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EXPLORING THE IMPACT OF ISLAMIC BANKING ON ECONOMIC GROWTH: A REVIEW STUDY OF CONVENTIONAL AND ISLAMIC BANKING SYSTEMS

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ABSTRACT

Purpose of the study — *This study aims to fill this gap by conducting a comparative analysis of the impact of Islamic and conventional banking systems on economic growth.*

Research method— *Literature review by examining the key principles and practices of Islamic banking, as well as the relevant theories and empirical evidence.*

Result— *this research will shed light on the unique features of Islamic banking that contribute to its potential impact on economic growth. The results of this study will provide valuable insights for policymakers, economists, and practitioners, as well as for scholars who are interested in the field of Islamic finance.*

Conclusion— The study aimed to analyze the impact of Islamic and conventional banking systems on economic growth through a literature review. The results showed that Islamic banking has a positive impact on economic growth, especially in GCC countries and several East Asian countries. The relationship between GDP per capita and economic growth is weaker if Islamic banking is taken into account, and the relationship varies based on the legal origins of the country. The study found that the only significant factor of Islamic banking performance that influences economic growth is profit. This study provides valuable insights for policymakers, economists, and practitioners in the field of Islamic finance.

Keywords: *Islamic Bangking, Economic Growth, Islamic Banking Sistem, Comparative Study.*

INTRODUCTION

The recent rise in popularity of Islamic banking has sparked a global interest in its potential impact on economic growth (Naz & Gulzar, 2022). Despite its growth and increasing

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presence in the financial sector, there is a limited understanding of the effects of Islamic banking on economic performance. Islamic banking is a financial system that operates based on principles and values derived from Islamic law (Sharia). Unlike conventional banking, which is based on interest-based transactions, Islamic banking prohibits the payment or receipt of interest and instead structures financial transactions as partnerships or risk-sharing arrangements between the bank and the customer (Al Rahahleh et al., 2019).

Islamic banking offers a range of financial products and services that are in compliance with Sharia law, including profit and loss sharing, mudharabah (partnership) and ijara (lease) contracts, and Islamic bonds (sukuk) (Dewar & Hussain, 2021). These products aim to promote ethical and socially responsible investing, while also providing customers with access to financial services that are aligned with their values and beliefs.

In addition to its unique financial products, Islamic banking also differentiates itself from conventional banking in its approach to risk management and financial inclusion (Shinkafi et al., 2020). By encouraging risk sharing and promoting financial inclusion for previously unbanked or underbanked populations, Islamic banking has the potential to contribute to economic growth and stability in the countries where it operates. Overall, Islamic banking is a growing and dynamic sector that offers a unique alternative to conventional banking, and it has attracted significant attention and interest globally in recent years.

Islamic banking has gained recent global interest due to its principles of risk sharing and ethical investment, which are seen as potential drivers of economic growth. Unlike conventional banking, Islamic banking prohibits interest-based transactions and speculative activities, and instead focuses on financing real economic activities through profit and loss sharing arrangements. This aligns with the principles of sustainable finance and responsible investment, which are increasingly important in the current economic and financial landscape. Additionally, the growth of Muslim populations in many countries has also increased demand for financial services that align with Islamic values. As a result, Islamic banking has seen significant growth in recent years, particularly in Muslim-majority countries and is attracting interest from a growing number of investors and financial institutions globally.

METHOD

qualitative research, Literature review with 10 studies related to the topic: Explore The Impact Of Sharia Banking On Economic Growth: A Comparison Study Of Conventional Banking And Sharia Banking Systems.

Table 1. literature review reference journal data

Author	Topic	Finding
(Zarrouk et al., 2017)	"The impact of Islamic banking on economic growth: Evidence from selected countries"	The relationship between economic growth and financial development is one in which the former drives the latter; nonetheless, real gross domestic product (GDP) causes Islamic

Author	Topic	Finding
		financial development without having an opposite effect. Furthermore, the results of the forecasting show that the relationship between financial development and real economic activity in the past and future is inversely correlated. This will probably keep fostering the growth of Islamic fiance.
(Mohd. Yusof & Bahlous, 2013)	“Islamic banking and economic growth in GCC & East Asia countries: A panel cointegration analysis”	In the long term as well as the short run, Islamic banking has been proven to boost economic growth in the GCC nations as well as a few chosen East Asian (EA) nations. However, compared to the GCC nations, Islamic banking has a more immediate impact on economic growth in Malaysia and Indonesia.
(Johnson, 2013)	"The role of Islamic banking in economic growth: Evidence from selected OIC countries"	According to the study on Solovian specifications, if Islamic banking is taken into account, the link between starting GDP per capita and economic growth becomes weaker. The results did not support the theory that Islamic banks lessen the effect of legal origin on expansion. Based on the legal origin of the nation, it was discovered that the relationship between Islamic banking and financial deepening varied, having negative consequences for nations with British legal origins and good implications for nations with French legal origins.
(Bendriouch et al., 2020)	“Do Islamic banks contribute to economic growth? Evidence from the GCC Countries”	Our findings make a substantial contribution to the understanding of how the operations of Islamic financial institutions stimulate economic growth. Our research could help Islamic bank managers better understand how their institutions can boost economic performance while lessening the severity of the financial crisis by avoiding significant flaws in the traditional banking system.
(Furqani & Mulyany,	“Islamic banking and economic growth: Empirical evidence	We discovered that between 1997:1 and 2005:4 only fixed investments made by

Author	Topic	Finding
2009)	from Malaysia"	Granger led to the development of Islamic banks. In contrast, evidence suggests that over the long term, there is a bidirectional relationship between Islamic banks and fixed investment, and evidence supports the demand-following theory of GDP and Islamic banks, according to which an increase in GDP drives the growth of Islamic banking rather than the other way around.
(Gazdar et al., 2019)	"Oil price volatility, Islamic financial development and economic growth in Gulf Cooperation Council (GCC) countries"	"Empirical evidence of a significant positive relationship between oil terms of trade growth volatility and economic growth. The effect of oil terms of trade growth volatility on growth is reinforced by the development of Islamic financial system".
(Ahuja & Pandit, 2020)	"Public expenditure and economic growth: Evidence from the developing countries"	"The results at large support the Keynesian framework that asserts the importance of government expenditure in stimulating economic growth."
(Mensi et al., 2020)	"Impact of Islamic banking development and major macroeconomic variables on economic growth for Islamic countries: Evidence from panel smooth transition models"	"The results for the separated oil-importing and oil-exporting economies are generally consistent with the combined sample regarding the Islamic banking development variables. As for the macro variables, they have a positive and significant (insignificant) effect on EG for the oil-importing (oil-exporting) economies for almost all models."
(Raghutla & Chittedi, 2021)	"Financial development, real sector and economic growth: Evidence from emerging market economies"	"The results of long-run elasticities document that real sector and financial development play a significant role in promoting economic growth".
(Ledhem & Mekidiche, 2020)	" Economic growth and financial performance of Islamic banks: a CAMELS approach"	"The findings demonstrated that the only significant factor of the financial performance of Islamic finance, which affects the endogenous economic growth, is profitability through return on equity (ROE). The experimental findings also indicated the necessity of stimulating other financial performance factors of Islamic finance to

Author	Topic	Finding
		achieve a significant contribution to economic growth."

RESULTS AND DISCUSSION

There are several factors that can influence the impact of Islamic banking on economic growth, including:

1. Financial stability: The stability and soundness of Islamic financial institutions can have a positive impact on economic growth by increasing the flow of credit to the real economy.
2. Risk sharing: The risk-sharing principles of Islamic finance can encourage investment in productive projects, which can lead to increased economic activity and growth.
3. Financial inclusion: Islamic banking can provide access to financial services for previously unbanked or underbanked populations, which can increase their participation in the economy and drive growth.
4. Ethical considerations: The ethical principles of Islamic finance, such as the prohibition of interest-based transactions, can promote socially responsible investment and contribute to sustainable economic growth.
5. Government support: The level of support and regulatory framework provided by the government can play a key role in the growth and development of the Islamic finance sector and its impact on the wider economy.

These are some of the factors that can influence the impact of Islamic banking on economic growth, but the specific impact can vary depending on the country, region, and other economic and social factors.

There are several key differences between conventional and Sharia-compliant (Islamic) banking systems:

1. Interest prohibition: The most fundamental difference is that Islamic banking prohibits the payment or receipt of interest, while conventional banking is based on interest-based transactions.
2. Risk sharing: In Islamic banking, financial transactions are structured as partnerships, where the profits and losses are shared between the bank and the customer, while in conventional banking the customer bears all the risk.
3. Ethics and morality: Islamic banking is based on ethical and moral principles, such as fairness and justice, while conventional banking is more focused on maximizing profits.

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4. Investment: In Islamic banking, investments must be in compliance with Sharia law, which prohibits investment in industries such as gambling, alcohol, and tobacco. Conventional banking has no such restrictions.
5. Product offerings: Islamic banking offers a different range of products, such as profit and loss sharing, mudharabah (partnership) and ijara (lease) contracts, that are compliant with Sharia law, while conventional banking offers traditional products such as loans and deposits.
6. Accounting: The accounting and reporting standards for Islamic banking are different from those for conventional banking, due to the unique structure of Sharia-compliant transactions.
7. These are some of the main differences between conventional and Sharia-compliant banking systems, but the specific differences can vary depending on the country, region, and other factors.

CONCLUSION

The conclusions from the ten literatures show that the relationship between economic growth and financial development is that economic growth influences financial development. Islamic banking has a positive impact on economic growth, especially in GCC countries and several East Asian countries such as Malaysia and Indonesia. The relationship between GDP per capita and economic growth is weaker if Islamic banking is taken into account. Based on the legal origins of the country, the relationship between Islamic banking and financial deepening varies. This study contributes to understanding how Islamic banking operations affect economic growth and can help bank managers understand how they can improve economic performance. There is a positive relationship between variables such as oil requirements, volatility of trade growth, government spending, and real and financial sector developments with economic growth. This study also shows that the only significant factor of Islamic banking performance that influences economic growth is profit.

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