in *mudharabah* framework is a specific regression model, where the independent variables consist of profit sharing, trust, *amanah* (fulfilling trust), business characteristics, productivity, skills, prudence, and dummy of *mudharabah* practice versus the conventional one. Meanwhile, the dependent variable is income distribution, including the sub-variables of *shahibulmaal*, *mudharib*, and labor that will be specifically calculated with the Gini Index method.

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**INTRODUCTION**

Measurement of income distribution introducing Islamic values is not something new. The literature, for instance, shows that Ahmad (2000) has conducted measurement of income distribution in both Muslim and non-Muslim countries. He employed Gini coefficient as the proxy of income distribution. With the institutionalization of Islamic economy, Ahmad (2000) proposes a hypothesis that income distribution in Muslim countries is better than that in non-Muslim countries. His hypothesis was tested by looking at the Gini coefficient of each country. The main cause of the gap lies in the ownership of production tools and physical capital, concentrated land ownership, sizes of land ownership, and the low bargaining power of the working farmers.

Our previous research has resulted proposition determining income distribution in *mudharabah* practice which is a direct reflection of the behaviors of the actors involved in the practice, namely *shahibulmaal*, *mudharib*, and workers (Dariah, et. al, 2014 and 2015). Terminologically, Islamic clerics define the term *mudharabah* differently, albeit the definitions are essentially the same, namely referring to a form of partnership between the capital owner (*shahibul mal*) and the capital manager (*mudharib*) with previously agreed profit sharing.

Details of our proposition are as follows:

- (1) The overvaluation of *shahibulmaal* over his or her own capital will lower wage level.
- (2) Increased product prices will raise labor wage, and consequently prompting the need for additional work time in the company, demanding the workers to reduce their work time in their other jobs.

- (3) Time resources should be valued appropriately by employees, as overvaluation will reduce the wage given by the company led by the *mudharib*.
- (4) Wage determination is inseparable from subjective assessment. Hence, it is only natural if Sadeg (1989) argued that wage level lies on the moral stance of the businessman.
- (5) The wage level determined through *musatarak* contract reflects the net productivity value of the workers weighted by the profit share of the *mudharib*.
- (6) The higher the marginal physical product of labor, the higher the wage.
- (7) *Shahibulmaal* increased share for *mudharib* will increase wage per unit of labor.
- (8) Profit sharing contract between *mudharib* and *shahibulmaal* highly determines wage level. In the contract, both parties should calculate the impact of their shares on labor wage.

The eight propositions are the variables determining factor pricing that will determine income distribution. Implicitly, this means that the practice of *mudharabah* as an institutional order being introduced here will change the structure of people's income that will in turn change income distribution. The problem is how to prove the items in the proposition. An instrument is needed to measure and prove the proposition. In this paper, a method of income distribution measurement under *mudharabah* scheme drawn from the conventional measurement method that has been analyzed with the principles and practices of *mudharabah* and *ijarah* is proposed.

### Methodology

The data obtained from the primary sources of Al-Quran and Hadith are concerned with *mudharabah*, *ijarah*, and ownership right. To analyze the meaning of certain words from Al-Quran, content analysis technique with qualitative approach was conducted (Chalil, 2009).

Other equally important sources of data or information were the various research results on conventional income distribution measurement. The secondary data and information were further analyzed and compared to find the strengths and weaknesses of the conventional functional income distribution method. The results were linked to the nature of *mudharabah* practice. Meanwhile, the results of content analysis, especially related to the practice of *mudharabah*, will be used to establish the proposition. The whole analysis results in a proposed method of functional income distribution measurement in Islamic perspective.

In addition to the analysis of the two kinds of information and data above, experts' view is equally important. Their input which was obtained from a special interview and FGD with competent related sources will refine the concept that we have proposed.

### Result and Discussion

The framework for income distribution measurement in Islamic perspective is synthesized from the research results of Ahmad (1984) and Ahmad (2000). The synthesis results in the institutional framework of Islamic economy as the basis for income distribution measurement. The institutional principles according to Ahmad (1984) are:

1. The decision and action of all economic actors (producer, consumer, labor, and businessmen) are motivated by their own interest and their belief in the Judgment Day.
2. The economy is managed by private companies, and there are public sectors for certain activities.
3. The free market is controlled by *Al-Hisba*, which is an organization that regulates output and input prices when necessary.
4. Economic activities are managed on the basis of cooperation and mutual help in goodness.
5. Interest rate institution is not allowed in the economy.
6. *Zakat* is obligated to all Muslims who own property above the amount determined by *fiqh*. It is collected by the state and distributed to the *mustahik*.
7. Business and production activities are managed with *mudharabah* as the basis.
8. The composition of production and consumption commodities in Islamic economy is different from that of other economies. To start with, *Al-Hisba* controls production and import commodities as permitted by Islam. Then, consumers have control over their consumption according to Islamic teachings.
9. The government is assumed as the regulator and policy maker that improves the social welfare in line with sharia. The government will intervene with the market if private sectors cannot provide products for social purposes.

*Mudharabah* is included under the nine institutional principles above. In the *mudharabah* contract itself, there are some principles to abide by, namely:

1. The principle of profit sharing between the parties involved in the *mudharabah* contract.
2. The principle of loos sharing between the parties involved in the agreement, with equality and justice is the basis.
3. The principle of clarity. In *mudharabah*, the amount of capital to be invested by the *shahibulmal*, the percentages of shared profit, the requirements desired by each of the parties, and the contract duration should be explicitly and clearly stated.
4. The principle of prudence.
5. The principle of trust and *Amanah*.

This research proposes modification to the principles by including labor as part of the parties involved in the *mudharabah* contract. In addition, the workers are bounded by the contract as employees, what is familiarly termed as *ijarah* contract. There are also specific principles applicable in *ijarah* contract, namely:

- The principle of equality. This principle refers to the hadith of Prophet Mohammad to Aisyah that ‘Your reward is based on your efforts’. In relation to wage, the principle means that the amount of one’s wage is in line with his or her effort.
- *Al-ujrah bi qadri al masyaqah*: the wage is gained based on “the level of difficulties” perceived by the workers.
- *Al-Jaza min jinsi al-amal*: The profit/wage/share gained is based on the type of work, which works in the same principle as level of difficult.

The principles of *mudharabah* and *ijarah* further strengthen our proposition partly stated in the introduction. However, with the second set of principles considered above, there are some changes to the proposition.

The subsequent effort is to find the appropriate measurement method based on analysis of the conventional method of the previous research results. Chotikapanich and Griffiths (2006), to start with, were concerned with Bayesian method used to study the domination in income distribution. Rummel (2009) proposes a model of distribution dynamics by considering error measurement. Meanwhile, Bargain (2014) emphasized on the discussion of macro-simulation of tax-benefit systems that is able to describe the changes in the poverty and inequality over the time. Vanesa Jorda’, Jose’ Mari’a Sarabia and Faustino (2014), proposed a different approach to the estimation of income distribution. First, they used the Lame distribution, namely the distribution version of Sigh-Maddala and Dagum. Secondly, a new global and regional income distribution model was drawn from the combination of Lame distribution and population segments. Then, Naranpanawa (2012) estimated the best functional form of income distribution for a different group of incomes in an attempt of measuring the poverty and inequality index in Sri Lanka.

The effort of elaborating the inequality index of income has also been made by Gounder, Rukmani, and Zhongwei Xing (2012) by making Fiji household income as the case. More specifically, they measured the inequality level through household income, quantile income distribution, inequality decomposition according to region and ethnic group, and income inequality based on income sources. The method employed was Gini coefficient, Nelson ration, and Atkinson index.

However, Permana (2006) viewed that Gini Index cannot be decomposed, as the total Gini index is not the same as the total sum of the subgroups in the index. Permana (2006), quoting Adelman and Morris (1974), said that inequality has the characteristic of being multidimensional; therefore, inequality can be measured with various methods. The approach in the economy of labor (Mincerian (1974) cited in Permana (2006)) shows that income function can be estimated. The main reason being the fact the percentage of income difference should be the main consideration in finding inequality, which can be realized by the semi-log model. Here is the explanation of the basic equation to estimate income in the formal sectors:

$$y = \ln Y = a_0 + \sum_{i=1}^n a_i X_i + \varepsilon$$

Where,  $y$  is the dependent variable, namely individual income, and  $X_i$  is the set of independent variables. The basic equation is more relevant for the present research, so that the proposition can be sharpened and corrected by putting forward the variables determining income distribution among *shahibulmaal*, *mudharib*, and labor as shown in the following table.

Table 1. Independent Variables of Functional Income Distribution Method in Islamic Perspective

No	Proposition	<i>Mudharabah</i> and <i>Ijarah</i>	Independent variables
1	<i>Shahibulmaal</i> overvaluation of his capital will lower the wage per unit of labor	The equal proportion previously agreed upon and explicitly stated in the contract	Profit sharing
2	Time resource valuation should be appropriately made by labor, as overvaluation will reduce their income from the company lead by the <i>mudharib</i>	Equality and justice principle in the loss sharing between the parties involved in the contract. Trust and <i>Amanah</i>	Profit sharing
3	The income received by labor is not inseparable from the subjective elements (the moral of <i>mudharib</i> and <i>shahibulmaal</i> )	Trust and <i>Amanah</i> Prudence	Trust and <i>Amanah</i> Prudence
4	Wage level is determined through <i>musyatarak</i> contract, reflecting the net productivity of labor weighted by the share of <i>mudharib</i>	One's wage is according to his or her efforts	Productivity Skills
5	The higher the marginal physical product of labor, the higher the wage.	One's wage is according to the efforts s/he has made	Productivity Skills
6	<i>Shahibulmaal</i> increased share for <i>mudharib</i> will increase wage per unit of labor.	The principle of equality and justice is in the loss sharing between the parties involved in the contract Trust and <i>Amanah</i>	Profit sharing Trust and <i>Amanah</i>
7	Profit sharing contract between <i>mudharib</i> and <i>shahibulmaal</i> highly determines wage level.	Business outcome is generated collectively/with expenses Profit is generated collectively (based on) the risk Profit sharing is based on the characteristics of types of business	Profit sharing Business characteristics
Dependent Variable: Income Distribution		Independent variables: Profit Sharing, Trust, <i>Amanah</i> , Business Characteristics, Productivity, Skills, and Prudence	

Based on Table 1 above, there are seven explanatory variables of income distribution, namely profit sharing, trust, *amanah*, business characteristics, productivity, skills, and prudence. With this finding and results of comparison between the conventional method of income distribution and the functional income distribution in Islamic perspective, a specific regression model is proposed as follow:

$$Y = f(X_1, X_2, X_3, X_4, X_5, X_6, X_7, D)$$

Where:

Y = Income Distribution among *shahibulmaal*, *mudharib* and labor

X<sub>1</sub> = Profit Sharing

X<sub>2</sub> = Trust

X<sub>3</sub> = *Amanah*

X<sub>4</sub> = Business Characteristics

X<sub>5</sub> = Productivity

X<sub>6</sub> = Skills

X<sub>7</sub> = Prudence

D = dummy variable, 1 = conventional business activity, 0 = *mudharabah* practice

Considering income distribution can be measured at the micro level, where the company running in various sectors applies the practice of *mudharabah* instead of the conventional one, the Gini index for the micro level has to be calculated as well. To gain the value of Gini index, Lorenz Curve approach is employed.

## Conclusion

There are essentially some highlights from this research:

- (1) The conventional method to measure income distribution is focused on quantitative approach with its varieties, without considering the institutional aspects that shape income. The institutional aspects represented by *mudharabah* contract results in a more specific order for the practice of business.
- (2) The method of income distribution measurement can be adjusted to the problems and the institutional order accompanying them.
- (3) The efforts of finding a method to measure income distribution under the institution of *mudharabah* is built based on the principles of *mudharabah* and *ijarah*, which strengthen as well as correct the income distribution method previously proposed.
- (4) The method of income distribution measurement in the framework of *mudharabah* is specific regression model, where the independent variables consist of Profit Sharing, Trust, *Amanah*, Business Characteristics, Productivity, Skills, Prudence, and Dummy variables of *mudharabah* versus the conventional one. Meanwhile, the independent variable is the income distribution among *shahibulmaal*, *mudharib*, and labor that will be specifically calculated with Gini index approach.

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