

## Chapter Two: Theory of Production in Islam

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**Production:** Production is a process of combining various material inputs and immaterial inputs (plans, know-how) in order to make something for consumption (the output). It is the act of creating output, a good or service which has value and contributes to the utility of individuals.

Economic well-being is created in a production process, meaning all economic activities that aim directly or indirectly to satisfy human wants and needs. The degree to which the needs are satisfied is often accepted as a measure of economic well-being. In production there are two features which explain increasing economic well-being. They are improving quality-price-ratio of goods and services and increasing incomes from growing and more efficient market production.

### Production in Islam

Production in his view must refer to the utility value and is still in the frame of halal value and does not endanger a person or a group of people.

Production is defined as any form of activity carried out by humans to realize benefits or add it by exploring the economic resources provided by Allah *Subhanahu wa Ta'ala*, so that become a problem to meet human needs.

Thus it can be concluded that production in Islamic definition is different from conventional production. Islamic production emphasizes efficiency optimization and profit optimization. It is clear that Islamic production is not merely seeking profit (*profit oriented*), but to (*ibadah oriented*) so that whatever goods are produced then an Islamic producer will emphasize ethics in production.

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## **Factors of Production**

Factors of production are the resources used by a company to produce goods and services. The universally recognized factors of production include land, labor, and capital. Some scholars include enterprise - entrepreneurship - as a fourth factor, while many argue that it should fall under labor.

### **Types of Factors and Examples**

Let's take a look at each of the factors along with some examples.

**Land:** Land is often an essential factor of production in many economic activities. In fact, if you really think about it, it's impossible to do anything without land - where else are you going to place your factory, grow your crops, mine your minerals, drill for oil, or even stand to provide a service to a customer? Keep in mind that land includes not just the dirt, but also the natural resources on it or in it, such as trees, water, precious metals, minerals, and fossil fuels.

**Labor:** The second factor of production is labor. Labor is the effort that people contribute to the production of goods and services. Labor resources include the work done by the waiter who brings your food at a local restaurant as well as the engineer who designed the bus that transports you to school. It includes an artist's creation of a painting as well as the work of the pilot flying the airplane overhead. If you have ever been paid for a job, you have contributed labor resources to the production of goods or services. The income earned by labor resources is called wages and is the largest source of income for most people.

**Capital:** The third factor of production is capital. Think of capital as the machinery, tools and buildings humans use to produce goods and services. Some common examples of capital include hammers, forklifts, conveyer belts, computers, and delivery vans. Capital differs based on the worker and the type of work being done. For example, a doctor may use a stethoscope and an examination room to provide medical services. Your teacher may use textbooks, desks, and a whiteboard to produce education services. The income earned by owners of capital resources is interest.

**Entrepreneurship:** The fourth factor of production is entrepreneurship. An entrepreneur is a

person who combines the other factors of production - land, labor, and capital - to earn a profit. The most successful entrepreneurs are innovators who find new ways produce goods and services or who develop new goods and services to bring to market. Without the entrepreneur combining land, labor, and capital in new ways, many of the innovations we see around us would not exist. Think of the entrepreneurship of Henry Ford or Bill Gates. Entrepreneurs are a vital engine of economic growth helping to build some of the largest firms in the world as well as some of the small businesses in your neighborhood. Entrepreneurs thrive in economies where they have the freedom to start businesses and buy resources freely.

## **Principles of Production Activities**

### ***Tauhid Principle***

Islamic economics is an economy based on divinity. It has a starting point from Allah and has final goal in Allah. This economic goal helps humans worship for Allah.

### ***Humanity Principle (al-Insaniyyah)***

The principle of humanity, first is the obligation of humans to worship Allah SWT and prosper the earth (Q.S. Hud (11) : 61)

*To the Thamud People (We sent) Salih one of their own brethren. He said: "O my people! worship Allah: ye have no other god but Him. It is He Who hath produced you from the earth and settled you therein: then ask forgiveness of Him and turn to Him (in repentance): for my Lord is (always) near ready to answer." (QS. Hud : 61)*

The implementation of humanitarian principles includes:

- A) Production activities are directed at improving human well-being, not just some people.

- B) Management and utilization of economic resources are the rights of all humans whose implementation can be prepared by public or state policies.
- C) Production activities are manifestations of submission to Allah, as a way worshipping Him.
- D) Increasing the welfare of individuals and the community becomes the goal of Humanitarian-based production activities.

### ***Equity Principle (al-‘Adl)***

This principle affirms that being fair with anyone will increase production capacity and quality of life for humans. This principle, for example in the letter Al-Maidah verse 8, the word ‘*adl*’ is an attitude that is close to piety.

The principle of justice is the implementation of human relations based on belief in God.

Because humans are created based on rights, obligations and responsibilities, the principle of justice seeks justice in all life contexts, besides justice or balance is the character of the universe and human character that is implemented in his life. One form of distributing wealth (Zakat), optimizing the supply of labor, paying attention to the rights of workers and companies, setting production prices in accordance with the ability of consumers. In activities in the Islamic world of work requires to do justice and it is no exception to those who are not liked (QS Al-Maidah: 8)

*O ye who believe! stand out firmly for Allah as witnesses to fair dealing and let not the hatred of others to you make you swerve to wrong and depart from justice. Be just: that is next to Piety: and fear Allah for Allah is well-acquainted with all that ye do. (QS Al-Maidah : 8)*

Implementation of the principle of justice can increase production capacity with the aim of increasing the volume of human welfare in general. In the concept of Islamic production, the form of justice is distributive which has two meanings. First, the parties involved get the portion

of welfare in accordance with the input given proportionally. Second, the rights of the community and consumers as production stakeholders must be met by producers.

### ***Benefaction Principle (al-Maslahah)***

This principle confirms the understanding that humans must do as much virtue as possible in their lives. This principle has vertical and horizontal implications. In the vertical dimension, this principle is God's command and every virtue will be rewarded. While the horizontal dimensions of goodness are done to fellow humans and their natural environment. In the principle of benefaction, there is a principle that by managing (SDE), in fact humans have actualized their goodness as servants of Allah and His caliphs that are actualizing their natural potential optimally to put their functions in the world and glorify the commands of Allah SWT.

### ***Independence Principle (al-Hurriyah) and Responsibility (al-Fardh)***

Islam recognizes and respects human freedom because the creation of humans has a clear purpose (QS Ali Imran 190-191) that is, not submit to anything but Allah (Lukman : 32)

*When a wave covers them like the canopy (of clouds) they call to Allah offering Him sincere devotion. But when He has delivered them safely to land there are among them those that halt between (right and wrong). But none reject Our Signs except only a perfidious ungrateful (wretch)! (QS. Luqman : 32)*

The implementation of the independences principles and responsibility includes:

A) Every human being is given the freedom by Allah to actualize various ways of living according to his nature but in each free choice will be held accountable in the last day.

B) Every producer is given the freedom to carry out production activities along with responsibilities to maintain the overall human dignity, religious values and environmental

preservation. The implication is that every production activity must have a positive influence on survival, economic growth, and general welfare improvement.

C) The responsibility of producers is a logical consequence of their freedom to develop their production capacity. Responsibility has an eschatological meaning, namely the responsibility before Allah even though its implementation relates to fellow human beings and their environment.

The principles of production ethics are imperative because they demand enforcement in production activities. The implementation of this principle has a real influence on the mechanism and performance of the production

## **Capital Mobilization Modes in Islam**

### **1. Lending Modes**

- a. Qard e Hasana (Benevolent Loan)
- b. Loan on Normal Profit

### **2. Trade Related Modes**

- a. Bai- E- Murabaha (Contract Sale)
- b. Bie- E Muazzal (Sales Under Deferred Payment)
- c. Bie-E- Salam (Advance Purchase)
- d. Ijara (Leasing)
- e. Ijara Wa Iqtina (Hire Purchase)

### **3. Participatory Modes**

- a. Mudaraba (Trust Financing)
- b. Musharaka (Partnership)
- c. Mujahra (Share Cropping)
- d. Musakah (Irrigation)

## **Mudaraba (trust financing)**

To engage in a commercial venture, one party supplies resources to the other party with the expectation that any income would be exchanged based on the agreement. Losses will be taken by capital supplier. Mudaraba deals with those with expertise for those who have money, where the first party provides capital and the other party provides the expertise to gain Halal (legal) benefit that will be shared in a mutually agreed proportion. This sort of business venture serves the interest of the owner of the capital and the Mudarib (agent).

## **Musharaka (partnership)**

Musharaka is an investment model focused on profit-loss-sharing (PLS), where one, two, or more entrepreneurs approach Islamic Financial Institutes (IFIs) to request the funding needed for a project. The IFI provides the requisite funding for the project along with other partners. Both participants have the right to participate in the project, including IFI. This right can also be waived by them. The income must be allocated by the negotiated ratio, which must not be the same as the capital ratio. However, costs are shared in precisely the same proportion as the funding for the project was given by the various partners.

## **Murabaha (cost-plus financing)**

Under this process, the Islamic microfinance institution buys shariah-approved products from the seller and sells the products to the customer at a fixed rate of profit. At some settled upon future date, the consumer must pay the price in installments (s). Under this model, the consumer is not needed to keep any record. Still, it should be required to preserve the transaction record as records that show purchasing during the transaction are necessary - making it a possible production mode for small businesses.

### **Bai e Muajjal (sale and purchase under deferred payment)**

'Bai-Muajjal' means a transaction for which payment is made at a future date or a fixed period. It is a contract between the buyer and the seller. In a lump sum or fixed installments, the seller sells certain particular goods, permissible under the Shariah rules of the country, to the buyer at an agreed fixed price payable at a specific fixed future date.

### **Bai e Salam (advance purchase and sale)**

Bai e Salam means advance buying and sale, the mode of financing unique to agriculture in Islam. Contracts are conducted under this system to satisfy customers' short-term funding needs. The item is designed such that the spot price is smaller than the shipped item's future price. Bai e salam is a useful and efficient mode for microfinance clients, and It has been known that a significant proportion of clients who are only involved in short-term investment funding are in the target class.

### **Ijara (leasing)**



Ijara is a contract for a fixed period, at the end of which the company may give the asset to the same customer or sell it. As asset ownership remains with the MFI, the organization must bear all risks and liabilities that differ significantly from conventional leasing, making it a more desirable option for microfinance customers. The institution is subject to the risk of ownership under ijara. In the event of damage to or deterioration of the asset, the institution is liable for all damages and not the customer, unless the customer's negligence has caused the loss.