

DISTRIBUTION OF INCOME AND WEALTH IN ISLAM

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ABSTRACT

There are numerous studies, related to distribution of income and wealth under Capitalism and Socialism/Communism. While Capitalism failed to ensure a fair distribution of income, a Socialist Economic System, despite succeeding in creating an egalitarian society, is essentially associated with a non democratic state controlled economic system. As a whole there is clear evidence that the reversal to Capitalism and dominance of Market Economies, after failure of Socialist System in USSR and Eastern Europe, is creating gross inequalities in distribution of income and wealth; though some, as a result of strong state intervention, are having a better distribution of income and wealth. Islamic Economic System, not totally practiced anywhere in the world, is a non state controlled economic system for a just and equitable distribution of income and wealth. The present study is an effort to show that how an Islamic Economic System, if fully implemented, could deter excessive accumulation of wealth and also ensure an equitable distribution of income. The key variables of the system are Ushr/Zakaat, Elimination of Interest and Islamic Laws of Inherence. There is visible dampening effect of Zakaat on accumulation of wealth besides reducing income inequalities. Elimination of interest is crucial to further reduce the inequality in distribution of income. Finally the elaborate Inheritance Laws of Islam distribute the accumulated wealth of a person and ensure that wealth is not concentrated in few hands. Unless all these three elements are put together and implemented in totality the expected impact on distribution of income and wealth would not be realised.

Keywords: *Distribution of Income, Gini Co-efficient, Capitalism, Communism, Islamic Economic System*

INTRODUCTION

Economic and political systems are very closely interrelated. It is well known that while democracy is associated with Capitalism, Socialism and Communism have ultimately created a one party controlled political system e.g. (China and North Korea). However there are exceptions such as Sweden where a democratic government has organized its economy on socialist principals and in a number of countries the Capitalism market economies running under the dictatorship. Similarly, in order to have a credible Islamic Economic System, the political, judicial, administrative etc. systems of that country, to a large extent, be based on Islamic principles. Despite the fact there are a number of Muslim countries around the world, currently there is hardly any country that could be strictly described as an Islamic State in all respects. As a result the so called Islamic Economic System implemented by some Muslim countries could not produce the results expected from the system.

An important aspect, discussed in the context of an economic system, is its impact on distribution of income and wealth in that economy. Capitalismⁱ has remained major instrument of phenomenal economic growth during past three hundred years and is associated with creating gross inequalities in distribution of income and wealth in the society. The well-known central theme of Communism, forcefully presented by Karl Marx (1867), is a 're-action' to this 'injustice' of the Capitalist Economic System (described as 'exploitation of labour class' by the capitalist). Despite the failure of Communism to provide a better alternate (i.e. state controlled economic system) to ensure equal (or equitable) distribution of income and wealth in the society, its argument could not be ignored by the Capitalist Societies. As a result almost all over the world a mixed economic system has evolved with different level of emphasis on the role of private and public sector in different countries.

There are numerous studies, books and research articles related to distribution of income (and wealth) under Capitalism and Socialism/Communism. Empirical research has fully established that:

1. A gross inequality in distribution of income and wealth will occur if the economic system is dominated by the market forces.
2. Government intervention (using different economic policies.g. fiscal, monetary price policies, public sector investment) has successfully reduced the inequality in distribution of income and wealth.
3. The command economies with a total or major state control over productive assets have created an egalitarian society (though the total income and wealth of the nation might not be as big as in a capitalist economy under same conditions).

In a comprehensive study by Flemming and Micklewright (1999) clearly shows that inequality in almost all the Eastern European economies has increased after moving from socialist controlled systems to market base economies. It is very interesting that some of these economies have now a bigger Giniⁱⁱ coefficient (indicator higher inequality) than Sweden. Another important finding is that prior to moving to market oriented capitalist system, the income was much equally distributed in these countries as compared to many capitalist European economies though not perfectly equal or near equal as envisaged by

Karl Marx). Gini coefficient of these economies under socialist system was between 0.20 to 0.25. An important evidence of increasing inequality under market driven capitalist system is in distribution of income in China resulting from 'market reforms' implemented during past three decades. Its Gini coefficient, together with a very high GDP growth, according to China's National Bureau of Statistics, is currently 0.474 (well above the alarming rate of 0.4). (see [http:// www. bbc.co. uk/news/business](http://www.bbc.co.uk/news/business)). China is planning to implement major Tax Reforms to reduce inequality in distribution of income. In his article Mobiot (2013), analysing and commenting on the results of market based reforms, has provided alarming state of growing inequality in the world today. According to him, 'Last year, the world's 100 richest people became \$241 billion richer. They are now worth \$1.9 trillion: just a little less than the entire output of the United Kingdom'

A comparison between Socialist and Capitalist Systems in terms of distribution of income is much easier as both these systems stand practically implemented in a number of countries under compatible political systems. In absence of a practical model of an Islamic Economic System there is no such empirical evidence that could be produced. In the following sections, therefore, with the help of some hypothetical data, an effort has been made to see that how the distribution of income (and wealth) would change if an Islamic Economic System is implemented. For this purpose the rest of the paper has been organised as following:

- a) A brief comparison of three economic systems (i.e. Capitalism, Socialism/Communism, and Islamic Economic Systems)
- b) Key features of Islamic Economic System
- c) Islamic Economic System and its impact on distribution of income/wealth
- d) Conclusion

Capitalism, Socialism And Islamic Economic Systems

Literature on Capitalism and Socialism is too large and beyond the scope of this paper to synthesize. Similarly, the comparison of these two systems with Islamic Economic System has also expanded exponentially during past five/six decades. In his famous article, presented at International Conference in Febury, 1968 (and then published several times), Maulana Mufti Muhammad Shafi (1968) provided an excellent comparison of these three systems, besides describing the key features of Islamic Economic System. Now there are a numerous books and articles on the subject written both by Islamic religious scholars and professional economists.ⁱⁱⁱ The key features of these three systems are could be summarised as following:

- (i) The concept of Capitalism has significantly changed over past three centuries In 18th century Adam Smith emphasized on self interest, 'invisible hand' and specialization as key elements for capital accumulation. The present day definition emphasises the private ownership of means of production and decision regarding demand, supply, prices (of products and factors of production), distribution and investment to be governed privately under liberal market forces with bare minimal government intervention. However, in practice in all over the world there is some government intervention though the degree of emphasis significantly varies among different countries. For example Sweden has very large share of public sector and government expenditure as compared to United States. Thus in present days the capitalist system is truly a "Mixed Economic System". The degree of control by the private sector (as compared to public sector) has significant impact on distribution of income/wealth. Sweden society is much more egalitarian than US (with Gini Co-efficient 0.45 and 0.23 in US (2007) and Sweden (2005) respectively)^{iv} as in Sweden a much larger economic activity is controlled directly or indirectly by the state. In summary, while capitalist system is a widely acceptable and practiced economic system, it is its inherent characteristics to create enormous inequality in distribution of income and wealth. These inequalities would persist and continue to increase unless rectified by strong government intervention. Three 'Ps' i.e. Price (determined by the market forces of Demand and Supply both for goods and factors of production), Profit (earning and maximisation as the sole objective of private investment) and Private Ownership (of productive and other assets) are the key ingredient on which the Capitalist System has been built.
- (ii) Communism (and Socialism as a step towards Communism) is fundamentally a rejection of capitalist system. According to Karl Marx (Capital, 1867) the Capitalist System which accumulates capital by re-appropriating the 'surplus value' generated by labour, will ultimately collapse because of its inherent 'structural contradictions. Karl Marx, instead of waiting for this 'natural collapse' predicted a 'proletarian revolution' (by the working class) against the 'bourgeoisie' (the capitalist). As a result of the revolution, all the productive assets would be owned by the state and thus creating a 'classless society'. In this 'classless' society 'everyone will work according to his ability and get share (from the income generated) according to his requirement. In the backdrop of this thesis, the Socialist Economic System practiced in a number countries resulted in :

- a) A total controlled economy under a single political party (communist or socialist party), with little role of market in allocation of resources and distribution of income; and
- b) Macroeconomic Planning (alternate to market system) as an effective tool for allocation of resources and production decision makings.

Communism/Socialism under such a revolutionary system did result in eliminating the gross inequality in distribution of income/wealth witnessed by millions under Capitalist System. At early stage of planning these economies also witnessed a very high economic growth (particularly in industrial sector). However, it could not sustain this momentum even for a century. Socialism as an economic philosophy received a great setback after down fall of its pioneer and leader - Soviet Union. However,

despite this failure of Socialism, it is still practiced with some modifications and blending of market system in some countries. China has emerged as an alternate model to USSR by integrating its economy more closely with dominant capitalist market economies and allowing market forces of demand, supply, prices etc. to function (but government is still a leader and final economic decision maker). As a result of these fundamental changes (now called reforms) China achieved the highest GDP growth never achieved by any other country in the history of economic growth. However, as discussed above it is also creating inequality in distribution of income. This blending of Socialism with Capitalism under one Communist party rule is a new phenomena in the history of economic systems. World is curiously waiting that how long this system would work without uprising against its political system on one hand and social unrest against increasing inequality in distribution of income and wealth on the other. As already discussed China is taking measures to reduce inequality in distribution of income. As a whole Socialist System which emerged on the face of earth in 1917 from USSR, has gradually disappeared and Capitalist System has filled the vacuum.

- (iii) Islamic Economic System, contrary to Capitalism and Socialism, is based on following three divine principles to establish a '*falahi*' (or we may call it Islamic Welfare Economic System^v):
- a) Man is not absolute owner of resources. God own all the resources and man is trustee to use these resources according to guidelines and protection provided to him.
 - b) Economic activities are not guided by self interest only (as in Capitalism). There are binding Islamic moral and legal constraints to acquire and develop resources.
 - c) The religious aspect of earning and spending are as important as other worship obligations and practices of Islam,

Chaudhry (2003-p/1) has summarized as following the economic system which emerges from above three principles:

'The Islamic concept of 'falah' is very comprehensive. It refers to spiritual, moral and socio-economic well-being in this world and success in the Hereafter. At micro level, 'falah' refers to a situation where an individual is adequately provided for in respect of his basic needs, and enjoys necessary freedom and leisure to work for his spiritual and material advancement; whereas at macro level, it aims at establishment of an egalitarian and happy society with clean environment, with freedom from want and with opportunities to its members for progress in socio-political and religious affairs'

Key Features Of Islamic Economic System

As already mentioned the objective of this paper is limited and, therefore, could not provide all the details of Islamic Economic System. While the Communist System is fundamentally different from an Islamic Economic System by totally denying private ownership, profit and the market; Capitalism and Islamic Economic Systems have apparent resemble in many areas such as allowing private ownership, permission of earning profit by the entrepreneur (with some legal and moral constraints in Islam), determination of prices by the market forces (without manipulation of market, hoarding and speculation in Islam) etc.etc^{vi}. Following are the THREE key elements of Islamic Economic System, markedly different from Capitalism and with significant implications for distribution of income and wealth (if fully implemented):

- 1) System of Ushr and Zakaat
- 2) Prohibiting Interest.
- 3) Inheritance Law of Islam.

In the following section the impact of all the three instruments has been discussed with some under hypothetical data to explain the point. In absence of empirical evidence and data, this is a rational approach for analysis and providing logical explanation.

System of Ushr and Zakaat:

In essence there is no difference in Ushr and Zakaat except that Ushr is paid for produce of land and Zakaat on accumulated assets/wealth. The distribution of funds collected from both is the same (discussed below).

Ushr is an obligatory payment from agriculture output at the time of harvesting. If agriculture land is irrigated by rain or some other natural freely available water the producer is obliged to pay ten percent of the output as Ushr. In case irrigation water is not free of cost then the deduction would be five percent.^{vii} It could a big source of funds and effectively reduce an inequality of distribution of income. For example in Pakistan the value addition of agriculture sector contributing towards GDP is about 20 percent. Normally the value addition (which is only the cost of primary factors of production i.e. Rent, Wages, Profit and Interest-not permissible in Islam) is roughly 30-33 percent of total sale value of output. In other words the output subject to Ushr would be about 60 to 66 percent of GDP. Let us assume it 60 Percent of GDP. Since the irrigation system in Pakistan is mixed, an average of 7.5 percent $((5+10)/2= 7.5\%)$ is assumed to be compulsorily collected from farm producer. This would be 4.5 percent (7.5 % of 60%) percent of GDP. Even this conservative estimate would generate from agriculture sector a very respectable amount of funds to be distributed among the neediest sections of the society. It is emphasised here that this is not a tax on agriculture income. The fundamental principles of taxation (direct or indirect) are totally different and the spending of the tax collection is not defined or restricted by Islam as applicable to Zakaat and Ushr (to be discussed below).

Zakaat is a major instrument of restricting excessive accumulation of wealth and helping the poor and most vulnerable members of the society. Without going in to details of defining wealth for payment of Zakaat, which is extensively documented (see for

example Choudry (2013, Chapter/13), a hypothetical example has been used to analyse the impact of payment of Zakaat on the process of accumulation of wealth. The case has been built under following assumptions:

- a) Starting wealth -Rs.50 Million
- b) Earned Income per annum - Rs.10 Million (kept constant for the sake of simplicity)
- c) Consumption kept constant (for the sake of simplicity) as 80% of earned income i.e. Rs, 8.00 Million per annum.
- d) Savings (Income less Consumption) assumed to be the only addition to wealth.
- e) Accumulated assets/wealth not utilised for earning (particularly to earn interest which is strictly prohibited in Islam-discussed below). Investing in other modes permissible in Islam will briefly touched in discussion.

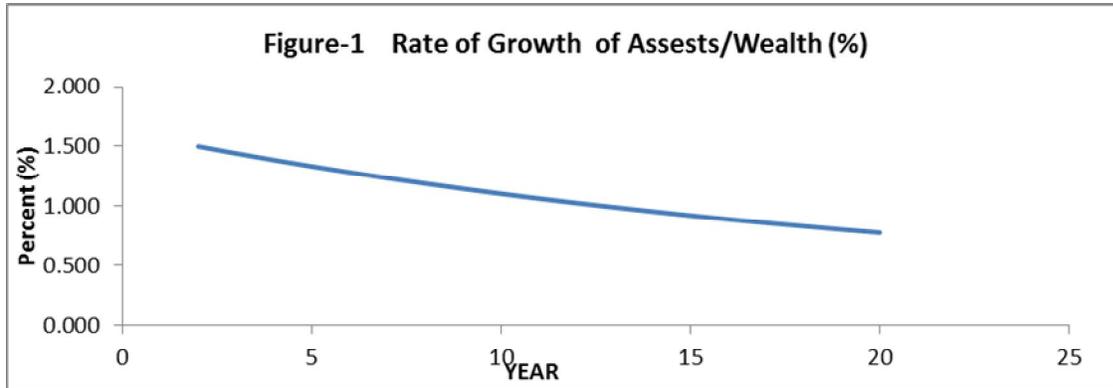
Table-1 clearly shows following three important effects of Zakaat on accumulation and growth of assets/wealth:

- a) As a result of deduction of Zakaat @2.5% from accumulated assets/wealth (kept for one year) the process of further accumulation of assets/wealth becomes slower and slower,. In other words it has a clear dampening effect on accumulation of assets/wealth.
- b) The rate of growth of wealth continuously declines and moving towards zero in the long run. (see Figur-1)
- c) The net income available after Zakaat payment (Zakaat being paid from running income) for consumption and savings is visibly declining. If someone has the obligation to increase his/her consumption over years, further increase in assets would soon stop unless the income is also increasing. Payment of Zakaat pushes an individual to continuously strive to work productively (according to principles of Islam) if he/she wishes to further improve his standard of living. Using 'idle' money for earning through the instrument of interest is not an option in Islam.

Table-1 ZAKAAT PAYMENT AND WEALTH ACCUMULATION

Million Rs

| Year | Wealth | Zakaat Payment @2,5% | Income Per Annum | Net Income Per Annum | Consumption As 80% Of Earned Income | Savings | Rate of Growth of Assets/Wealth (%) |
|------|--------|----------------------|------------------|----------------------|-------------------------------------|---------|-------------------------------------|
| 1 | 50.000 | 1.250 | 10.000 | 8.750 | 8.000 | 0.750 | |
| 2 | 50.750 | 1.269 | 10.000 | 8.731 | 8.000 | 0.731 | 1.500 |
| 3 | 51.481 | 1.287 | 10.000 | 8.713 | 8.000 | 0.713 | 1.441 |
| 4 | 52.194 | 1.305 | 10.000 | 8.695 | 8.000 | 0.695 | 1.385 |
| 5 | 52.889 | 1.322 | 10.000 | 8.678 | 8.000 | 0.678 | 1.332 |
| 6 | 53.567 | 1.339 | 10.000 | 8.661 | 8.000 | 0.661 | 1.281 |
| 7 | 54.228 | 1.356 | 10.000 | 8.644 | 8.000 | 0.644 | 1.234 |
| 8 | 54.872 | 1.372 | 10.000 | 8.628 | 8.000 | 0.628 | 1.188 |
| 9 | 55.500 | 1.388 | 10.000 | 8.612 | 8.000 | 0.612 | 1.145 |
| 10 | 56.113 | 1.403 | 10.000 | 8.597 | 8.000 | 0.597 | 1.104 |
| 11 | 56.710 | 1.418 | 10.000 | 8.582 | 8.000 | 0.582 | 1.064 |
| 12 | 57.292 | 1.432 | 10.000 | 8.568 | 8.000 | 0.568 | 1.027 |
| 13 | 57.860 | 1.447 | 10.000 | 8.553 | 8.000 | 0.553 | 0.991 |
| 14 | 58.414 | 1.460 | 10.000 | 8.540 | 8.000 | 0.540 | 0.957 |
| 15 | 58.953 | 1.474 | 10.000 | 8.526 | 8.000 | 0.526 | 0.924 |
| 16 | 59.479 | 1.487 | 10.000 | 8.513 | 8.000 | 0.513 | 0.893 |
| 17 | 59.992 | 1.500 | 10.000 | 8.500 | 8.000 | 0.500 | 0.863 |
| 18 | 60.493 | 1.512 | 10.000 | 8.488 | 8.000 | 0.488 | 0.834 |
| 19 | 60.980 | 1.525 | 10.000 | 8.475 | 8.000 | 0.475 | 0.806 |
| 20 | 61.456 | 1.536 | 10.000 | 8.464 | 8.000 | 0.464 | 0.780 |



It is somewhat difficult to precisely measure the total assets in an economy available for Zakaat deduction. However, such assets certainly grow in volume as an economy grows. It could be, under conservative estimate, double the size of GDP for a country like Pakistan where per capita in is about \$ 1200 and \$2800 at official exchange rate at purchasing power parity (PPP). As per this estimate Zakaat could easily generate about 5 percent of GDP for distribution among poor section of the society. Thus Zakaat and Ushr together could generate 9 to 10 percent of GDP as Zakaat/Ushr fund annually in a country like Pakistan.

The deduction of Zakaat reduces the inequality of income and wealth from the front, and the clearly defined modes of spending of Zakaat in Islam are targeted towards the most needy and vulnerable class of the society. Those who are entitled to receive Zakaat are of following eight categories:-

- (i) **The Fuqaraa (the poor who do not beg):** Having no or enough money, to meet their basic needs.
- (ii) **The Masaakeen (the poor who beg):** These are extremely poor and, therefore, ask others for food and clothing.
- (iii) **The Debtors:** Debtors burdened by debts because of personal needs or social necessity, and are forced to borrow to spend on himself and his family or do not have enough money after meeting their basic needs to repay the debt, are entitled for Zakaat
- (iv) **Attracting Hearts:** Zakaat is also to be paid to attract the hearts of those who have been inclined towards Islam and facing economic hardship because of this change. Such payment should be made on need basis.
- (v) **Freeing Captives:** Zakaat can be used to get the slaves freed. There is hardly any case of this type in these days.
- (vi) **The traveler:** If traveler is genuinely in need of money to return to his home and his purpose for traveling is lawful, he is entitled to get from Zakaat.
- (vii) **Allah's Cause:** The fighters of an Islamic State, not receiving salary for his services.
- (viii) **Zakaat Collectors:** The employees collecting Zakaat can be compensated for their services from Zakaat fund.

According to Imam Shaafi spending of Zakaat and Ushr on all the above modes is essential. However, the widely accepted view is that of Imam Abu Hanifa that Zakaat and Ushr should be only spent with in these defined areas but not necessarily to be distributed among all the categories all the time.

Prohibiting Interest:

Elimination of interest from the economic system is a revolutionary step with profound effects on all spheres of economic activities. Unfortunately, the approach of many Muslim countries to eliminate interest from the system is not the way it should have been done. The strong condemnations of interest in Islam is widely documented in almost all the books related to this topic besides very clear and unambiguous verses of Qur'an and many Sayings of the Prophet Muhammad (Peace Be Upon Him). Therefore, for the sake of brevity these have not been produced here. In most case, it seems, the conventional interest under an Islamic Title (e.g. Profit and Loss Accounts, Markup, Mudharibah etc.) have been introduced. As a result the desired results of eliminating interest from the system could not be achieved (and would never be achieved).

If interest is eliminated from the system then the famous Hicks-Hansen IS-LM Model (Hicks John and Hansen Alvin, 1937 & 1947/48) and its further extensions would not be relevant for an Islamic country. We know that IS-LM model is a **macroeconomic** tool that establishes a relationship between interest rates and real output in the goods/services market and the money market. Without interest the system would not achieve a state of equilibrium. Similarly, the banking system and its Money Creation Multiplier (or Credit Creation Multiplier) would not work in its present form. The whole system of momentary policy has to change fundamentally if interest is removed from the system. This has not happened in any Islamic country which is a clear indicator that interest is still functional (slightly in a different shape) and a true Islamic Financial and Banking System

is nowhere in the world. The world has seen that when interest (and profit/rent also) was eliminated in the socialist economies then the conventional interest related monetary instruments became redundant. In view of the complexity this issue is not further discussed and the rest of the discussion is kept simple and easy to interpret.

In a capitalist system Income (i.e. GDP) is distributed among four factors of production as following:

$$\text{Wages (W) + Interest (i) + Rent (R) + Profit(P)} \\ W + i + R + P \quad \text{[Equation-1]}$$

In Islamic System the distribution of income would be simply as:

$$W + R + P \quad \text{[Equation-2]}^{\text{viii}}$$

According to equation [1] the capitalist (or those who owns assets) gets income on two accounts that 'i' and 'P'. If 'i' is eliminated it would naturally be distributed among other three factors of production. Beyond any doubt this would create an economic system inherently having less inequality in distribution of income as compared to capitalist system. Zero interest rate together with impact of Zakaat, which taxes the accumulated wealth, would certainly encourage investing. It is reiterated that elimination of interest should not be taken as simple minor change in banking practices. Such a measure must accompany fundamental and revolutionary change in the whole financial management of the economy. This requires strong political will, belief and determination parallel to 'communist atheist' of 1917, after revolution in USSR; where interest, rent and profit (not social surplus) were totally eliminated from the system. Islam is demanding to eliminate only ONE of the four sources of income of Capitalist System-INTEREST.

Inheritance Law Of Islam:

It is beyond the scope of this paper to fully explain the Islamic Inheritance Law. The fundamental principal is that it starts the distribution of property of a deceased person from closest family members and moving towards farthest of family. Son(s), daughter(s), wife, husband and parents are the prime recipients. This distribution is explicitly illustrated in Qur'an and cannot be changed or modified. Under varying conditions the share of relatives accordingly changes. The important principle is that the owner at the time of his/her death cannot change these shares. This is a very powerful and effective instrument of redistribution of all kinds of assets and wealth accumulated by a person during his/her life time. (For a comprehensive discussion on Inheritance in Islam see Razi (2008))

CONCLUSION

Capitalism and Communism are two extreme for distribution of income and wealth. While pure Capitalism put no restriction to accumulate assets and wealth. The forces and system of Capitalism also results in highly skewed distribution of income. On the hand Communism imposes un-natural restrictions under the editorship of one party. As a result the system could not survive. Islamic Economic System provides a midway without compromising the liberty and fundamental human rights. Islamic System discourages earning without effort (as interest) and motivates to work and invest and tax simple accumulation of assets and wealth. Unfortunately there is no complete practical example anywhere in the world which could be presented as an example.

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End Notes:

ⁱ Currently pure Capitalism is not practiced anywhere in the world. There are, however, some countries are having a dominate private sector guided fundamentally by the market forces but still a number of areas are controlled and operated by the government negating the market forces as the sole agents for allocation of resources

ⁱⁱ Zero and 1 Gini coefficient mean perfect equality and perfect inequality respectively. When an economy moves away from zero indicates increasing inequality and vis versa.

ⁱⁱⁱ For a very comprehensive documentation of bibliography of Islamic Economic System see Islahi Abdul Azim (1997 and 1998)

^{iv} See The World Fact Book <https://www.cia.gov/library/publications/the-world-factbook>

^v For a more elaborate account of these divine principles see Chaudhry (2003)

^{vi} For a very good comparison of these two system see Salimi Meysam (2012)

^{vii} For a full account of Ushr on different kinds of products, see Chaudry (chapter 13).

^{viii} In pure socialist or communist system only labour is considered to be the factor of production and all income would be only in terms of 'W'. The rest of the society takes share from their income called 'Social Surplus'.