

memprioritaskan pembiayaan PLS di sektor riil, meningkatkan dukungan terhadap Usaha Mikro, Kecil, dan Menengah (UMKM), serta mendorong kolaborasi pemangku kepentingan yang komprehensif.

Keywords :

Islamic Banking; Economic Growth; Financial Inclusion; Profitability; Sustainable Development

Abstract

The Islamic banking sector has demonstrated substantial expansion since its inception; however, its global market share remains disproportionately low, particularly within Muslim-majority nations facing declining GDP growth. This study aims to evaluate whether Islamic banking genuinely fosters sustainable economic development by analyzing its specific influence on four dimensions: economic growth, profitability, financial stability, and distributive justice. Employing a systematic qualitative meta-synthesis and analytical review framework, this research triangulates empirical findings across these macroeconomic dimensions, focusing on Organization of Islamic Cooperation (OIC) member states. The findings indicate a mixed impact on sustainable development. First, regarding economic growth, Islamic banking's current scale and heavy reliance on non-PLS contracts severely limit its macroeconomic influence on national GDP. Second, profitability is positively correlated with macroeconomic factors, though it remains constrained by operational mimicry of conventional counterparts. Third, concerning financial stability, smaller-scale Islamic banks demonstrate stronger resilience and stability compared to larger commercial entities. Finally, in terms of distributive justice, Islamic banks successfully act as catalysts for financial inclusion and social finance, though true equitable wealth distribution remains suboptimal. The novelty of this research lies in its analytical triangulation of micro-financial viability against macroeconomic intermediation, providing a multidimensional assessment of how operational deviations hinder systemic sustainability. To achieve genuine economic sustainability, the Islamic banking sector must reform its operational models by prioritizing real-sector PLS financing, enhancing support for small and medium-sized enterprises (SMEs), and fostering comprehensive stakeholder collaboration.



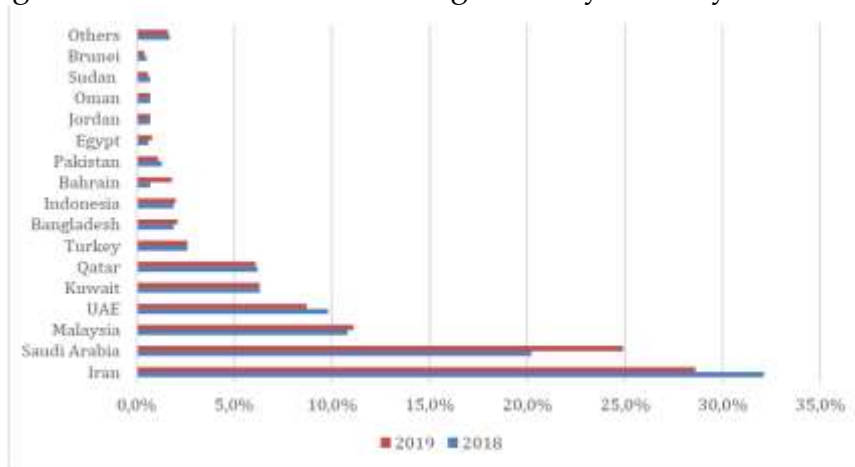
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INTRODUCTION

The development of Islamic development has shown significant growth in the past few decades, since this Islamic bank was introduced by the Dubai Islamic Bank in 1975 (World Finance, 2026). Massive acceptance in the early decades of its launch was influenced by the large public expectation of an Islamic banking platform that is free of usury, gharar, mayshir and all elements that are related to Islamic sharia, plus a profit-sharing system that is projected to create fair and equitable economic growth (Chowdhury, 2015).

However, in reality, the market share of Islamic banking in Muslim-majority countries is still very low. If we consider the following data:

Figure 1: Share of Islamic Banking assets by Country 2018-2019

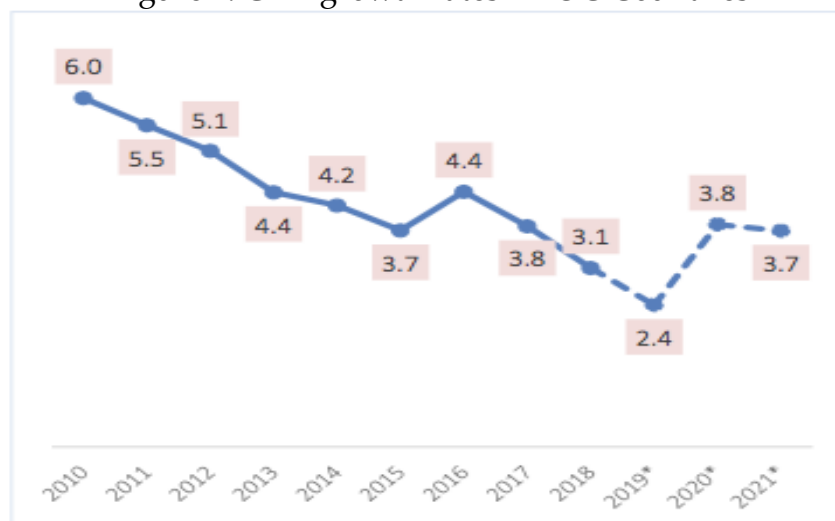


Sourced: COMCEC financial outlook (2020) (COMCEC, 2020)

The graph above shows that although the overall growth of Islamic banking assets in Islamic countries has experienced quite good growth, the amount in each country is different and not all of them show a large share of assets. Iran certainly has large assets because this country has been using the Full fledged Islamic Bank system for a long time with assets in 2019 of 28.6%. Other Muslim-majority countries have to accept that their assets are still very small. The multicultural Southeast Asian country only places Malaysia with quite large assets (11%) while its neighboring country Indonesia must be satisfied with assets of 4%, a very small number considering the large number of Muslim population in this country.

In relation to GDP growth as one of the macroeconomic indicators of a country, Muslim countries that are members of the IOC Countries also do not show good development.

Figure 2: GDP growth rates in IOC Countries



Sourced: COMCEC financial outlook (2020)

The chart above shows us how the average GDP growth in IOC countries from 2010 to 2021. Starting from 2010, every year GDP always shows an average decline with a significant amount until 2015, only showing a slight increase in 2016 however, it cannot reach the value it started in 2010. In 2016, GDP only reached 4.4%, while in 2010 it started at 6%. Then until the end of the period the trend again shows a decline. In 2018, with an average growth rate of 3.1%, growth in OIC declined below the world average.

Economic growth in OIC countries is expected to decline to 2.4% in 2019 and continue to remain below the world average. The main factor behind this anomaly in the growth of Islamic banking is the general criticism of the imposition of an emergency which allows Islamic banking to still adopt some conventional banking operational practices. If many preparations have been achieved, why is the whole system in accordance with sharia, while over the decades there have been many centers of study and development of Islamic banking pioneered by Middle Eastern countries (Belouafi. A, 2015).

Criticism of the implementation or operation of Islamic banking is also indicated as a trigger for the stagnant development of Islamic banking so that the impact on economic activities in the country where the Bank operates is not significant. The criticism in question includes three main parts, namely: criticism of the operational basis, criticism of the time of implementation, and criticism of the final results of Islamic banking operations (Kamaruddin, 2022).

In the critical section of the initial fundamentals of Islamic banking operations are those who argue that there are deviations between theory and practice in establishing the operational basis of Islamic banking, including that Musyarakah and Mudharabah with Profit and Loss sharing theory in practice are very deviant, Islamic banking is more likely to use the creation method. Debt in order to obtain fixed profits as in conventional banks (Jumaa, 2016).

In addition, Islamic Banks set benchmarks related to interest such as LIBOR; impose a predetermined interest rate on customers on the asset side and impose an interest rate that follows certain benchmarks to depositors as is applied by conventional banks in certain jurisdictions.

In other words, Islamic banking is still based on Deposit Taking Bank. Meaning that, the distribution of credit for financing carried out by Islamic banks is still sourced from funds deposited by customers, so that banks in a state of profit or loss must continue to think about the rewards that have been indicated at the beginning to depositors who deposit their money in Islamic banks (Gök, 2025). It is appropriate for Islamic banks to use Investment Accounts for their financing sources. This Investment Account is customer funds managed by the Bank with the principle of Profit and Lose Sharing (PLS) with a Syirkah contract, if there is a loss on investment due to credit distribution, both the bank and the customer share the responsibility in accordance with the agreement (Febianto, 2012).

While criticisms of the implementation of Islamic banking operations include; Islamic Banks are not actually involved in trading activities as allowed in the Qur'an.. Islamic banks do not have a stockpile of goods to be sold in the context of Murabaha, but rather involve customers in the agency system and are often involved in repurchase and Tawaruq activities or monetization or obtaining funds through trade contracts that are designed in such a way. Tawaruq itself in some countries actually gets the title of sharia (Jaber, 2024).

On the criticism of the final result, operational financing between Islamic and conventional banking is the same. In leasing, for example, Islamic banks add up all costs, including insurance, transportation, registration of leased assets and so on in order to determine the rent associated with an interest-based benchmark; and ultimately provide leased assets to customers (Shujaat Saleem, 2020). In mortgage financing, Islamic banks also use the IRR as a benchmark for charging profits. Even in modes based on Syirkah contracts such as Musyarakah and Mudharabah , the main concern of Islamic Banks is to earn profits based on the market rate of return on investments made (Kahmil.M.D, 2023).

In the midst of various criticisms that have caused the development of Islamic Banking to stagnate in several Muslim countries, it is interesting whether Islamic Banking becomes a relevant institution in relation to the economic growth of a country. This is a serious study considering that this institution carries out a noble goal for equitable distribution of the economic sector and making it more equitable and for the welfare of the people of a country.

Therefore, this paper tries to elaborate further on whether there is an influence of Islamic banking on economic growth. And there is how and to what extent it affects and if not what is the problem, so that all criticisms that cause doubts for the majority of the Muslim community can be answered.

In relation to looking at the influence of Islamic banking in the economic sector, the indicator used in this paper is the extent to which the influence of Islamic banking on four main things, namely: Economic growth, Profitability, Stability and Income distribution, including financial inclusion and social welfare. This Paper analyzes four main papers that discuss each topic and are supported by theories and research results published in various supporting literature.

METHODS

Research Design

This study employs a systematic qualitative meta-synthesis and analytical review framework to evaluate the macroeconomic and structural impacts of Islamic banking. Moving beyond traditional narrative reviews, this research adopts a comparative matrix framework to triangulate empirical findings across four critical economic dimensions: Economic Growth (GDP Nexus), Micro/Macro Profitability, Financial Stability, and Distributive Justice (Financial Inclusion) (Farah A, 2025).

Document Selection and Inclusion Criteria

To ensure Scopus and WoS compliance, a rigorous literature retrieval strategy was implemented. Studies were selected based on the following strict inclusion protocols:

- **Thematic Alignment:** Peer-reviewed papers explicitly modeling the quantitative or qualitative transmission channels of Islamic banking assets/financing to macroeconomic indicators.
- **Geographical and Jurisdictional Scope:** Focused primarily on Organization of Islamic Cooperation (OIC) member states, with specific comparative reference to dual-banking ecosystems like Indonesia and Malaysia.
- **Methodological Rigor:** Inclusion of papers using advanced econometric modeling

Framework for Analytical Triangulation

The structural assessment of selected literature is classified into two distinct analytical phases (Onwuegbuzie.J.A, 2015):

Table 1. Analytical Triangulation Framework

Dimension Evaluated	Primary Indicators Evaluated	Core Analytical Approach
Macroeconomic Intermediation	GDP growth rates, gross asset shares, total deposit accumulations.	Intermediation & Supply-Leading Hypothesis testing.
Micro-Financial Viability	ROA, ROE, NPF (Non-Performing Financing), and FDR.	Operational alignment with Basel frameworks vs. Shariah ethical constraints.
Structural Resilience	Z-score indices, Capital Adequacy Ratios (CAR), regulatory capital to risk-weighted assets.	Scale-competency analysis (Small vs. Large-scale systemic risk propagation).
Socio-Economic Inclusivity	SME financing units, redistributive access, utilization of <i>Tabarru'</i> contracts (<i>Qardh</i> , <i>Wadiah</i> , <i>Wakalah</i>).	Social finance optimization assessment.

Synthesis and Operational Analysis

The data extracted from the foundational literature are evaluated against the Theory of Financial Intermediation and the overarching objectives of Maqashid al-Syariah. This dual-lens approach allows the study to critically reconcile why quantitative growth in assets does not automatically translate into optimal real-sector development or equitable wealth distribution.

RESULT AND DISCUSSION

Islamic Banking and Economic Growth : sustainability economic

In a way theoretical If allocation financing the more Good then more physical capital can be formed which can contribute positively to economic growth. Size growth economy a country is usually seen from GDP growth , because growth economy is something condition occurrence Gross Domestic Product (GDP) development which reflects existence per capita output growth and increasing standard life society . Therefore , some research literature using GDP to measuring the impact of Islamic Banks in term short and term long .

As example Research conducted by Farahani, and Dastan (2013) used empirical evidence to examine the role of Islamic banks' financing on economic performance of selected countries (Malaysia, Indonesia, Bahrain, UAE, Saudi Arabia, Egypt, Kuwait, Qatar and Yemen). The results generally signify that, in the long run, Islamic banks' financing is positively and significantly correlated with economic growth and capital accumulation in these countries. The results obtained from the Granger causality test reveal a positive and statistically significant relationship between economic growth and Islamic banks' financing in the short run and in the long run. It was also found that the long run relationship is stronger than the short run relationship (Farahani.Y.G, 2013).

Furthermore result of research conducted by Al- Oqool , Okab , and Basyareh (2014) is that the relationship appears to be a unidirectional relationship between gross domestic product and deposit (AL-Oqool. M, 2014). Ogege and Shiro (2012) investigated the long relationship between deposit money banks and economic growth in the Nigerian context from 1974 to 2010. The deposit money banks variables exert a modest influence on the GDP (Shiro, 2013).

The review conducted by the author on the paper written by Muhamad Abduh Mohd Azmi Omar which examines the impact of Islamic Banks on economic growth in Indonesia in the 2009 period. This study is interesting because it examines the impact of both deposit and financing products on the largest Muslim population countries. The impact is studied in the long term and short term (Muhamad Abduh, 2012).

The conclusion of this research using a series of statistical tests concludes that: first, there is a correlation between deposits in the Indonesian Islamic Bank and Indonesia's economic growth which is represented by GDP, this correlation is referred to as a bidirectional relationship. A bidirectional relationship means that the flow of data is mutual between the related forms. This means Islamic banking effectively facilitates the transmission of funds to the real economy. The linkage between deposits, financing and offices to economic growth is simultaneously in the long run.

The second conclusion shows that financing and the existence of Islamic Banking offices play an important role in supporting economic growth in Indonesia, thus indicating that if full support is given, Islamic Banks can be made a state priority to help economic growth.

Meanwhile, in comparison with similar research with the Islamic Bank sample in Malaysia conducted by ---which tries to test whether there is an effect between Islamic Bank financing and economic growth in Malaysia, the results are quite contradictory, that in the long term Malaysia's GDP does not show sensitivity to financing from Islamic Banks. Which means there is no influence from Islamic Bank financing on GDP or economic growth in Malaysia. This is in accordance with the reality on the ground that Islamic Banks in Malaysia have marginalized the Profit and Loss Sharing system and are heavily involved in short-term projects.

Therefore, the recommendation from this study for Islamic Banks in Malaysia to prioritize PLS-based contracts so as to reduce economic imbalances and encourage people to contribute more to creating capital accumulation and providing added value to their investments.

Actually, if we observe the results of research between Indonesia and Malaysia, there are similarities in the Islamic Bank financing sector. The case of Malaysia mentions more specifically that there is no effect on Economic growth, in Indonesia it does not clearly state that there is an influence but only recommends the government to pay more attention to Islamic Banks so that in the future it may have an impact on economic growth.

The impact of the Islamic Bank financing sector in the two largest Muslim countries is insignificant if according to the above theory on economic sustainability, the portion of financing based on PLS contracts such as Musyarakah and Mudharabah is still very small. In Indonesia, for example, almost 50% of the total financing was disbursed. The majority of this financing is cash money which is used for public consumption such as buying houses, financing for civil servants and the private sector purposes which has no impact on the real business sector

The concept of sustainable economic growth requires every country in the world to be able to use existing resources optimally so that a responsible and profitable balance can be achieved in the long term. This concept is important for developing countries in their journey to become developed and developed economies, as well as for developed countries to maintain the sustainability and stability of the economies of their countries which they have worked so hard to achieve. Economic sustainability also allows an increase in every macroeconomic indicator of a country which will ultimately increase economic growth.

But economic growth also depends on how the government manages every economic sector in the country. Among the sectors that support economic growth, the financial sector has proven to be able to influence other sectors, several crises such as the crisis in 2008 have proven this.

Therefore, it is important to manage the financial sector so that it becomes a healthy sector and has a good impact on the entire national economy. The financial sector attracts attention in the growth literature. This helps the accumulation of capital for the development and dissemination of technology. In theory, an advanced financial system allows individuals to diversify their investments.

In this way, investment risk for deposit holders decreases and contributes positively to growth. The relationship between financial development and growth has been the subject of discussion in the literature where three main views on the direction of this relationship are being reviewed. According to Schumpeter, known as the supply-leading approach, the direction of the financial development-growth relationship moves from financial development to growth. In addition, the dynamics of financial developments have a positive impact on growth.

While Robinson offers a slightly different theory in which the core of this hypothesis is that the real sector leads while the financial sector follows, the direction of linkage is opposition; in other words, financial development is driven by growth. Therefore, financial developments have no impact on growth. In the end, according to the two-way relationship approach, there is a dual relationship. Growth affects financial development and financial development affects growth. Under this theory, the two can influence each other most of the time.

The existence of the influence of the banking sector on the economic growth of a country is based on the theory that banking has a function as an intermediary between funds from the community to be channeled to the productive economic sector in the form of credit for conventional banks. As for Islamic banks in the form of financing that must reach the real business sector. Especially for Islamic banking, the distribution of financing is indeed focused on the real business sector, because the existence of Islamic banking should not be the cause of the emergence of Bubble economics, namely economic conditions that appear to be good and continue to grow but are actually not real, aka bubbles.

Furthermore, if the allocation of financing is getting better, more physical capital can be formed which can contribute positively to economic growth. The size of a country's economic growth is usually seen from GDP growth, because economic growth is a condition for the development of Gross Domestic Product (GDP) which reflects the growth of output per capita and increasing people's living standards.

Since Islamic Banks have to provide funds based on the PLS model, their funds are generally used in real development projects and mechanisms. For this reason, they do not respond to requests for funds other than real investment tools because of their legal status. Savings make a positive contribution to the national economy on a macro basis by supporting the real economy. In essence, the PLS model is based on risk and revenue sharing and thus can be defined as a financing method in which financial intermediaries join as partners. In a financed project, financial capital is provided by the bank, while the customer contributes his labor and expertise.

In the PLS model, the projects selected by the bank are supported on the principle of profit and loss sharing. However, the bank's mission is not limited to providing financing. To see if the project is moving forward in line with the project, a monitoring group consisting of the Shariah Council and Shariah Audit is formed to monitor whether the project has been carried out according to procedures and on target.

The main tools of the Islamic Banking medium financing model include the partnership model, commercial model, sharing model and so on are specific contracts or contracts according to their needs. For example, Mudharabah is the monetization of labor and capital partnerships, Salam agricultural partnerships, Ijara finance leases, Murabahah production support and Tawarruq goods. As seen above, Islamic Banking can only support real sector investment; because of this feature, it can be said that it makes a greater contribution to growth. In both financial models, there are theoretical and empirical findings that show a positive relationship between financial development and growth; these findings offer some insight into the future of technological change as well as the level of financial development, growth and capital movements.

As the level of financial development improves, these indicators are generally more positive. On the other hand, it is still controversial whether growth leads to financial development or financial development leads to growth or not. In this context, it is necessary to analyze several theories and the findings that resulted from several studies as will be written next.

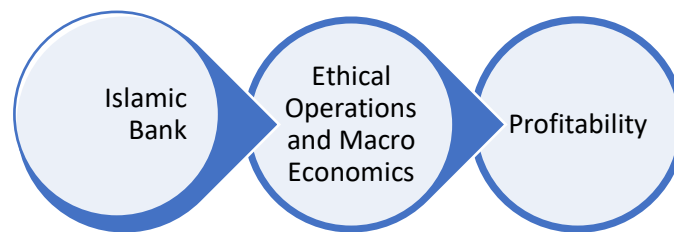
Islamic Banking and Profitability

Profitability is the ability of a company to use its resources to generate revenues in excess of its expenses. In other words, this is a company's capability of generating profits from its operations (Gedviliene.N, 2018). The two key aspects of profitability are revenues and expenses. Revenues are the business income. This is the amount of money earned from customers by selling products or providing services (Alhayek.M.A, 2018). Generating income isn't free, however. Businesses must use their resources in order to produce these products and provide these services (Jerab.D, 2025).

What is the correlation with banking? The ability of banks to generate profitability has an impact on the growth and development of Islamic banking. The low profitability of the bank indicates that the bank is not performing well (Widarjono.A, 2022).

Research conducted by Hajer Zarrouk Corresponding Author, Khoutem Ben Jedidia, Mouna Moualhi which analyzes whether the profitability produced by Islamic banks comes from the same source as conventional banks trying to provide a fairly clear picture of the profitability generated by the two types of banks. This study uses a sample of 51 conventional and Islamic banks operating in the MENA region in 1994-2012 with the conclusions: first, the ratios to measure profitability in banks in general can also measure the profitability ratios of Islamic banks in MENA Countries with a positive correlation (Jedidia, 2016). The two macroeconomic factors also seem to have an effect on increasing profitability for Islamic banking, these factors are economic growth and increased investment. From the conclusions of the research above, a flow of Islamic Bank profitability can be made as follows:

Figure 3: Islamic Banking and Profitability



Sourced : Proceed By The Authors

Where Islamic Bank operates by carrying out muamalah ethical principles in collecting funds and distributing financing which will ultimately make the profitability ratios (ROA, NPF, FDR) will improve so that profitability will increase. In addition, the performance of Islamic Banks is also influenced by Macroeconomics as evidence that Islamic Banks operate cannot be separated from the environment. Therefore, several studies also suggest that the government takes a role in increasing the profitability of Islamic banks

Profitability is still something that Islamic banking always wants to improve because it sees the growth movement of Islamic banking which is still far behind conventional banking. To increase profitability it is necessary to know what factors can influence and can support the level of performance of Islamic banking so that when performance is good, it will increase its profitability. One of the supporting factors for the foundation of economic stability in Indonesia is the banking sector. The performance assessment of Islamic banking is very important for the survival of the banking sector.

In general, the measurement ratio of Islamic Bank Profitability is the same as the profitability measurement ratio for Banks in general, because Islamic Banks are still operating according to the rules contained in BASE Ratios such as Return on Assets (ROA), Return on Equity (ROE), Non Performing Financing (NPF) and Financing to Deposit Ratio (FDR) are relevant to be used in Islamic Banks. However, what makes the difference is the existence of ethical considerations in Islamic banks in generating profits.

The ethical considerations include sharia rules that limit financial transactions in Islamic banks, both funding and financing, so as not to deviate from the rules that have been made by the sharia supervisory board. Therefore, profit in the sense of Islamic banking is profit that is free from elements of usury, gharar , maisir , unfair transactions, dharar (damage) and untransparency .

Thus, although it looks the same as a Conventional Bank, in its implementation it will be very different in encouraging Profitability because First, Islamic bank activity should be in compliance with the Shariah law. The main difference between Islamic and conventional banks is the prohibition of interest rates. Further, transactions must

be free from gharar and all forms of speculation. All financial transactions must be backed by real assets. Islamic banks do not permit investments in any company whose activity is prohibited by the Koran, such as pork products and alcohol. Second, there are specificities of Islamic banking relating to solvency (ie capital). Third, Islamic banks are younger and enjoy more experiences compared with conventional ones.

Islamic Banking and Stability Economy

A stable financial system is capable of efficiently allocating resources, assessing and managing financial risk, maintaining employment levels close to the economy's natural rate, and eliminating relative price movements of real or financial assets that would affect monetary stability or employment levels (Schinasi.J.G, 2004). The financial system was in a range of stability when the financial system disappeared.

Imbalances that arise endogenously or as a result of significant adverse and unexpected events. Instability, the system will absorb shocks mainly through self-correction mechanisms, preventing adverse events that have a disruptive effect on the real economy or other financials. Financial stability is paramount to economic growth ,because most transactions in the real world of the economy are made through the financial system (World Bank Group, 2016).

Financial stability is an essential feature of a well-functioning financial sector. The recent rapid growth of the financial sector must be accompanied by appropriate risk management and regulation to avoid systemic risks that can pose a severe threat to global financial stability.

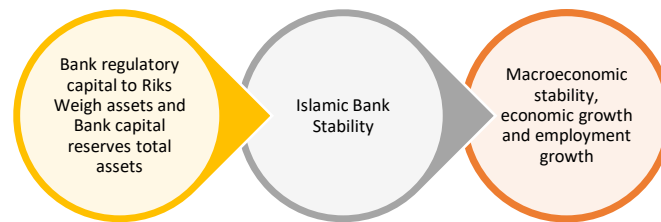
In this regard, the system has created various mechanisms for measuring systemic risk, stress tests and other tools for financial stability. As global financial markets have integrated over the past few decades, the importance of financial stability has increased since then in close relation to macroeconomic stability, economic growth, employment, etc.

Indicators to measure the level of banking stability are Bank regulatory capital to risk-weighted assets, bank capital to total assets ratio and banks non-performing loans to total gross loans variables are used to measure financial stability of financial institutions

Another indicator used to measure the stability of financial intermediary institutions is the ratio of bank capital and reserves to total assets. Capital and reserves include funds contributed by owners, retained earnings, general and special reserves, provisions, and valuation adjustments.

Capital includes tier 1 capital (paid up stock and common stock), which is a common feature in all country banking systems, and total regulatory capital, which includes some specified types of subordinated debt instruments that do not need to be repaid if funds are needed to maintain a minimum level of capital (this consists of capital level 2 and level 3). Total assets include: all non-financial and financial assets.

Figure 4: Islamic Banking and Stability



Sources: Proceed By The Authors

The paper written by Martin Čihák & Heiko Hesse aims to measure and analyze empirically the impact of Islamic Banks on financial stability by taking a sample of 18 individual and commercial Islamic banks (Hesse, 2010). The results presented by this research show three things, namely:

1. Small Islamic Banks are stronger or financially stable than commercial banks
2. Large commercial banks are stronger or financially stable than large Islamic commercial banks
3. Small Islamic Bank is stronger or financially stable than The large Islamic Bank

This study generally concludes that Islamic Banks look more stable and financially strong if they operate on a smaller scale. Due to the complexity of regulations and financial systems in Islamic banks and their business models that must impact the real sector, Islamic banks will tend to be able to create stability if they operate on a smaller scale. This paper may still be criticized regarding the importance of mergers carried out by Islamic banks in several Muslim countries to form a strong Islamic banking system and have a significant impact on the macroeconomy of a country.

Therefore, it is very possible for Big Commercial Islamic Banks to create a stable Islamic banking system as long as they are managed properly and have an impact on economic growth, job creation and macroeconomic stability by maintaining and increasing Bank regulatory capital to Riks Weigh assets and Bank capital reserves total assets. owned by the bank concerned. However, what needs to be underlined is that the small Islamic banks in the above study mean that banks are better able to reach the lower middle class consumers or SME's, so the spirit that needs to be encouraged is that no matter how big the size of Islamic banking is while still prioritizing SME's as a market priority, stability will be maintained. stay awake.

Islamic Banking and Promoting The Justice

In theoretical framework, it has long been heard that operational Islamic banks exist as an answer to the absence of justice after banking has been dominated for a long time by an economic system based on administration with conventional banks as the financial system (Al masry. A, 2015). This theory is based on the fact that Islamic banks

operate with the PLS system so that the expected justice can be easily realized. Promote of Justice in this context is how Islamic banks can realize: Financial Inclusion, Social finance and reduce income inequality (Novreska.S, 2024).

Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way (Naili.M, 2023). Further, being able to have access to a transaction account is a first step toward broader financial inclusion since a transaction account allows people to store money, and send and receive payments.

The paper written by Sami Ben Naceur & Adolfo Barajas & Alexander Massara with the title Can Islamic Banks increase Financial inclusion tries to examine whether Islamic Banks in OIC countries have a good impact or become financial inclusion in these countries (Massara, 2017).

The results of this study are quite encouraging that there is a relationship between Islamic Banks and financial inclusion indicators in OIC countries, which means that although the share of Islamic banking in these countries is still relatively small, access to Islamic banking in OIC countries is very easy. Islamic banking has truly become an inclusive financial entity .

Therefore, some of the recommendations given by the authors of this paper are quite good so that in the future Islamic Banks will not only become financial inclusion but also with their affordability, they will be able to encourage economic development in the country. Recommendations include: we propose changes to the operating model of Islamic banks that may enhance inclusion: Islamic banks could create separate SME business units and improve the training of bank personnel in Sharia'ah -compliant instruments, while concurrent actions are taken to support the development of PE and VC activities.

Moreover, for the purpose of equitable welfare, access to financial accounts provided by Islamic banks is important to show that poor people are also entitled to financial services, both funding and financing provided by Islamic banking. For example, during the COVID-19 Pandemic as it is today, a lot of aid from the government is channeled through financial institutions. So, it would be better if Islamic banking was able to reach the target groups to be lifted from poverty and easily get access to government assistance.

Only Islamic Banking can carry out the social finance function in its operations. Because apart from Zakat which is the difference between Islamic and conventional institutions, Islamic banking also applies social contracts (Tabarru ') in addition to commercial contracts (Tijarah). Some examples of tabarru ' contracts used by Islamic banks include:

- Qardh – Money loans provided that the borrower returns the principal amount of the loan only.
- Qardul hasan – is the qard that is given up by the lender, so that the borrower does not have to return the principal.

- Rahn – is a qardh which requires the existence of collateral belonging to the borrower that is held by the lender.
- Hiwalah – is a loan that requires the existence of receivables from the borrower.
- Wakalah – Wakalah is authorizing another party to take certain legal actions on behalf of the party giving the power of attorney
- Wadiah – is the transfer of power to another party to supervise the property or property of the authorizing agent. This transaction is known as a deposit transaction.
- Kafalah – is borrowing the services of one party as a guarantor, which provides guarantees for the service borrower to another party

Because of the ability to organize social finance, Islamic banking is expected to be able to reduce income inequality or the gap between rich and poor people.

In addition, the potential development of Islamic microfinance could be explored, as well as the establishment of Islamic equity funds for SMEs and the institutionalization of Islamic redistributive mechanisms. Finally, improving financial infrastructure, introducing more competition in the banking system, improving the quality of credit information, and enhancing the efficiency of the legal system will help promote financial inclusion, regardless of whether the banking industry contains Islamic banks.

A Holistic Framework of Economic Growth, Profitability, Financial Stability, Distributive Justice and The Transmission Mechanism of Sustainable Development

The overarching objective of Islamic banking—rooted in the principles of *Maqashid al-Syariah* (the objectives of Islamic law)—cannot be achieved by analyzing economic growth, profitability, financial stability, and distributive justice in isolation. A critical evaluation of the industry reveals that these four macroeconomic dimensions are not mutually exclusive; rather, they form a symbiotic nexus that dictates the systemic sustainability of the Islamic financial ecosystem. To transition from a marginalized market share to a catalyst for national economic resilience, Islamic banks must adopt an integrated operational framework.

The failure of Islamic banks to significantly influence GDP growth in Muslim-majority nations stems largely from an over-reliance on debt-based operational benchmarks that mimic conventional banking. Addressing this requires a paradigm shift grounded in Stakeholder Theory and Good Corporate Governance (GCG).

Unlike conventional models that prioritize shareholder wealth maximization, the Islamic banking model is inherently stakeholder-centric. It requires balancing the financial returns of investors (profitability) with the economic empowerment of the community (distributive justice) and the mitigation of systemic risk (financial stability). Effective corporate governance within Islamic banks must therefore enforce strict adherence to real-sector Profit and Loss Sharing (PLS) financing, ensuring that capital is directed toward productive economic activities rather than speculative or purely consumptive debt.

When integrated effectively, the four dimensions reinforce one another through a specific transmission mechanism:

1. From Justice to Growth: By prioritizing financial inclusion and expanding access to microfinance and SME funding—often utilizing social finance contracts (*Tabarru'*)—Islamic banks stimulate grassroots economic activity. This equitable distribution of capital directly fuels real-sector economic growth.
2. From Growth to Profitability: As SMEs and real-sector projects succeed, the PLS mechanism ensures that the bank shares in the generated wealth. Thus, profitability becomes a direct derivative of actual economic growth, rather than being synthetically generated through predetermined interest rates linked to external benchmarks like LIBOR.
3. From Profitability to Stability: Profitability derived from diverse, real-sector investments inherently diversifies the bank's risk portfolio. Furthermore, empirical evidence suggests that smaller-scale, highly inclusive Islamic banks exhibit superior financial stability and resilience compared to large-scale commercial entities. By maintaining strong capital-to-asset ratios and focusing on community-level economic empowerment, these institutions build intrinsic systemic resilience.

Strategic Impact and Implications

The integration of these four pillars confirms that the ultimate value proposition of Islamic banking lies in its structural differences from conventional finance, not its similarities. When Islamic banks prioritize distributive justice through genuine PLS contracts, they do not sacrifice profitability or stability; rather, they redefine them. Profitability becomes sustainable, stability becomes deeply rooted in real assets rather than financial derivatives, and economic growth becomes inclusive. Therefore, to foster genuine sustainable economic development, policymakers and regulators must incentivize Islamic financial institutions to operationalize this holistic framework, moving beyond superficial Shariah compliance toward substantive economic impact

CONCLUSION

This study set out to evaluate whether Islamic banking genuinely fosters sustainable economic development by analyzing its influence on economic growth, profitability, financial stability, and distributive justice. The findings indicate that while Islamic banking has made positive socio-economic contributions, its current capacity to drive holistic sustainable development remains constrained by structural and operational limitations.

Specifically, the impact of Islamic banks on national economic growth (GDP) is currently minimal, primarily due to the industry's relatively small market share and a persistent over-reliance on non-PLS (Profit and Loss Sharing) contracts that mimic conventional debt mechanisms rather than stimulating real-sector productivity. While the industry demonstrates robust profitability, this financial performance is often tied

to macroeconomic conditions and conventional benchmarks rather than the intrinsic value generated through equitable risk-sharing. Conversely, in terms of financial stability, the operational model proves highly resilient; empirical evidence suggests that smaller-scale Islamic banks exhibit superior stability compared to larger commercial entities, highlighting the strength of community-focused financial intermediation. Finally, regarding distributive justice, Islamic banks serve as effective catalysts for financial inclusion and social finance (for example through *Tabarru'* contracts), yet achieving true equitable wealth distribution requires a much stronger commitment to funding micro, small, and medium enterprises (MSMEs).

Ultimately, for Islamic banking to transcend its current limitations and fulfill its mandate of sustainable economic development, the sector requires a paradigm shift rooted in strong corporate governance. This entails reforming operational procedures to prioritize real-sector PLS financing over speculative or consumptive credit. Furthermore, a comprehensive stakeholder framework is essential; collaborative synergy between regulators, the private sector, academia, and Shariah practitioners is necessary to ensure that Islamic finance operates not merely as a technically compliant alternative, but as a genuinely equitable economic engine.

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