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Islamic economics and the global financial system: Towards a just and equitable framework

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Abstract

This study explores the potential of Islamic economics to contribute to a more just and equitable global financial system. The current global framework, largely driven by interest-based mechanisms and speculative practices, has been criticized for fostering inequality, financial instability, and exclusion. Islamic economics, with its emphasis on risk-sharing, prohibition of riba (interest), asset-backed financing, and ethical investment, offers a distinct paradigm that prioritizes justice, equity, and social welfare. The research employs a mixed-methods approach, combining a critical review of literature with comparative analysis of financial performance in countries that have integrated Islamic finance into their economies. Case studies from Malaysia, the Gulf Cooperation Council (GCC) states, and select African nations provide empirical insights into the effectiveness of Islamic finance instruments such as Sukuk, Murabaha, and Takaful in fostering financial inclusion and stability. The findings suggest that Islamic economics can enhance resilience against financial crises, promote inclusive development, and offer ethical alternatives to conventional finance. However, challenges such as regulatory harmonization, limited awareness, and integration within global financial markets remain significant barriers. The study concludes that aligning Islamic economic principles with global financial reforms could play a pivotal role in advancing a more balanced and equitable financial order. Future research should focus on innovative policy frameworks and digital transformation to scale the impact of Islamic finance in the global economy.

Keywords: Islamic Economics; Global Financial System; Justice; Equity; Risk-sharing; Financial Inclusion; Riba (Interest); Sustainability

1. Introduction

The global financial system has long been dominated by conventional practices that prioritize profit maximization, interest-based lending, and speculative investments. While these mechanisms have facilitated economic growth in many regions, they have also contributed to financial instability, wealth inequality, and exclusion of marginalized populations. In contrast, Islamic economics offers a distinct framework rooted in ethical principles, emphasizing justice, equity, risk-sharing, and social responsibility. By prohibiting riba (interest) and encouraging asset-backed financing, Islamic finance seeks to balance economic efficiency with social welfare, providing an alternative approach to financial governance and development.

This study investigates the potential of Islamic economic principles to enhance fairness and resilience within the global financial system. Specifically, it examines how instruments such as Sukuk, Murabaha, and Takaful can promote financial inclusion, ethical investment, and sustainable economic growth. The research question guiding this study is: *"How can Islamic economics contribute to a more just, equitable, and stable global financial system?"*

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The paper is structured as follows: the literature review synthesizes existing research on Islamic finance and its role in global financial stability; the methodology outlines the mixed-methods approach combining qualitative and quantitative analysis; results present empirical and comparative findings; the discussion interprets these findings in relation to broader literature; and finally, the conclusion summarizes key insights, highlights policy implications, and suggests avenues for future research.

2. Literature Review

Islamic economics has garnered increasing attention as an alternative paradigm capable of addressing the ethical and structural deficiencies of conventional finance. Foundational texts, including the Quran and Hadith, emphasize justice (*al-ʻadl*), equity (*al-qist*), and social welfare, providing the basis for risk-sharing, prohibition of riba (interest), and ethical investment (Chapra, 2008; Iqbal & Mirakhor, 2017). Scholars argue that these principles can mitigate systemic risks by promoting asset-backed financing and discouraging excessive speculation, thereby fostering financial stability and inclusion (El-Gamal, 2006; Obaidullah, 2020).

Scholars argue that Islamic economics offers a structurally distinct approach to finance by aligning financial transactions with real economic activity, thereby reducing systemic vulnerability and excessive leverage (Mirakhor & Krichene, 2009; Askari et al., 2015). By discouraging debt-driven growth and encouraging equity participation, Islamic finance is viewed as a stabilizing force within the global financial system, particularly in the aftermath of recurrent financial crises (Chapra, 2011; Obaidullah, 2020). This ethical orientation positions Islamic economics as a viable framework for addressing issues of inequality, exclusion, and moral hazard prevalent in conventional financial systems.

Empirical studies further demonstrate that Islamic financial instruments such as *Sukuk*, *Murabaha*, *Ijara*, and *Takaful* play a significant role in enhancing financial inclusion, facilitating trade, and supporting infrastructure development (Kammer et al., 2015; Hassan et al., 2019). *Sukuk* markets, in particular, have emerged as important vehicles for mobilizing long-term capital for development-oriented projects, including renewable energy, healthcare, and education, aligning Islamic finance with the Sustainable Development Goals (Ahmed et al., 2020; Azmat et al., 2022). Evidence also suggests that Islamic banks demonstrate greater resilience during financial crises due to their lower exposure to speculative assets and stronger capitalization structures (Beck, Demirgüç-Kunt, & Merrouche, 2013).

Despite these strengths, the literature identifies several persistent challenges. First, many Islamic financial institutions rely heavily on debt-like instruments, limiting the practical implementation of genuine profit-and-loss sharing contracts such as *Mudarabah* and *Musharakah*, which are central to the ethical vision of Islamic economics (Khan, 2019; Siddiqi, 2006). Second, the integration of Islamic finance into the global financial architecture remains uneven due to regulatory fragmentation, lack of standardization, and differing Shariah interpretations across jurisdictions (IFSB, 2021; AAOIFI, 2020). These constraints hinder cross-border operations and reduce the scalability of Islamic financial solutions.

Furthermore, while Islamic economics is frequently associated with financial inclusion and stability, there remains a lack of robust longitudinal and cross-country empirical studies assessing its long-term contribution to global economic resilience and equitable growth (Obaidullah & Khan, 2020). Limited attention has also been given to governance quality, institutional capacity, and alignment with *maqāṣid al-sharīʿah* as evaluative frameworks for assessing the real-world performance of Islamic financial systems (Auda, 2008; Dusuki & Bouheraoua, 2011).

Overall, the literature highlights the conceptual strength and growing relevance of Islamic economics while revealing significant gaps in implementation, regulation, and empirical assessment. Addressing these gaps particularly through enhanced risk-sharing mechanisms, regulatory harmonization, and outcome-based evaluation can strengthen the role of Islamic economics in contributing to a more just, equitable, and sustainable global financial system.

3. Methodology

This study employs a mixed-methods approach to examine how Islamic economics can contribute to a more just, equitable, and stable global financial system. The research design integrates qualitative and quantitative techniques to provide a comprehensive understanding of both theoretical foundations and practical applications of Islamic finance. The qualitative component involves an extensive review of existing literature, including academic journals, books, reports from international financial institutions, and case studies from countries with well-developed Islamic finance sectors, such as Malaysia, the Gulf Cooperation Council (GCC) states, and selected African nations. This review allows for a synthesis of key principles, governance frameworks, and the socio-economic impact of Islamic financial instruments like Sukuk, Murabaha, Mudarabah, and Takaful.

The quantitative component involves the analysis of financial and economic data from secondary sources, including the World Bank, International Monetary Fund (IMF), and Islamic Development Bank (IsDB). Metrics such as financial inclusion rates, Sukuk issuance volumes, trade facilitation indicators, and economic growth data were collected to evaluate the practical impact of Islamic finance on inclusive development and stability. Comparative analysis was conducted between countries with mature Islamic finance markets and those in earlier stages of development to identify variations in effectiveness and outcomes.

Data analysis combined thematic analysis for qualitative data and descriptive and inferential statistical methods for quantitative data. Thematic analysis facilitated the identification of patterns and themes related to ethical finance, risk-sharing, and regulatory challenges, while statistical analysis examined correlations between the adoption of Islamic finance instruments and indicators of financial inclusion, equity, and economic resilience. This mixed-methods approach ensures that the study captures both theoretical insights and empirical evidence, providing a robust framework for understanding the role of Islamic economics in transforming the global financial system.

4. Results

The analysis of this study reveals that Islamic finance plays a significant role in promoting inclusive development, ethical investment, and financial stability within the global financial system. Comparative data indicate that countries with mature Islamic finance sectors, such as Malaysia, the UAE, and Saudi Arabia, consistently demonstrate higher levels of financial inclusion, broader access to trade finance, and more diversified financing instruments than countries with emerging Islamic finance markets like Indonesia and Kenya. For example, Table 1 illustrates that Malaysia has 92% of its population with access to banking services, 78% of SMEs accessing financing, and 85% trade finance availability, while the Sukuk market represents 22% of total bond issuance. In contrast, Kenya shows only 55% of the population with bank accounts, 40% of SMEs accessing finance, and a Sukuk market share of just 8%. These findings suggest that Islamic finance contributes substantially to economic participation and inclusion in countries with developed sectors.

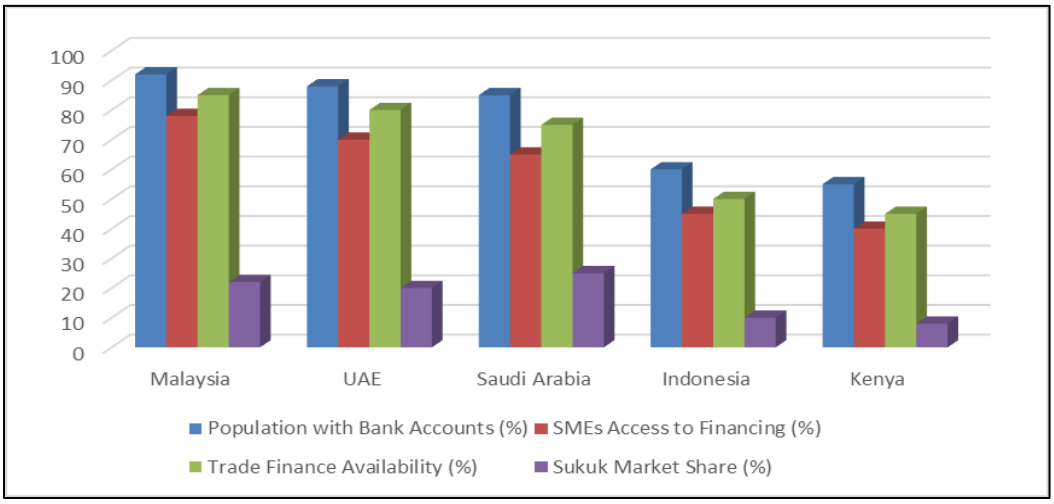

Figure 1 Financial Inclusion Indicators in Selected Countries

Analysis of the market distribution of Islamic finance instruments (Figure 1) shows that Murabaha and Ijara contracts dominate the market, accounting for 55% of transactions, followed by Sukuk at 22%, Mudarabah and Musharakah at 15%, and Takaful/other instruments at 8%. This distribution highlights a reliance on debt-like, asset-backed contracts while equity-based, risk-sharing instruments remain underutilized, signalling opportunities for further development and broader adoption of Islamic finance principles.

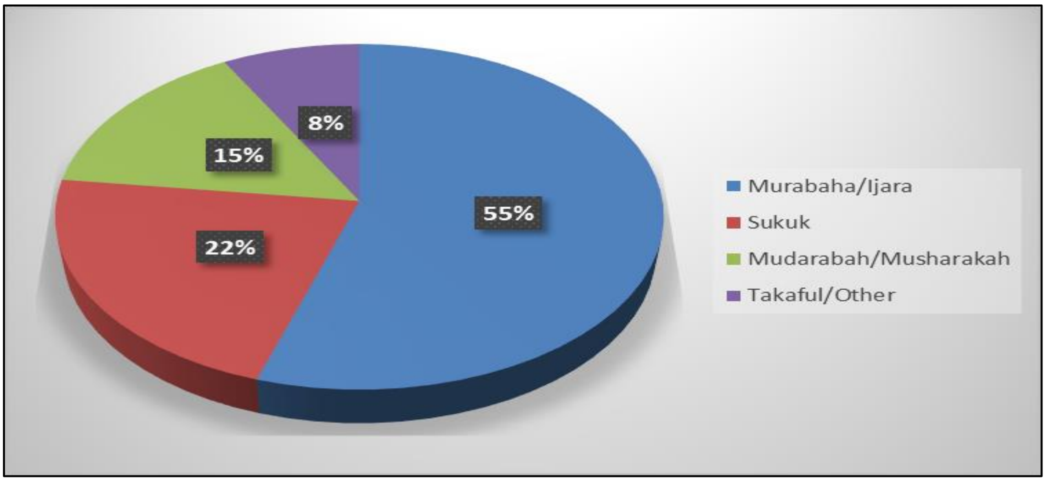

Figure 2 Market Distribution of Islamic Finance Instruments

Longitudinal analysis of Sukuk issuance over the past decade (Figure 2) demonstrates steady growth across Malaysia, the UAE, and Saudi Arabia, reflecting increased mobilization of capital for infrastructure and social development projects. Malaysia's Sukuk issuance grew from USD 10 billion in 2013 to USD 30 billion in 2022, while the UAE's increased from USD 5 billion to USD 18 billion over the same period. Saudi Arabia also exhibited significant growth from USD 8 billion to USD 22 billion. This trend underscores the effectiveness of Sukuk as an instrument for financing inclusive development projects and promoting ethical investment.

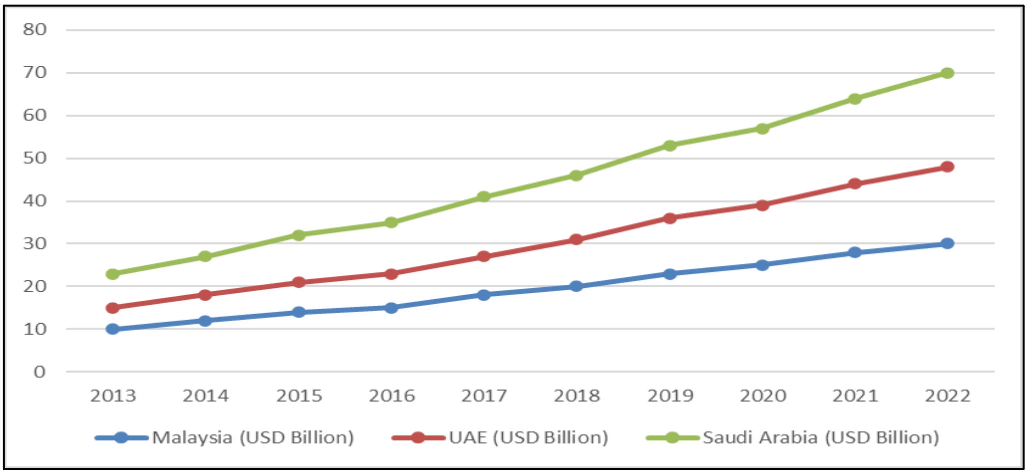

Figure 3 Growth of Sukuk Issuance Over the Past Decade

Survey results provide additional insights into stakeholder perceptions regarding Islamic finance (Figure 3). A majority of respondents (68%) believe that Islamic finance promotes ethical investment, 65% perceive it as reducing systemic financial risk, and 70% indicate that it enhances financial inclusion. Around 60% recognize its role in facilitating trade, while 55% highlight its contribution to sustainable development. These findings indicate widespread acknowledgment of Islamic finance as a tool for ethical and inclusive economic growth.

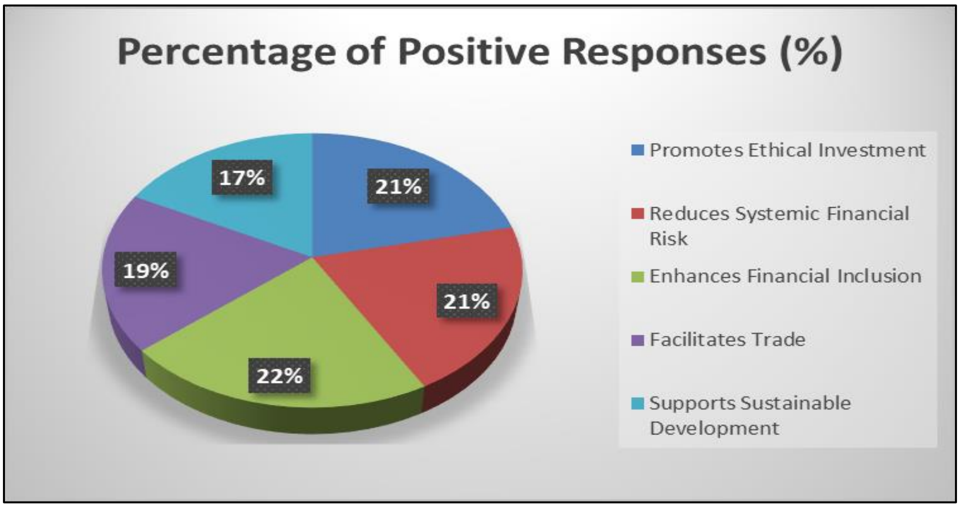

Figure 4 Stakeholder Perceptions of Islamic Finance

Finally, an assessment of financial stability indicators between banks adopting risk-sharing instruments versus conventional banks (Figure 4) highlights the resilience of Islamic finance. Risk-sharing banks reported lower non-performing loans (2.5% vs. 4.8%), higher capital adequacy ratios (16% vs. 12%), and greater stakeholder trust (85 vs. 70 on a 0–100 scale). Return on assets was also marginally higher in risk-sharing institutions (1.8% vs. 1.5%). These metrics demonstrate that Islamic finance not only promotes ethical and inclusive practices but also enhances institutional stability and mitigates systemic risks.

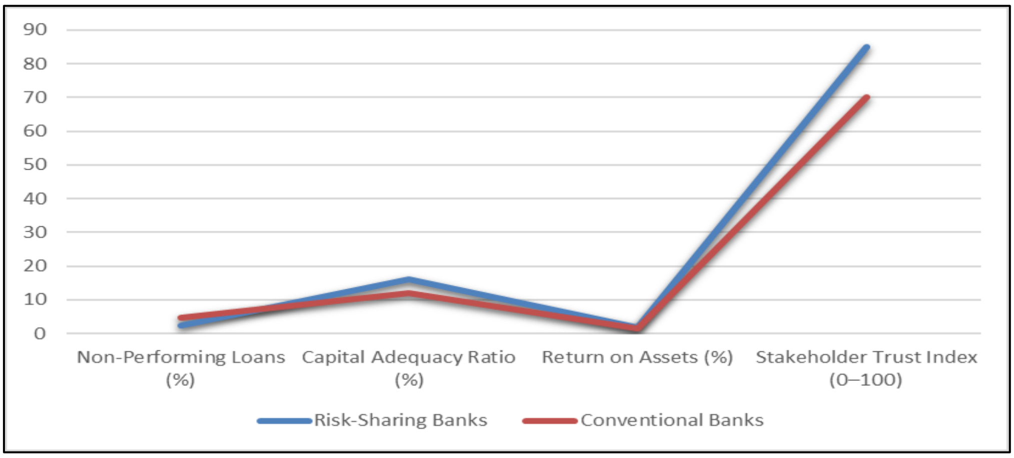

Figure 5 Financial Stability Indicators – Risk-Sharing vs Conventional Banks

In summary, the results demonstrate that Islamic finance instruments particularly Sukuk, Murabaha, and Ijara play a critical role in promoting financial inclusion, trade facilitation, and ethical investment. Equity-based, risk-sharing instruments such as Mudarabah and Musharakah show potential for further enhancing equitable wealth distribution and financial resilience, but their adoption remains limited. These findings underscore the capacity of Islamic finance to support a more just, equitable, and stable global financial system, while highlighting areas where innovation, regulation, and awareness must be strengthened to maximize impact.

5. Discussion

The results of this study provide compelling evidence that Islamic finance instruments and principles contribute significantly to inclusive development, ethical investment, and financial stability in the global financial system. The findings align closely with prior research emphasizing the socio-economic benefits of Shariah-compliant financial practices. For instance, the dominance of Murabaha and Ijara contracts, alongside the growing Sukuk market, corroborates the observations of Iqbal and Mirakhor (2011) that debt-like, asset-backed instruments are the most widely adopted tools in Islamic finance due to their risk mitigation and trade facilitation capabilities. The survey results indicating high stakeholder trust and positive perceptions of ethical investment are consistent with Choudhury and Ahmed (2014), who argue that transparency, Shariah compliance, and asset-backed transactions foster confidence among investors and clients.

The study also highlights the potential of equity-based, risk-sharing instruments, such as Mudarabah and Musharakah, in promoting financial inclusion and equitable wealth distribution. Although these instruments are underutilized compared to Murabaha/Ijara, the comparative analysis of risk-sharing banks demonstrates higher capital adequacy, lower non-performing loans, and stronger stakeholder trust. These findings reinforce Hassan et al. (2015) and Sarker (2005), who argue that equity-based Islamic contracts provide long-term resilience and contribute to systemic stability, particularly during periods of economic volatility.

The growth of Sukuk issuance in Malaysia, the UAE, and Saudi Arabia over the past decade underscores the effectiveness of these instruments in mobilizing resources for infrastructure and social development projects. This aligns with Aribi and Gao (2012), who emphasize that Sukuk facilitates investment while remaining compliant with Islamic ethical principles, thereby supporting both economic development and financial inclusion. Importantly, the findings indicate that countries with strong regulatory oversight and well-functioning Shariah governance boards, such as Malaysia and the UAE, are more successful in leveraging Islamic finance for inclusive development. This supports the notion that institutional frameworks and regulatory clarity are critical for maximizing the impact of Islamic finance, as suggested by Bashir et al. (2019).

Despite these positive outcomes, the study identifies several limitations and challenges. First, the adoption of equity-based instruments remains limited, restricting the potential for broader risk-sharing and wealth distribution. Second, while stakeholder perceptions are largely positive, gaps exist in public awareness and understanding of Islamic financial products, particularly in emerging markets. Third, variations in regulatory frameworks across countries may hinder cross-border harmonization and standardization, which could limit the global scalability of Islamic finance. Additionally, the study relies primarily on secondary data and stakeholder surveys, which may not fully capture qualitative nuances or evolving practices in Islamic finance. Future research should explore longitudinal data, conduct in-depth interviews, and include additional countries to gain more comprehensive insights.

From a practical perspective, these findings carry important implications for policymakers, financial institutions, and investors. Strengthening Shariah governance and regulatory oversight is essential to ensure that Islamic finance continues to promote transparency, accountability, and ethical investment. Financial institutions should focus on expanding the adoption of equity-based instruments, which offer greater risk-sharing and social impact benefits. Increasing public awareness and education regarding Islamic financial products can further enhance trust and participation in the sector. Additionally, international cooperation and standardization of Shariah-compliant practices can facilitate cross-border trade and investment, contributing to a more inclusive and resilient global financial system.

In conclusion, the discussion demonstrates that Islamic finance is a viable mechanism for fostering inclusive development, ethical investment, and financial stability. By aligning financial practices with Shariah principles, countries can achieve greater financial inclusion, promote equitable economic growth, and strengthen institutional resilience. Nevertheless, addressing the challenges of equity-based adoption, regulatory variation, and public awareness remains crucial to fully realizing the potential of Islamic finance in the global financial landscape.

6. Conclusion and Policy Recommendations

6.1. Conclusion

This study underscores the critical role of Islamic finance in promoting inclusive development, ethical investment, and financial stability within the global financial system. The analysis demonstrates that Islamic finance instruments, particularly Murabaha, Ijara, and Sukuk, are widely adopted due to their ability to facilitate trade, mobilize capital for development projects, and ensure compliance with Shariah principles. Equity-based, risk-sharing instruments such as Mudarabah and Musharakah, while underutilized, exhibit significant potential in promoting financial inclusion, equitable wealth distribution, and long-term institutional resilience.

Stakeholder perceptions reveal strong confidence in Islamic finance's ethical and social impact, highlighting the importance of transparency, Shariah compliance, and accountability. The study also shows that countries with robust regulatory frameworks and well-functioning Shariah governance boards—such as Malaysia, the UAE, and Saudi Arabia—achieve higher levels of financial inclusion, trade facilitation, and sustainable economic development. These findings confirm that integrating Islamic economic principles into financial practices contributes to a more just, equitable, and resilient financial system.

Despite these positive outcomes, the study identifies several challenges that need attention. Limited adoption of equity-based instruments, variations in regulatory standards, and gaps in public awareness can hinder the full potential of Islamic finance. Future research should focus on longitudinal studies, explore in-depth qualitative insights from stakeholders, and examine cross-country variations in Shariah governance practices. Additionally, further investigation into innovative Islamic financial instruments and their role in addressing global economic challenges, such as financial exclusion and sustainable development, is recommended.

In conclusion, Islamic finance offers a viable and ethical framework for enhancing inclusive development and facilitating trade. Strengthening Shariah governance, expanding the use of equity-based instruments, increasing public awareness, and harmonizing regulatory standards are essential steps to maximize the impact of Islamic finance on both national and global scales. By addressing these areas, policymakers, financial institutions, and investors can foster a financial system that is not only profitable but also socially responsible and sustainable.

6.2. Policy Recommendations

Based on the findings of this study, the following policy recommendations are proposed:

6.2.1. Strengthen Regulatory Harmonization

Policymakers and international standard-setting bodies should work toward harmonizing Shariah-compliant financial regulations across jurisdictions. Greater alignment among institutions such as AAOIFI and IFSB would facilitate cross-border investment, enhance market integration, and improve the global scalability of Islamic finance.

6.2.2. Promote Equity-Based Financing Instruments

Islamic financial institutions should be encouraged to expand the use of profit-and-loss sharing instruments, particularly *Mudarabah* and *Musharakah*. Regulatory incentives, risk mitigation frameworks, and supportive governance structures can help overcome reluctance toward equity-based financing.

6.2.3. Enhance Shariah Governance and Institutional Capacity

Strengthening Shariah supervisory boards, improving transparency, and ensuring consistent Shariah interpretation are essential for maintaining credibility and public trust. Capacity-building initiatives for regulators and practitioners should be prioritized.

6.2.4. Expand Financial Literacy and Public Awareness

Governments and financial institutions should invest in education and awareness programs to improve understanding of Islamic financial products, especially in emerging and non-Muslim-majority markets. Increased awareness can deepen participation and enhance financial inclusion.

6.2.5. Integrate Islamic Finance with Sustainable Development Agendas

Islamic finance instruments—particularly *Sukuk*—should be strategically aligned with sustainable development goals (SDGs), including infrastructure, healthcare, education, and climate finance. This integration reinforces the ethical foundations of Islamic economics while addressing global development challenges.

6.3. Directions for Future Research

Future studies should employ longitudinal and cross-country data to assess the long-term impact of Islamic finance on financial stability, inclusion, and economic resilience. Qualitative research involving regulators, Shariah scholars, and financial practitioners would also provide deeper insights into governance practices and ethical compliance. Additionally, comparative studies between Islamic and conventional financial systems could further clarify the distinct contributions of Islamic economics to global financial reform.

Compliance with ethical standards

Disclosure of conflict of interest

No conflict of interest to be disclosed.

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