

A SURVEY ON ISLAMIC PRODUCTION THEORY

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Abstract

Islamic economics has been growing immensely for almost four decades since the First International Conference on Islamic Economics held in Makkah in February 1976. Many improvements on developing Islamic economics as an independent discipline have been done by many scholars. For instance, there are scholars that attempt to develop Islamic economics from the point of view of *fiqh* (jurisprudence) and some try to cultivate it from the economic approach. The latter's effort is to critically integrate between Islamic heritage and modern economics in order to establish such discipline. This actually is the part of the realization of Islamization of Knowledge (IOK) agendas as proposed by Al-Attas and Al-Faruqi. One of the major challenges faced by Islamic economics theory is to build microeconomic concept rather than its macroeconomic counterpart. Correspondingly, it is commonly known that one of the most important microeconomic concepts includes the actions done by producers in order to execute production in the economy. This paper, hence, aims to present the production theory from the Islamic economics perspective. It provides economic thought from several contemporary Islamic economists including Muhammad Abdul Mannan, Muhammad Nejatullah Siddiqi, and many more.

Keywords: Production theory, Islamic economics

1. Introduction

Islamic economics has been undergoing a remarkable growth for nearly four decades, since the First International Conference on Islamic Economics held in Makkah in February 1976. It is developed with the vision to apply the *shariah* rule comprehensively in the present Muslim society. It is believed to provide better solution to the economic tribulations occur in

the Muslim countries, which hence is expected to develop the betterment of people's life in this world and the Hereafter (Beik, 2013).

Currently, Islamic economics is still on the process of evolution. Many improvements on developing this subject as an independent discipline have been done by many Islamic scholars. For instance, there are scholars that attempt to develop Islamic economics from the point of view of *fiqh* (jurisprudence) and some try to cultivate it from the economic approach. The former, according to Haneef (1995), can be considered as the earliest academicians that write on the issue. Their significant contributions are more on the legalistic approach in developing the subject, such as issues on *riba* and interest, *zakat*, and banking sector.

On the other hand, the latter's effort is to critically integrate between Islamic heritage and modern economics in order to establish such discipline. Haneef (1995) argues scholars under this category usually have conventional mainstream economics background, i.e. neoclassical-Keynesian synthesis. Therefore, their analyses typically employ a *step-by-step* approach to inject Islamic content in mainstream economics in purposeful and progressive manner. This actually is the part of the realization of Islamization of Knowledge (IOK) agendas as proposed by Al-Attas and Al-Faruqi.

One of the major challenges faced by Islamic economics theory is to build microeconomic concept rather than its macroeconomic counterpart (Chapra, 2000). Unlike Islamic finance and macroeconomics, the literatures on the Islamic microeconomics are still limited. This notion is also in line with Yalcintas (1986) as cited in Chapra (2000) that opines, "Construction microeconomic theory under the Islamic constraint might be the most challenging task before Islamic economics."

With regard to the microeconomic concepts, it is commonly known that one of the most important ideas is the action done by producers in order to execute the activity of producing goods and services in the economy. Different Islamic economists have different idea in defining and analyzing this concept. For instance, Mannan (1980) defines production as the creation of utilities with some constraints including moral as well as social restrictions. In addition, Kahf (1987) as cited in Haneef (1995) views production from the positive and normative perspectives. He argues the former relates to "material and economics laws and

matters dealing with the production functions”, while the latter refers to “stimuli and goals of production”.

This paper, thus, aims to present the production theory from the Islamic economics viewpoint. It provides economic thought from several contemporary Islamic economists including Muhammad Abdul Mannan, Muhammad Nejatullah Siddiqi, Monzer Kahf, and many more. Specifically, this paper attempts to answer three research questions that are as follows.

1. What is the production concept based on Islamic economics perspective?
2. What are the general ethics and principles of Islamic production?
3. What is the firm objective?

This paper is divided into six chapters including introduction in the first one. Chapter two deliberates methodology, followed by the concept of production theory from Islamic angel in chapter three. Chapter four presents Islamic ethics framework and principles for production. Chapter five presents profit maximization according to Islamic economics. Chapter six concludes and delivers some critical review toward the theory.

2. Methodology

Methodology is a general approach to conduct a particular research topic. In this regard, it is a system of explicit rules and procedures upon which research is based and against which claims knowledge are comprehensively evaluated (Imaduddin, 2006).

The present study extracts from secondary sources of the literature and aims to provide production theory from Islamic point of view. In this case, several cotemporary Islamic scholars have been selected as the main references of the study. Moreover, various journal papers, books, and articles have been referred for the purpose achievement of this paper. In addition, this study does not test any hypothesis. It only delivers economic thought of some Islamic scholars that relate to the production theory.

3. Islamic Concept of Production

3.1. Introduction

This section discusses the Islamic concept of production. It starts with the definition of production from several Islamic scholars. Subsequently the next part explains the factors of production. Last part of this section explains productivity from Islamic perspective.

3.2. Definition of Production

Mannan (1980) defines production as ‘the creation of utilities’ that are *halal* (permitted) and beneficial for the economic welfare from the perspective of Islamic teaching. He argues that the increase of production of beneficial goods is one condition to achieve economic welfare according to Islam. This can be realized through maximum utilization of human and material resources, as well as through the participation of maximum number in the process of production. Therefore, the process of production consists of four fundamental aspects namely quality, quantity, maximization, and participation. These distinguish the role of firm in the economy of which is not only as the products provider, but also as the “joint-guardian” with the government of the economic welfare.

With regard to production process, Mannan (1984) argues that it is a “cooperative effort between members of the society to produce goods and services for their economic well-being”. This indicates the importance of brotherhood to generate cooperation, not competition, among economic agents in the production process. In this case, the center of economic agent is “individual through group”, which can be seen as moderate version of capitalism and socialism systems. Mannan further explains surplus production is necessary in an Islamic economy in order to ensure provisions sufficiency for the present and future generations.

Mannan also defines production as a social process. In this case, different with the neoclassical approach, Mannan highlights the need for the distributive criterion to determine production decisions. This indicates the importance of production process to provide basic needs for all members in the society, specifically for the poor. Therefore, production is not merely based on the market price, but also based on the plan of the state that serves basic

human needs. Haneef (1995) summarizes diagrammatically pertaining the production concept proposed by Mannan as seen in Figure 1.

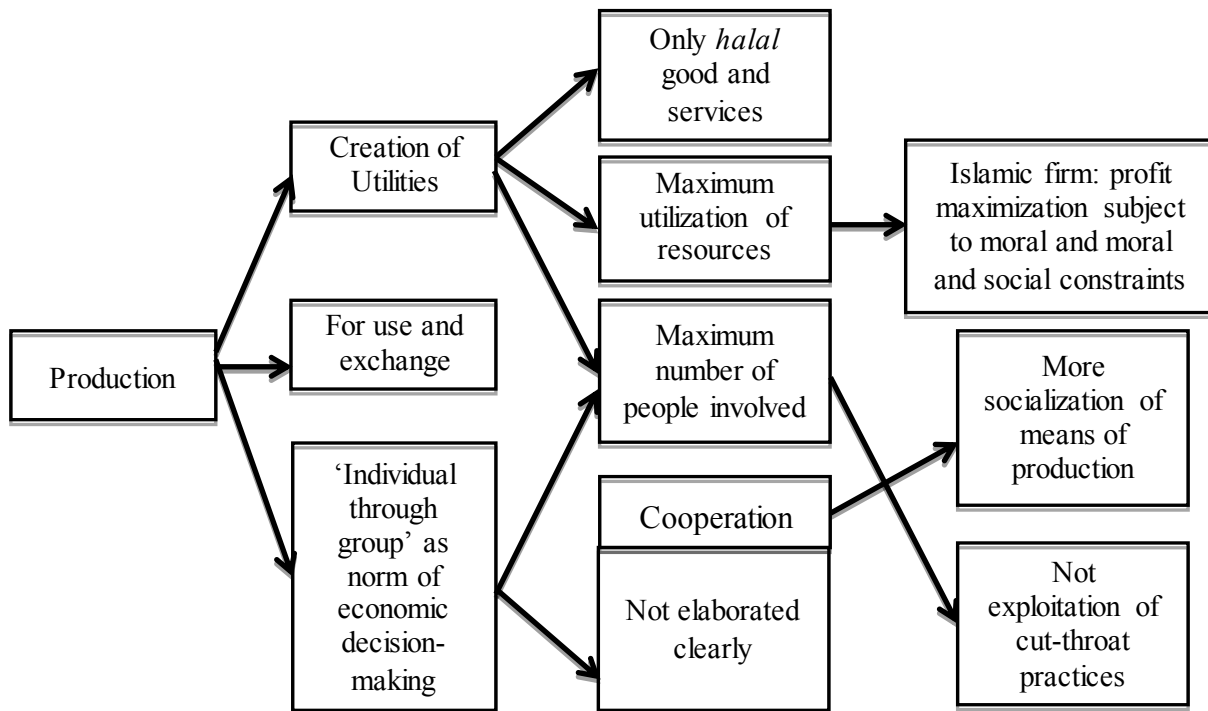


Figure 1: Islamic Production Concept according to Mannan
 Source: Haneef (1995)

Similarly, Akhtar (1992) argues that production must contemplate the questions of morality, education, religion, and many other things. In line with Mannan, Akhtar is on the view that urgency of moral aspects inclusion is for the maximum utilization of human and material resources through the participation of the maximum number of people in the productive process.

Moreover, Akhtar opines in terms of price, the producers should attempt to produce goods as cheaply as possible and exploit both material and human resources in order to realize full employment. In this case, the production activity does not only aim to increase the volume of production, but also to ensue participation of the maximum number of people in the productive process.

In addition, Pramanik (1995) argues just price is based on full cost or average cost principle taking into account cooperation and compassion and not “cut-throat competition”.

Besides, producer has a special obligation for the society and thus they should remain with fair level of profit and not maximum level of profit.

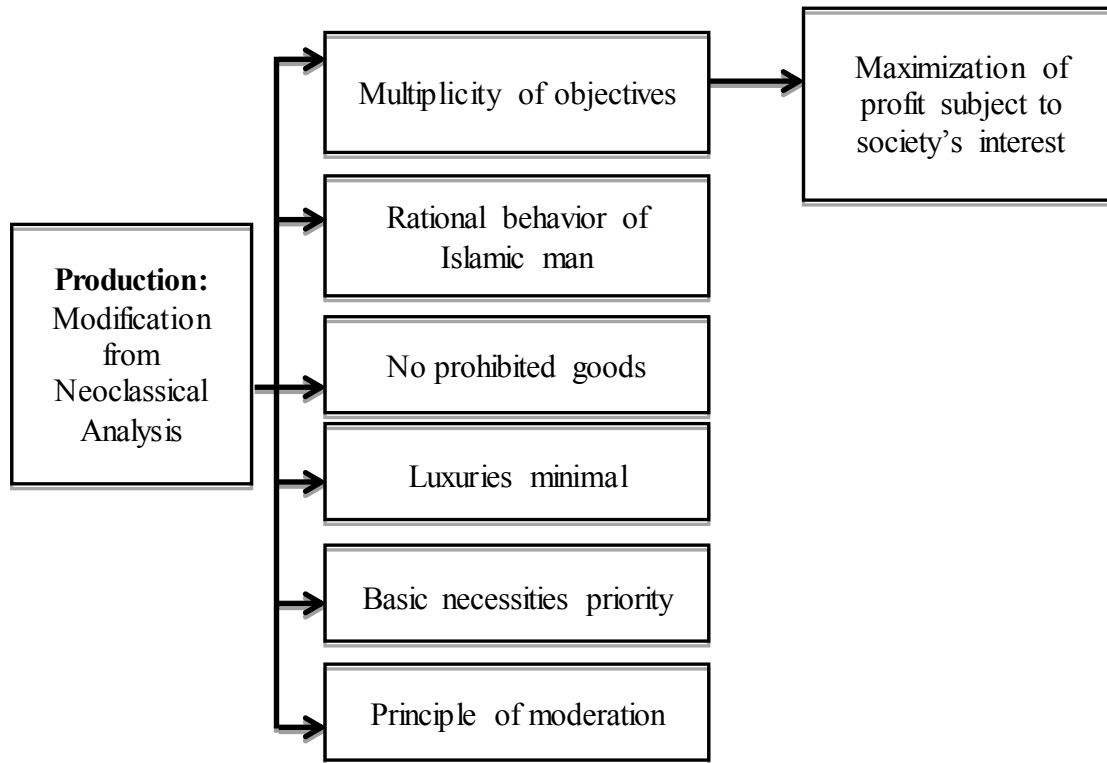


Figure 2: Islamic Production Concept according to Siddiqi
Source: Haneef (1995)

Siddiqi (1988) is on the view that cooperation among producers is essential to achieve social objectives. Hence, social goods production shall always be prioritized over individual benefit in the Islamic production structure. Haneef (1995) is on the opinion that Siddiqi's view of production is modification of neoclassical analysis of which there are several principles must be included, namely multiplicity of objectives, rational behavior of Islamic man, absence of prohibited goods, luxuries minimization, basic necessities priority, and moderation principle. The modification of neoclassical economics according to Siddiqi's point of view is that he proposed the idea of 'Islamic man' to the production concept. Figure 2 presents the diagrammatical summary of Islamic production concept according to Siddiqi.

Pramanik (1995) highlights producer behavior should consider whether or not the goods and services to be produced are forbidden. He opines all factors in favor of promoting imperfect markets through deceptive advertising, speculation, hoarding, and discrimination of information are false categorically discouraged in favor of free market. High priority for producing need-based as apposed to want-based goods and services, effective need and not-demand are the criterion of production.

Kahf (1992) defines production as human's means to repair moral and material condition in order to achieve happiness in the world and the Hereafter according to Islamic teaching. The happiness can be realized when people are able to produce sufficient economic well-being. This definition is based on the *Quran* 7: 32 where Allah SWT says, "Say, 'Who has forbidden the adornment of Allah which He has produced for His servants and the good things of provision?' Say, 'They are for those who believed during the life of this world, exclusively [for them] on the Day of Resurrection.' Thus do We detail the verses for a people who know."

Sukarno (2010) defines production as human activity that generates goods and services for the benefit of the consumers. This activity does not only about how to manage and take benefit from the economic resources, but also on how to actualize human's ability and capability. Therefore, Islam guides production activity from the process, the goals, as well as the final results. Sukarno further argues there are several Islamic standard with respect to production, those are:

1. Profit maximization should not be the only motivation of production. This goal must include social return consideration and economic justice achievement (*al-'adalah al-iqtisadiyah*).
2. Producers should strengthen their spiritual conditions as their basis of decision-making in the process of production.
3. Production should focus on two things, namely functioning human resources in order to achieve good quality of life and fulfilling basic necessities of human.

3.3. Factors of Production

Pramanik (1995) explains factors of productions under Islamic worldview consist of similar aspects with secular worldview with significant differences in each aspect. Those factors of productions are land, labor, capital, and organizer/entrepreneur.

With regard to land as factor of production, Pramanik (1995) argues since as a part of this earth, land belongs to God and landlord cannot charge any rent, unless the owner of land as a factor puts his capital and labor on the land. Besides, landlord can go for *Mudaraba* (sale) contract or profit and loss sharing contract if he can put only capital but no labor on his own. Therefore, sharecropping is discouraged in Islam. Unlike secular worldview, landlord forfeits the rights to his land even though legally acquired for not utilizing land for three consecutive years.

It is agreed that the best course for a person having land in excess of what he himself uses is to give it to his landless brother for cultivation free of charge. However, if rent is to be taken there is no consensus regarding its form. Some permit only cash rent, some only sharecropping i.e. *muzara'ah* and there are still others who allow both. On balance, sharecropping is considered to be the best. For the outcome of cultivation being uncertain, predetermined, absolute rent may only be a kind of *riba* (Hasan, 1983).

Additionally, Akhtar (1992) explains Islam recognizes the creation of only those utilities, which can maximize the economic welfare of the community—a welfare, which takes into account the basic principles of economic ethics. Both the Quran and *ahadith* lay much emphasis on the proper cultivation of land. Therefore, the Holy Quran drawn attention to the necessity of turning wasteland into gardens by making arrangements for watering it, and growing good crops. Islam has attached great importance to irrigation for increasing agricultural production, even more than fourteen hundred years ago Islam did realize the need for balanced growth, a balance between agricultural and industrial development.

Related to labor as factor production, Pramanik (1995) explains income earned through the use of one's labor is most honored in the eyes of God. Supposedly, labor's share is not determined by marginal productivity theory as understood in the neoclassical economics, but by the needs of the labor with average family size. Moreover, labor should be treated as partner in the production process, just like *Mudarib* using capital. Besides, he

argues the existence of institution to stabilize fluctuation in wage level is encouraged. Similarly, trade unions are also allowed in order to negotiate fair wages based on consultation for the mutual interest of employees and employers.

As for capital, Pramanik opines that it is actually the most controversial factor of production, as not all Islamic scholars recognize this point, as capital is labor embodied, a dead factor in-capable of doing anything without active factor labor. Interest is condemned for three reasons, namely concentration of income, exploitation of the poor, and encouraging laziness. Lastly, entrepreneurship, skilled labor and capital merged together to qualify for profits subject to *mudaraba* principle of contract.

3.4. Productivity in Islam

According to the OECD Statistics Directorate Division of Structural Economic Statistics (2008), productivity is defined as a ratio of a volume measure of output to a measure of input use. Productivity is a revealing indicator of several economic indicators, as it offers a dynamic measure of economic growth, competitiveness and living standards within the economy. Moreover, it helps in explaining the principal economic foundation that is important for economic growth and social development.

On the other hand, as comprehensive teaching, Islam also covers productivity, and even encourages its people to be productive. This is shown from many verses in the Holy Quran and *ahadith* Rasulullah (peace be upon him) that explain the importance of work and productivity for Muslims, such as in *Quran* 9: 105, *Quran* 62: 10, and *Quran* 67: 15.

Allah says, “*And say, ‘Do [as you will], for Allah will see your deeds, and [so, will] His Messenger and the believers. And you will be returned to the Knower of the unseen and the witnessed, and He will inform you of what you used to do.’*” (*Quran* 9: 105). Allah says, “*And when the prayer has been concluded, disperse within the land and seek from the bounty of Allah, and remember Allah often that you may succeed.*” (*Quran* 62: 10)

Allah says, “*It is He Who has made the earth manageable for you, so traverse ye through its tracts and enjoy of the Sustenance which He furnishes: but unto Him is the Resurrection.*” (*Quran* 67: 15)

With regard to the meaning of *Quran* 62: 10, Imam Ibn Katsir explains it reflects the strong relationship between Friday prayers and the obligation of people to search sustenance that has been provided in the world. He further elucidates that for people who do trading after performing Friday prayers, Allah will bless and reward them seventyfold (*Ibnu Katsir, Tafsirul Quranil 'Azhim*, volume IV).

From the aforesaid three verses, it is clear that Allah SWT orders Muslims and His believers to work and find fortune all over the world. Therefore, in Islam, work is considered one of the forms of worship of believers. Even more, Rasulullah (peace be upon him) stated, “*In the hereafter, honest and trustworthy traders will be together with the Prophets, other honest people, and martyrs.*” (Hadith narrated by At-Tirmidzi).

Furthermore, besides prayer, other forms of worship, such as *zakah* (alms), are also related to productivity, as they encourage work productivity as well as ethics. This implies that people who are willing to pay *zakah* must have a high spirit and work ethic, as can be shown in the *Quran* 18: 1-4, where Allah says, “*The believers. They who are during their prayer humbly submissive. And they who turn away from ill speech. And they who are observant of zakah.*”

Likewise, *zakah* also relates to good deeds in working. Those who pay *zakah* will always try to seek the means in a permitted way according to Islamic teachings. This is because Allah only accepts *zakah* worship of wealth that is gained through the proper way. As a result, *zakah* will lead to true peace, happiness, security and prosperity in this life and in the Hereafter. Rasulullah (peace be upon him) said, “*Truly Allah shall not receive Sadaqah (charity) with deception.*” (Hadith narrated by Muslim).

In addition, Allah says, “*Take Sadaqah (alms) from their wealth in order to purify them and sanctify them with it, and invoke Allah for them. Verily, your invocations are a source of security for them; and Allah is All-Hearer, All Knower.*” (*Quran* 9: 103).

Moreover, Islam encourages the professionalism of employers as well as employees. Employers have to give a proper wage to their workers. For instance, *Quran* 28: 23-28 present the story of the wage payment from Prophet Syuaib to Prophet Moses based on the contract they have agreed. At the same time, employees also have to perform their best efforts in their work. Because in one *ahadith* of Rasulullah (peace be upon him), it is stated

that Allah loves professional and committed workers. In addition, Qardhawi (1997) affirms hard work behavior as the basis production as it contains optimum effort of producers in order to realize individual and collective welfare.

From a religious perspective, it can be concluded that productivity is an important aspect in the life of a Muslim as an individual, as well as society. Thus, productivity not only economically relates to human life, but also has a broad dimension, including a worship dimension as God's creatures and servants.

4. Islamic Ethics Framework and Principles for Production

4.1. Introduction

As the only one Allah's religion based on the *Quran* 3: 19 and 85, Islam is the curriculum of human life (*manhaj al-hayat*) that becomes the main reference and framework for the life value system. In this context, Islam is not merely a moral and ethical base, but also an operational system that is applicable to every part of human life. Production is also derived from the Islamic teaching. This chapter discusses five general principles of Islamic production that are derived from the *Quran* and *ahadith*, namely unity (*at-tawhid*), humanity (*al-insaniyyah*), justice (*al-'adl*), goodness (*al-maslahah*), and freedom (*al-hurriyah*) with responsibility (*al-fardh*).

4.2. Unity (*At-Tawhid*)

Allah SWT says, "*He is Allah, other than whom there is no deity, Knower of the unseen and the witnessed. He is the Entirely Merciful, the Especially Merciful. He is Allah, other than whom there is no deity, the Sovereign, the Pure, the Perfection, the Bestower of Faith the Overseer, the Exalted in Might, the Compeller, the Superior. Exalted is Allah above whatever they associated with Him.*" (*Quran* 59: 22-23). This verse shows that Allah is the One above everything and human is created to worship Him. Therefore, all activities, including production must be intended only to worship Him.

Sukarno (2010) argues that unity (*at-tawhid*) is the fundamental principle of overall Islamic teaching. With regard to the production, the unity principle is reflected through how producers conduct their production activities for the sake of their submission to Allah. In

addition, this principle highlights Allah as the Creator and the Owner of this world and He has regulated all the rules and law for human's life, including production and producers' behavior. As the consequences, the implementation of unity principle in the production activity will have some effects that are as follows.

1. If producers do the production activities as their obedience to Allah, their actions would be counted as worship to God.
2. Production is one of the means of self-devotion to Allah as His vicegerent to utilize the earth wisely.
3. Production is one of the ways of self-actualization. This shows the ability of humans as leaders in this world among other God's creatures (*khalifah fi al-Ardh*).
4. The ownership of factor productions that the producers have is relative, as the legitimate possession only belongs to God. Therefore, the producers have the responsibility in employing them, without causing any harm to others.
5. As a consequence of worship motivation, profit maximization, hence, should not be regarded as the sole objective of producers. In this case, production aims to achieve multiple objectives, namely to realize profit, to fulfill society's needs, to redistribute wealth, to utilize economic resources in purposive manner, and to enhance people's capacity and capability.

4.3. Humanity (*Al-Insaniyyah*)

Humanity principle refers to human's role as God's servant (*'abd al-Allah*) and His vicegerent (*khalifah fi al-Ardh*). Allah says, "And to Thamud [We sent] their brother Salih. He said, 'Oh my people, worship Allah; you have no deity other than Him. He has produced you from the earth and settled you in it, so ask forgiveness of Him and then repent to Him. Indeed, my Lord is near and responsive'." (*Quran* 11: 61). This verse indicates the importance of human's existence in this world to conduct useful activities, including production, which aims at generating fair and prosperous life (Sukarno, 2010). The implementation of this principle towards production activities is through several channels that are as follows.

1. Production should aim at maximizing total welfare of all society's members. Mannan (1984) argues that the fundamental principle of process of production is the manifestation of "economic welfare", which considers the question of morality, education, religion, and many other things. To Mannan, Islamic concept of economic welfare consists in the increasing of income that results from maximum utilization of resources, as well as from maximum number of people in the productive process.
2. Economic resources management and utilization are humans' right. In this case, state may impose some rules pertaining the implementation in order to achieve economic welfare.
3. Process of production is the manifestation of submission to God, and thus this becomes one mean of worshipping Him.

4.4. Justice (*Al-'Adl*)

God commands mankind for being just and fair towards others that is clearly stated in the *Quran* 16: 90 where Allah says, "*Indeed, Allah orders justice and good conduct and giving help to relatives and forbids immorality and bad conduct and oppression. He admonishes you that perhaps you will be reminded.*" In regards production, it is believed that justice and fairness are very important in order to alleviate inequity among groups of people. It, thus, will avoid wealth and economic resources to be dominated by the hand of the rich only. Besides, this principle promotes the producers to become just in treating the factors of production that involve human resources, natural resources, and financial capital.

Sukarno (2010) argues that this principle has to be reflected through all of production aspect including the process, buy and sell activities, cost and benefit calculation, and many other things. Particularly, the application of justice principle towards process of production is through several means that are as follows.

1. Process of production has to be able to create redistribute economic resources among people in order to attain economic independence.
2. Process of production is the foundation to improve society well-being through output production and profit achievement.

3. Process of production must ensure the ecosystem and environment sustainability by using the resources in responsible and proportional manner.
4. Producers should pay attention to their employees' welfare by giving fair wage. As regards 'fair wage', it follows that a prime consideration governing income distribution in Islam is the fulfillment of the basic needs of all members of the community. These needs include the minimal requirements for food, clothing, shelter, education, and health care. A minimum wage must cover the cost of providing these needs for an average size family (Hasan, 2006).
5. Producers should focus on the needs and interests of overall society members by inducing society empowerment programs.
6. It is important for the producers to make strategies to solve problems that might arise from production process. For example, this can be done through imposing transparency strategy between shareholders, employers, employees, consumers, and society in general.

4.5. Goodness (*Al-Maslahah*)

Goodness principle connects the vertical and horizontal dimension. The former refers to the manifestation of human role as leaders in this earth; while the latter shows the responsibility that human has towards other. Allah loves people who do goodness for the sake of Him. This is reflected through many verses in the *Quran*, one of which is in the *Quran* 2: 195, "And spend in the way of Allah and do not throw [yourselves] with your own hands into destruction by refraining. And do good; indeed, Allah loves the doers of good."

As the relation with production activities, this principle is reflected through the efficient process of production, benefit distribution towards other parties through the activity, harm prevention, and wise-utilization of economic resources. In particular, Sukarno (2010) explains the implantation of this principle in the production activities that are as follows.

1. Producers produce only permitted (*halal*) goods and services and do not cause any harm from their process of production activities.
2. Producers give benefit for the society in the form of corporate social responsibility (CSR).

3. Producers should use natural and economic resources responsibly in order to maintain its sustainability for future generation and to stabilize the process of production.
4. Producers implement positive values and corporate culture in order to increase their employees' productivity.

4.6. Freedom (*Al-Hurriyah*) with Responsibility (*Al-Fardh*)

Allah SWT says, *"It is He who made the earth tame for you, so walk among its slope and eat of His provision, and to Him is the resurrection."* (Quran 67: 15). This *Quranic* verse explains human is given freedom to actualize his ability to use and manage natural and economic resources that are provided by Allah subject to Islamic framework. This indicates the freedom comes along with responsibility that human should bear. Specifically, the implementations of freedom with responsibility in the process of production are as follows.

1. Producers must remember that they are free to choose what to produce, for whom they produce, and how they produce as long as they do it with fully responsibility. In this context, producers must know what are permissible goods and services according to Islam, the goods and services needed by society, and how to perform the process of production with responsible manner (Sukarno, 2010).
2. Process of production should consider the sustainability of environment and human well-being in the sense that they have to contemplate that production is not only devoted for the present time, but also for the future time.
3. Responsibility held by producers is the consequence of their freedom to perform production, as the implication of God's vicegerent role.

To summarize, the five ethical frameworks and principles can be implemented in every aspects of production process including capital gain, partnership, and the relationship between producers with consumers, producers with producers, producers with society and environment, and more importantly producers with God. These five principles will shape production system with values that are reflected through input, process, and output. Figure 3 shows the interconnecting link between the five principles with the production process based on Sukarno (2010).

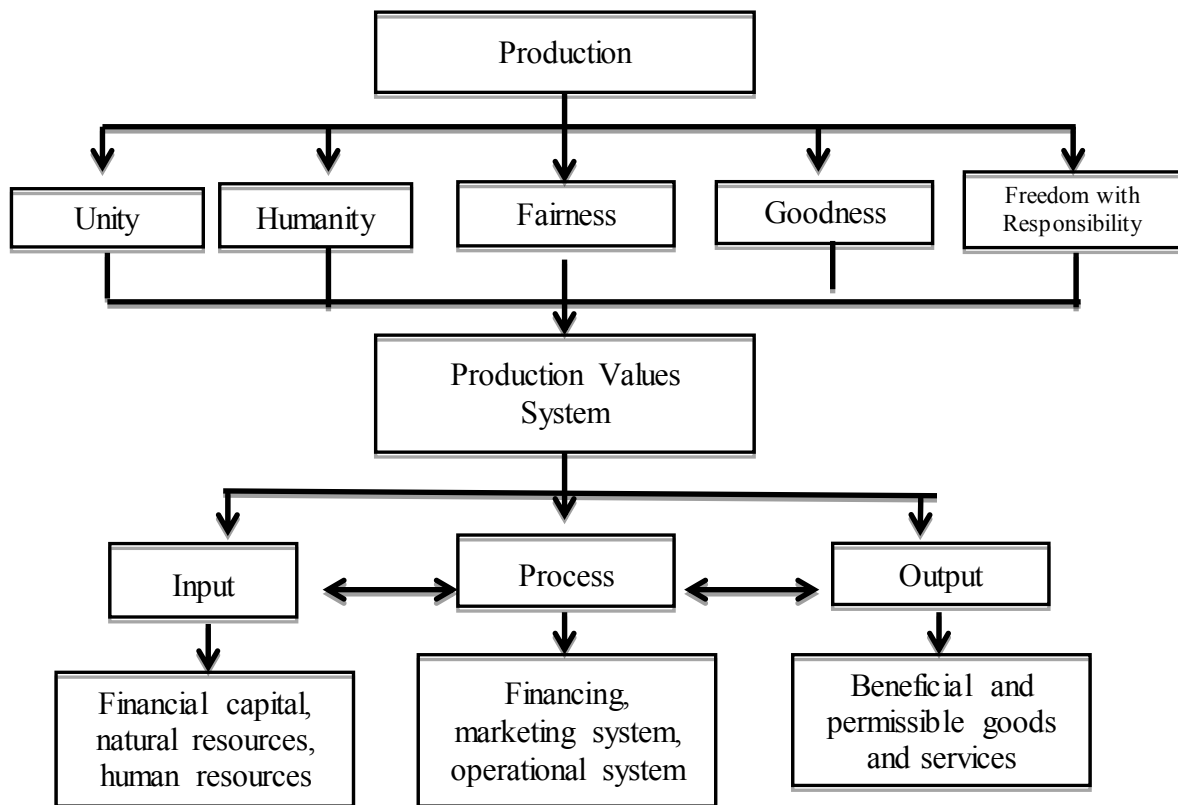


Figure 3: The Role of Ethical Frameworks towards Production
 Source: Sukarno (2010)

5. Profit Maximization from Islamic Perspective

5.1. Introduction

This chapter presents the profit maximization from Islamic perspective in order to answer the third research question as mentioned in the first chapter. It begins with the explanation of firm's objectives according to some scholars. The subsequent section explains Islamic profit concept that concludes profit maximization according to Islam.

5.2. The Firms Objectives

Many scholars have different ideas with respect to the firm objectives. For instance, Chapra (1984) views that firms in general should produce goods and services, which facilitate human beings to live a dignified existence in accordance with the requirement of their status as vicegerents of Allah.

Hasan (1975) is on the opinion that it is naturally believed that profit maximization is a business goal. However, to make profit maximization as the only motivation and objective of a business firm is not accepted in Islam.

Similarly, Mannan (1984) argues that the firm's objective of maximizing the profit must be subject to kinship, social responsibility, and moral framework. According to him, profit maximization is important but needs to consider moral, social and institutional aspects. Therefore, the overall value framework of Islam must be included in the maximizing profit process. Pramanik (1995) also argues performing social obligation and not-profit maximization is the primary consideration behind production of all permissible goods and services.

In line with Mannan, Siddiqi (1979, 1988) is also on the opinion that profit maximization is not the main objective of production. This is because Islamic economics deals with "Islamic man" as stated earlier. Therefore, this essential alteration changes the firm's objectives and behavior. Siddiqi further argues profit maximization is subject to the interests of society, society's basic needs, employment creation, and maintaining low prices for essentials.

Moreover, Siddiqi (1979) assumes producers are altruistic and hence despite maximizing profit, producers would "produce anywhere within a certain range of profits, the lower limit being just enough to keep him going". In addition, he uses the term "satisfactory profits" rather than "maximizing profits" to describe firm's appropriate objective. Hence, if profit maximization cannot be the main motive of production, he concludes "rationality" in Islamic economics differs with what is understood in neoclassical economics.

Correspondingly, Metwally (1993) explains the sole object of Islamic firm should not be profit maximization. Rather, the firm should realize a "reasonable" or "fair" level of profit if that enables it to achieve the more important objective of "doing good to please God". Therefore, profit maximization for the purpose of wealth accumulation will no longer suitable in Islamic firm. To Metwally, the Islamic firm would differ from non-Islamic firms not only in its goals, but also in its economic policies and market strategies. In particular, the differences exist in several aspects that are as follows.

1. An Islamic firm would not engage in any activity that is forbidden by Islam.

2. An Islamic firm must avoid those market strategies that result in the creation of barriers to entry and hence in monopoly.
3. An Islamic firm must follow fair rules in all its dealings while acting as a buyer and as a seller of goods and services.
4. An Islamic firm must refrain from the use of deceptive advertising and other deceptive market strategies, which could be used to expand its market share or raise the price of its product.
5. An Islamic firm must avoid all acts of exploitation, discrimination and restrictive trade practices, since Islam denounces all these.

In addition, Kahf (1978) as cited in Haneef (1995) is on the view that production is perceived 'not only as means to improve one's material state but also one's spiritual standing in the Hereafter'. Therefore, there are several implications on the objective of firms, which are as follows.

1. The first and foremost plausibility of profit is whether or not the goods are prohibited in Islam. In other words, if goods might be materially profitable, but they are not permissible according to Islam, then it will not be considered as profitable goods and hence shall not be produced. This, thus, influences decision-making and rationality concept as explained in neoclassical economics. Besides, this impacts the value of goods and services, as one's spiritual standing becomes one of the consideration factors.
2. The coverage of production beneficiaries should be as many as possible. In other words, it is very crucial to disburse the benefits of production to many people.
3. Scarcity stems from the human laziness and negligence to extract full benefits from resources that God has bestowed.

Finally, Abdullah Yusof and Mohd. Amin (2007) conclude that general consensus among Islamic scholar regarding firms' objective is the realization of *falah*. This should be the ultimate goal of a producer as an Islamic economic agent. Sattar (1988) as cited in Abdullah Yusof and Mohd. Amin (2007), for example, explains *falah* as 'the achievement of well-being in the present world and the Hereafter', while Abbas (1995) as cited in Abdullah Yusof

and Mohd. Amin (2007) explains *falah* as ‘material and spiritual felicity where the goal is for the attainment of social bliss as well as spiritual salvation’.

5.3. Islamic Profit Concept

Profit concept as proposed by several Islamic scholars is akin to neoclassical economics’ idea with some fundamental modifications. Hasan (1975, 1983), for example, defines profit as ‘a surplus of business earnings over contractual payments is a non-functional surplus whose origin lies essentially in progressive dynamic change’. Hasan (2007) also cites definition of profit from Ibn Khaldun that stated, “profit is the excess of earnings over what one spends to meet his interests and needs”.

Hasan (1983) explains in free enterprise economies, the sum of the contractual factor payments when deducted from the revenue product of the firms leaves a surplus that goes to the entrepreneurs. This surplus is akin to the accounting gross profit. A part of it represents capital compensation, which incidentally the market forces are powerless to determine. Capital compensation, however arrived at, is taken out of the gross profit to arrive at its ‘net’ component.

From the Islamic point of view, Hasan argues that Islam exhorts the believers to excel in this life no less than in the life hereafter. It urges them to engage in almost every material pursuit, especially trade and eulogizes profit as God’s bounty. But Islam is not unaware of man’s inordinate love for worldly gains. This is in line with the *Quran* 100: 8. So it instructs people to observe moderation in the drive for profit, behave in a prescribed way, and acquire only the legitimate, not the maximum. It advocates absolute honesty in business to the extent that one is enjoined not to falsely praise his merchandise, but to reveal to the customer any defects in it.

Therefore, Hasan opines profit is regarded as the reward for risk being in business. To be a just reward, there ought to be one-on-one correspondence between profit and risk. Islam seeks to moderate profit motive and promotes the perception of a fair return on investment.

The Islamic concept of permitted and prohibited is quite adequate to keep people on the right track. In case of conflict between wealth and virtue one has to be content with whatever can be acquired rightfully even though it may be little. This is in accordance with

the *Quran* 5: 103, where Allah SWT says, “Allah has not appointed [such innovations as] *bahirah* or *sa’ibah* or *wasilah* or *ham*. But those who disbelieve invent falsehood about Allah, and most of them do not reason.”

In addition, there are a number of *Quranic* verses and traditions that remind man of the transient nature of this world and its possessions relative to spiritual ends, and seek, by implication, to bring the pursuit of profit under Islam's moral discipline, for instance as stated in the *Quran* 4: 77, 28: 77, 29: 64, 57: 20-21 and elsewhere (Hasan, 1983).

Moreover, Hasan explains Islam aims at shaping all exchange relations among people on the principle of cooperation, mutual benefit, and fair play (*Quran* 4: 29-30). It directs men not to expose themselves or inflict on others loss that is possible to avoid. This principle lies at the heart of the celebrated Islamic notion of *gharar* or indeterminacy and hazard.

It comes about that Hasan defines profit, as ‘a surplus of business earnings over contractual payments is a non-functional surplus whose origin lies essentially in progressive dynamic change’. The real issues in profit theory are whether contractual payments, specially wages, as determined by the market forces can be shown to be just and second, whether the utilization of the residuum in the hands of the entrepreneurs is always proper.

As profit is the reward of entrepreneur services, it also relates to other production factors, such as labor whose reward is wage. According to Hasan (1983), Islam is not opposed to wage labor but it does insist that the wage contract should be an equitable one. Workers must have the fairest possible chance under the arrangement to receive their due, i.e. what they contribute to the value product of the firm. This also implies that payment to them is not excessive either.

The basis support for minimum wage in Islam lies in the *Shari’ah* itself. The Qur’an reminds people time to time and again that even though people may differ in regard to the quantum of sustenance granted to them, they are equal in the right for a livelihood from inexhaustible resources God has provided in the Earth and heavens (Hasan, 2006).

Thus Hasan argues in the area of mass production where business outcome is characterized by uncertainty, the Islamic ends of justice can be met only when interest is abolished and all capital participates in profits of the enterprise on an equal basis. In manufacturing, land partakes the form of capital. But even in agriculture where land is

important there is, as we have noted, strong presumption that Islam does not permit prefixed rent in cash or kind and prefers sharecropping to make the landlord-tenant relation free of *gharar*. These conclusions have great inferential significance for the determination of the remaining distributive share - the wage for labor.

Navqi (1984) as cited in Haneef (1995) argues that profit maximization as understood in neoclassical concept is accepted as long as its rate are kept at a level that satisfies the norms of Islamic equity. The Islamic norm will alter the motivational drive as well as the concept of rationality of producers. He also argues that excessive profits must be ruled out in the Islamic economy, which implies market structure such as monopolies and oligopolies must also be ruled out.

In a similar vein, Naqvi (1981) as cited in Abdullah Yusof and Mohd. Amin (2007) states that individual producers are free to maximize profits in an Islamic economy only under these modifications:

1. No excessive profits and keeping *al-Adl* between the relative shares of wages and profits.
2. The markets that lead to excessive profits must be rejected.
3. Increasing the ratio of public to private goods particularly in poorer countries.
4. The consumption basket must heavily contain "wage-goods" and strictly exclude prohibited goods.

With regard to profit calculation in the Islamic firm, Metwally (1993) explains there is significant different with its conventional counterpart. To begin with, Metwally highlights the existence of spending on charity or good deeds as the means to achieve God's satisfaction. In this case, this spending will create a goodwill for the firm's products, which in turn will help increase the demand for them at given prices. If spending on charity or good deeds is denoted by G and price by p , we would expect:

$$\frac{\partial p}{\partial G} > 0 \quad (1)$$

In this context, spending on charity or good deeds resemble expenditure on advertising. The difference is that, for a non-Islamic firm, advertising expenditure is pushed to the level which profit maximization warrants, while in Islamic firm, spending on charity or

good deeds is an object which must be realized whether or not profits are maximized. In other words, an Islamic firm may state this objective in the form of a positive dictum, such as 5 percent of the total revenue is devoted for charity spending, or in the form of non-operational system, such as target the firm as a leading-charitable firm in the industry.

With regard to the “reasonable” level of profit, Metwally argues that the firm must be capable to maintain its business or to distribute annually a reasonable amount of profit to its shareholders. The firm, hence, would seek the maximization of utility function, which is a function of the amount of profit and the amount of spending on charity, subject to the constraint that the amount of profit would, after the payment of all imposed taxes including zakat, be no less than a minimum “safe” level to keep the firm in the business. Metwally further develops a simple mathematical model incorporating the above notion. Let the utility function of an Islamic firm is as follows.

$$Y = Y(F, G) \tag{2}$$

Where

Y : Utility function

F : Level of profit

G : Expenditure on charity or good deeds

Assuming that M represents the level of actual profit, or the difference between its revenue and its production and charity costs, we have:

$$M = R - C - G \tag{3}$$

Where

R : Total revenue

C : Total production cost

If p represents the unit price and q represents the quantity produced, then:

$$R = pq \tag{4}$$

$$C = C(q) \tag{5}$$

The demand curve in this model is assumed to be negatively sloping, but charity spending helps increase demand for the firm's product. Thus we have:

$$\frac{\partial p}{\partial q} < 0 \tag{6}$$

$$\frac{\partial p}{\partial G} > 0 \tag{7}$$

The relationship between F and M is given by:

$$F = M - Z - U \tag{8}$$

Where

Z : Amount of tax and zakat paid on profits

U : Amount of additional dues paid on profits

If we assume the rate of zakat equals α and that of other dues equals β we have:

$$Z = \alpha M = \alpha(R - C - G) \tag{9}$$

$$U = \beta M = \beta(R - C - G) \tag{10}$$

Substituting (3), (9), and (10) into (8) we obtain:

$$F = (1 - \alpha - \beta)(R - C - G) \tag{11}$$

The firm's aim is to maximize its utility function (2) subject to the distribution of a minimum acceptable amount of profit π to satisfy its owners and maintain its business. In other words, the objective function is:

$$\begin{aligned} \text{Maximize } Y &= Y(F, G) \\ & q, G \end{aligned}$$

Subject to:

$$\varphi = \pi - F \leq 0 \tag{12}$$

The above maximization problem can be solved using the Kuhn-Tucker conditions. We establish the Langrangian:

$$L = Y(F, G) + \lambda(\pi - F) \tag{13}$$

The necessary conditions for maximization are:

$$\frac{\partial L}{\partial q} = \left(\frac{\partial Y}{\partial F} = \lambda\right) \left[\left(\frac{\partial R}{\partial q} - \frac{\partial L}{\partial q}\right)\right] \quad (14)$$

$$\frac{\partial L}{\partial G} = \frac{\partial Y}{\partial G} + (1 - \alpha - \beta) \left\{ \left(\frac{\partial R}{\partial G} - 1\right) \leq 0 \right\} \quad (15)$$

$$\frac{\partial L}{\partial q} q + \frac{\partial L}{\partial G} G = 0 \quad (16)$$

Where:

$$\frac{\partial L}{\partial q} = \frac{\partial Y}{\partial F} + \lambda(1 - \alpha - \beta) \left(\frac{\partial R}{\partial q} - \frac{\partial c}{\partial q}\right)$$

and

$$\frac{\partial L}{\partial G} = \frac{\partial Y}{\partial G} + \lambda(1 - \alpha - \beta) \left(\frac{\partial Y}{\partial G} - 1\right)$$

$$q \geq 0 \quad (17)$$

$$G \geq 0 \quad (18)$$

$$\frac{\partial L}{\partial \lambda} = (F - \pi) \geq 0 \quad (19)$$

$$\frac{\partial L}{\partial \lambda} \lambda = (F - \pi) \lambda = 0 \quad (20)$$

$$\lambda \geq 0 \quad (21)$$

Under the reasonable assumption (17) and (18), we obtain:

$$(i). \quad \left(\frac{\partial R}{\partial q} - \frac{\partial c}{\partial q} = 0\right) \text{ or } MR = MC \quad (22)$$

$$(ii). \quad \frac{\partial R}{\partial G} = 1 - \frac{Y_G}{Y_F} \frac{1}{\lambda(1 - \alpha - \beta)} \quad (23)$$

$$\text{or} \quad \frac{\partial R}{\partial G} = 1 - \frac{r_{GF}}{\lambda(1 - \alpha - \beta)} \quad (24)$$

Where:

MR: Marginal Revenue

MC: Marginal Cost

r_{GF} : Marginal rate of substitution between expenditure on charity or good deeds and distributed profit of $G_{G,F} = \frac{Y_G}{Y_F}$

Kuhn-Tucker second-order conditions would require the determinant below to be positive.

$$\begin{vmatrix} \frac{\partial^2 L}{\partial q^2} & \frac{\partial^2 L}{\partial q \partial G} & \frac{\partial \phi}{\partial q} \\ \frac{\partial^2 L}{\partial G \partial q} & \frac{\partial^2 L}{\partial G^2} & \frac{\partial \phi}{\partial G} \\ \frac{\partial \phi}{\partial q} & \frac{\partial \phi}{\partial G} & 0 \end{vmatrix}$$

However, Metwally argues to the above conditions, Islamic teachings clearly require that the marginal rate of substitution diminishes between any two goals and that the marginal utility of any single goal is also diminishing. That is a direct consequence of the Islamic demand for moderation and the hierarchy it places on the levels of achieving any single goal.

Equation (22) suggests that for an Islamic firm equilibrium requires that marginal revenue equals marginal cost. This does not mean that the resulting optimal output would be the same as that of a non-Islamic profit-maximizing firm, for $\frac{\partial R}{\partial q}$ is implicitly a function of G. Hence the optimal values of output will be different in the two cases.

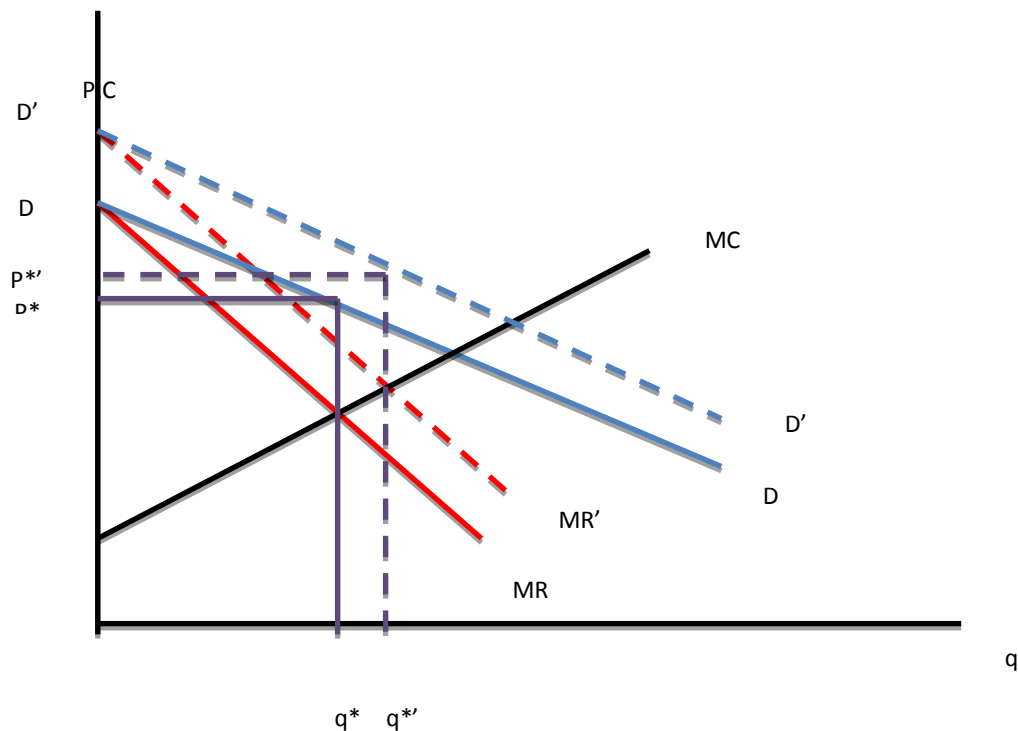


Figure 4: Equilibrium of an Islamic and Non-Islamic Firm

Source: Metwally (1993)

For Islamic firm with similar cost structure, equilibrium output and equilibrium price will be higher than in the case of non-Islamic firm. This can be seen on Figure 4, where DD represents the demand curve facing a non-Islamic firm and D'D' represents the demand curve facing an Islamic firm. D'D' reflects the assumption that in an Islamic economy $\frac{\partial p}{\partial G}$ is more than 0. Moreover, p^* and q^* represent the equilibrium of a non-Islamic profit-maximizing firm, while $p^{*'}$ and $q^{*'}$ represent the equilibrium of an Islamic firm.

Equation (24) suggests that in an Islamic economy, the proportion of revenue devoted to charity will depend on marginal rate of substitution between distributed profits and good deeds (r_{GF}) as well as on the rates of taxes of zakat and dues. The higher the rate of dues on undistributed profits, the less would be the proportion of revenue devoted to charity. This is reasonable; since it is assumed that higher dues would be collected for the purpose of achieving higher level of good deeds by the Muslim authorities. In a non-Islamic firm, $r_{GF} = 0$ and thus the only necessary condition for optimization is that marginal revenue equals marginal cost

However, Abdullah Yusof and Mohd. Amin (2007) highlight several points in the model as proposed by Metwally. Firstly, the assumption on equation (7) where $\frac{\partial p}{\partial G} > 0$ represents the positive relationship between charity and demand for producers' goods at given price is not suitable. Despite equation (7), they believe that the proper equation would be $\frac{\partial q}{\partial G} > 0$. However, they assert that those equations will not be qualitatively different.

Secondly, regarding the assumption that charity affects revenue through price or quantity, they argue that this will not only produce more output but also higher price level. This, according to them, would bring to question the effect of the firm's good deeds on the net welfare of the society. While on the one hand the firm will be able to produce more of the good, which may not necessarily mean better, consumers will have to pay a higher price for the good. The result of a higher price is not unexpected since charity is assumed to affect demand. This can only happen if the act of charity is made known to the public. Thus, another question that may arise is the intention of the firm in spending on charity.

Thirdly, Abdullah Yusof and Mohd. Amin (2007) argue there is another possible outcome that can be obtained from the first order condition of the optimization problem, which was not stated in the paper. This outcome is where the optimal level of output corresponds to the output at the minimum level of profit, which is 'safe' to keep the firm in business. A situation like this can take place if the firm places a very high importance to charity relative to profit to the extent that the firm is satisfied by just having the minimum level of profit set.

6. Conclusion

The study presents the production concept based on Islamic economics perspective from various cotemporary Islamic scholars. In general, Islamic production refers to goods and services creation in the economy for the benefit of society subject to moral and social values.

Besides, the general ethics and principles of Islamic production derived from *Quranic* verses are also taken into account. The five general principles are unity (*at-tawhid*), humanity (*al-insaniyyah*), justice (*al-'adl*), goodness (*al-maslahah*), and freedom (*al-hurriyah*) with responsibility (*al-fardh*). Those principles should become the framework for the producers in conducting the process of production in order to be in line with Islamic teaching.

The study also presents Islamic firm objectives. In general, Islamic scholars are on the view that Islamic firms should mainly aim to realize *falah*, which is the well-being in the present world and the Hereafter. This should be the final purpose of a producer as an Islamic economic agent. Profit maximization can surely be the goal of the production process, as long as it includes social and moral framework that is in line with Islam.

However, there are some points are noteworthy to be addressed. Firstly, many Islamic scholars only modify Islamic production concept from the neoclassical discipline. Every assumptions, concept, and hypothesis used and evaluated from Islamic angle was only taken from neoclassical school of thought. It is going to be more wide-ranging, if there are attempts from Islamic economists to include the economic perspectives from heterodox point of view, imbued with Islamic concept.

Secondly, regarding the notion to limit the luxuries goods and services production as mention by some scholars, there is not any standard of the concept. To what extent those

types of goods and services can be produced has not been clearly explained. Islam strongly discourages pursuit of idle desires, luxuries and conspicuous consumption. Following *Quranic* prescriptions will lead to economics based on simple lifestyles, hospitality, cooperation and trust of a type. Therefore, the absence of well-defined concept of luxuries could lead to misunderstanding among producers.

Thirdly, the theory on Islamic profit does not include the explanation on how much the profit can be imposed by the producer in precise percentage. It is only stated that the determination of profit in Islam must be loaded with normative considerations. It is going to be more useful if there exists suitable profit rate of a good sale in the trading process.

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