Islamic Economic Principles

Islamic economic system has more in common with mixed capitalism or Keynesian-type economics in which the government plays a major role in production of public goods, distribution of economic goods, and stability through spending and taxing policies.

Islamic economic principles are based on three sources: Sunnah (Quranic instructions), Ijma (the consensus of religious scholars), and Qiyas (personal opinions based on analogy and religious doctrines). Islam provides specific instructions on the following economic principles:

Property Rights: Private ownership of resources is recognized as God has created the world with natural resources for people to enjoy. Private owners are entitled to returns on their labor and capital investments. Also individuals involved in free trade must be rewarded for their investments and willingness to take risks. But, they all must contribute to the betterment of the community by making tax and charity payments. Unproductive hoarding of resources is prohibited and profit making is encouraged. Collective ownership of resources is not recognized as absolute ownership is only limited to God. In this Keynesian-type economic system, the government is responsible to provide public goods, redistribute income, and protect individual property rights.

Income Distribution: The state is responsible to collect taxes and provide direct transfer payments to the poor in order to improve income and wealth distribution. In addition, individuals are highly encouraged to make charitable contributions to the needy neighbors and expect to be rewarded by God on the Day of Judgment.

Taxation: There are four main categories of taxation:

1. Zakat is a generalized wealth tax imposed on all income earning assets including the ownership of animals, gold, and silver, articles of trade, and the produce of the land. It is collected by the government to ensure proper distribution among the poor and needy in order to improve income/wealth distribution.

2. Ushr or tithe is a property tax on fertile land when and only when it produces output. The tax rate depends on the quality of the land: 5% on irrigated land and 10% on rain-fed land.

3. Kharaj is tax on revenues from the land. It can be fixed (so much per unit of land or per tree) or proportional (depending on the type of crops).

4. Jizyah is tax paid only by non-Muslims to receive protection form the state. It is a lump-sum tax depending on the ability to pay (e.g., 48 dirhams by the rich, 24 dirhams by the middle-class, and 12 dirhams by the poor).

Interest and Usury: The taking of interest on money lending is forbidden. Usury is said to be exploitation of one person by another and therefore sinful for three reasons: (1) it increases the concentration of economic wealth (2) it involves a riskless economic venture, and (3) it is a selfish attempt to maximize the money's rate of return without labor activity and hard work. Accumulation of wealth must be based on
personal effort and labor and capital investment. In an Islamic banking system, depositors are partners who share the profit or loss of the activity and pay a small transaction cost.

**Rent:** Like interest, rent on virgin land or unproductive resources is forbidden. However, rent can be levied (only in cash, not in kind) on improved land and resources which require labor or capital investment. Rent is subject to property tax (ushr) to redistribute income.

**Inheritance:** The inter-generational transfer of wealth is based upon the following principles: (1) the deceased can transfer up to 1/3 of his/her property as desired; (2) women are entitled to share in inheritance, but only 1/2 of men's share; (3) the inheritors are members of the immediate family, but other relatives gain share of distribution if desired by the deceased; (4) the state inherits the estate of a person with no legal inheritors; and (5) the inheritors must pay property taxes to the state.