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Integration of Islamic Financial Growth in Evolving Islamic Nations: Comparative Analysis of Non-Islamic & Islamic Banking

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Abstract

The goal of this study is to contrast how Islamic and Non-Islamic financial development affects economic growth.The authors gathered data on the Islamic banking system and the conventional banking system from 2007 to 2014 in Pakistan, Turkey, and Malaysia, three comparable nations with a developing Islamic financial development industry. This study report provides an unbiased assessment of the economic progress and financial development's impact of Asian Islamic nations. The total assets, private credit, and influence on the economic growth of conventional and Islamic banking have all been rigorously examined in the study. Additionally, the random-effects GLS regression technique is used, and the findings show that financial development indicators significantly aide in the expansion of the economy. This study will emphasize the significant contribution of Islamic private-sector loans.

Keywords: *: Private Credits, Islamic Banking, Conventional Banking, GDP Per Capita.*
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1. INTRODUCTION

Since the previous three decades, economic growth and financial integration have steadily increased in Islamic nations. In 2014, these countries' normal growth rate of GDP rate was 3.6%. Additionally, the service sector contributes more than 50% of the GDP in Asian nations (Ahammad and Ahsan, 2011). Islamic banking is expanding around the world but is particularly strong in Islamic nations where it is essential to economic growth and development. Islamic banking practices adhere to Shariah law, and the system is organized on contracts that do not need fixed interest payments. Islamic banking can be considered a substitute method of doing away with fixed interest charges in financial transactions.

The formation of the IDB in 1975 marked a revolving point for Islamic finance banking as soon as it was able to start its commercial banking structure which was named as Dubai Islamic Bank. After that, it also inspired other sorts of banks to devote themselves to commercial bank's Islamic models, including Sudan's Islamic Bank i.e. in 1977 the Kuwait Finance House in Kuwait and Faisal Islamic Bank . Later, as another Islamic nation is Pakistan which also updated its banking system-related regulations to make them compliant with Shariah law. The legal structure was also changed in the early 1980s. Taking this into consideration, several other nations, including Iran, Turkey, Sudan, and others, have also embraced the By taking this into consideration, several other nations, like Iran, Turkey, Sudan, and others, have embraced Islamic banking practices and implemented them in their daily operations. Research in development economics has recently placed a lot of emphasis on the link between financial development and economic growth. Work on this link began in the early years of the twentieth century. Chhapra et al. (2018), Goldsmith (1969), Shaw (1973), McKinnon (1973), and Robinson (1952) all focused on the significance of financial development in their research in order to encourage domestic investment and economic progress in the long run.

There are 15,000 banks operating globally, of which 550 are Islamic banks. The yearly growth rate of Islamic banks was 17.6% from 2009 to 2013 and is expected to reach 19.7% by 2018. The expansion is accelerating not just in Islamic nations but other than Islamic nations. The continuing expansion of Islamic banks is seen as a reflection of the Islamic financial environment in the 1980s and 1990s. claims Faizulayev (2006–2009). Over $12 billion was deposited by almost 8 million account holders in only one year (2012). Islamic banking was first introduced in the 1970s with a relatively small number of financial institutions, but as time went on, it really took off, and it is now a very substantial business (Akbar, shahed, 2014).

It is necessary to determine how Islamic banking affects economic growth because it is expanding more quicker in Asian nations than traditional banking. In order to determine which sector has the most potential to boost economic growth, researchers compared the conventional and Islamic banking sectors' contributions to economic growth in Asian nations (Abdul Hadi et al., 2018; Rehan and Abdul Hadi, 2019; Rehan Abdul Hadi and Hussain, 2019). The banking industry is crucial to a nation's economy. Islamic banking nowadays has developed as a separate industry from the traditional banking system, and both of these banking practices help a nation's

economy prosper. A substantial opportunity exists to assess the contributions of both banking systems to economic integration in Asian nations with good, traditional banking operations (Abdul Hadi et al., 2019). In order to do this, the researcher has studied both Islamic and conventional financial development.

It is crucial to ascertain how Islamic banking affects economic growth. because it is expanding more quickly in Asian nations than traditional banking. For a comparison of the conventional and Islamic banking industries' contributions to the economic growth of Asian nations, see Abdul Hadi et al. (2018); Rehan , Abdul Hadi (2019); Rehan Abdul Hadi, Hussain (2019). A nation's economy depends heavily on the banking industry. Islamic banking nowadays has developed as a separate sector of the banking industry from the traditional banking system, and both of these banking practices support a nation's economic development. It is possible to examine how both banking systems contribute to economic integration in Asian nations with good, traditional banking operations (Abdul Hadi et al., 2019). The study on Islamic and conventional financial development was done by the researcher with this goal in mhis study looks at the impact of banking sector's financial development on growth of economies in Asian Islamic nations in strength to recognize how finance is incorporated into a country's economical growth and development. It contrasts Islamic money with mainstream finance. The following are the investigation's primary research goals:

I. To ascertain how Islamic and conventional banking's financial development are impacted private credit and economic growth.
II. The study will determine the importance of the link between private loans from selected Islamic banks and non-Islamic banks and the country's GDP.
III. The inquiry will conclude how private loans from Islamic and conventional banks relate to a nation's trade openness.
IV. The study will determine the significance of the link between the total Islamic and Non Islamic assets and the country's GDP.
V. The study will determine the significance of the link between the total conventional and Islamic bank assets and the country's GDP.

This study adds a number of new ideas to the body of knowledge. In contrast to traditional banking, this study is undertaken in several Islamic nations with diverse dynamics. The paper investigates experimentally how Islamic financing affects economic development in future Islamic nations. Additionally, it contrasts the impacts of the Islamic and Western financial systems on the economic expansions. Although the majority of past studies were focused on Gulf Corporation Council states, this study is specifically focused on Asian countries. Given the globalization of Islamic banking activities, decision-makers in the banking and financial sectors will find the study's comparison of Islamic and non Islamic banking to be helpful in long run. This study will also help Asian countries establish Islamic financial integration systems and understand the long-term relevance of Islamic banking.

2. LITERATURE REVIEW

2.1 Islamic Banking

According to research by Hernawati et al. (2021) and Mannan (1982), an Islamic banking is a academy which abides by laws, regulations, policies of a state or nation while expressing its commitment to Islamic principles and laws. Islamic banks are also prohibited from receiving or paying interest on any transactions. Islamic banking is also known as a financial middleman, according to Kahf (2005) and Abdul Hadi et al. (2019). They collect money and distribute the excess to customers and business owners who require it to maintain their operations. Islamic banking engages in financial intermediation based on various contracts but does not engage in lending or borrowing because Islamic law forbids charging interest.

According to Alan and Noreen (2011), the Shariah based banking system is a different type of financial system. Unlike the Western banking system, which permits both the receipt and payment of interest, Islamic banking bans both of these actions. The basis of Islam is Shariah economic activity, which is conducted in conformity with Islamic laws and values. El-Gamal (2006) described Islamic finance system adheres to sharia. It is officially against Islamic law to engage in any transaction where there is a give-and-take interest. The Quran is the primary source used in Islam to impose interest restrictions on individuals. The Quran clearly states that anyone who disregarded Islamic law in order to pursue their own interests are at war with God and the Holy Prophet. Islamic financial operations are intimately tied to Islamic rules and provide guidance for Islamic economics, according to the Spiral (2006). Manzerkahf (2005) outlined the guiding concepts of Islamic banking behavior. These principles are acquired from the two sides of human nature: one side is an aphorism of natural virtue and is applicable to everyday life. Islamic banks cannot accept interest-bearing lending or borrowing in contracts since the payment and recovery of interest is prohibited.

2.2 Conventional Banking

Ramiz ur Rehman (2010) clarified that conventional banks make money by charging various interest rates. They profited from the interest rate differential between lending and borrowing money. In addition to the traditional bank, money is also made through their services. Rami Zeitem (2012) examined traditional banking and described it as providing a good or service to the general public and businesses. The interest rate is the only factor that matters. The depositor is guaranteed a certain interest rate. According to Ghulam Shabir Khan (2010), traditional banking system is based on an unmixed financial model. In order to address the needs of the person or organization, the bank borrows money from savers. According to Msood (2009), a traditional bank operates profitably and generates income from deposited assets.

Based on the 2000–2005 financial statistics. With a total asset of 87.91% in 2000, conventional banks are in the lead in the GCC nations. However, their share of total assets fell to 40.64% in 2005. Cash to Asset and Cash to Deposits ratios, which measure liquidity, are crucial for the sustainability of the banking system. From the

examination of these ratios, it is clear that conventional banks bore a greater share of the risk associated with liquidity than Islamic banks. Conventional banks' D to A ratios show that they are more reliant on external liabilities. The conventional banks are supported by some factors, such as the asset, investment, and deposit-to-equity ratios, but this conclusion is uncertain because Islamic banks are more prevalent in Kuwait and Qatar than in Saudi Arabia, where conventional banks have a higher ratio. From one nation to another, it differs. These factors, as in the aforementioned argument, demonstrate that conventional banks have the capacity to sway their activities by luring deposits and investments. Conventional banks profit from the equity-to-asset ratio, and both ratios serve as important measures of capital adequacy. Higher values will replicate the bank's strong financial base and lessen the risk that financial operations will have issues (Loghod, 2005).

2.3 Islamic Banking and Economic Growth

Johnson (2013) used data from Bank Scope and the World Bank to studied the following factors: legal source, financial attachment, and other relevant development components, etc., and discovered how Islamic banking affects economic growth. His study looked at both conventional and Islamic banking's differing interest rates on different types of accounts as well as the banking system's other requirements. Other development indicators from the Wharton research database have been gathered from other useful sources that are made up of global development indicators. Following the analysis, it was found that there was a favorable link between countries of French origin and Islamic banks, but a negative correlation in countries with a legacy of British legal systems. The evidence demonstrates unequivocally that the Islamic system is preferable in countries with French ancestry (Johnson, 2013).

Data analysis, cost effectiveness, and technical efficiency Shahid (2010) used a variety of criteria, such as the constant return to scale and variable return to scale, to evaluate the performance of conventional and Islamic banks in Pakistan. Performance of conventional and Islamic banks in Pakistan should be compared based on factors such capital sufficiency, managerial effectiveness, earning potential, asset quality, and liquidity status, according to Jaffar's (2011) research. He employed CAMEL analysis in this study, which stands for capital sufficiency, assets, management potential, earnings, liquidity, and sensitivity. This is the most recent method in use today. Seetanah (2009) looked into the connection between financial progress and economic expansion. Date of the case includes the 1980–2005 collecting period. For the purposes of this essay, statistics from the World Bank's world development index were gathered.The study, which uses static punitive data, found that the pace of economic growth was positively impacted by financial development.

Research on the efficiency of Malaysia's Islamic and non Islamic banking systems was done in 2012 by Yahya and Hadi. The main objective of their study was to compare the effectiveness of Islamic and non-Islamic banks. To assess the performance of both organizations, data envelopment analysis is used to examine financial parameters. Data analysis found that there are no appreciable efficacy differences between the two banking systems. Omer (2012) investigated whether

there was a long- or short-term relationship between economic growth and Indonesia's Islamic banking system. For cointegration, the bound testing method is employed. The outcome demonstrates the strong link between economic growth and the Islamic banking system. In his study, Wasiuzzaman (2013) evaluated the performance of Islamic and conventional banking using financial statements, annual reports, and corporate finance statements from both types of banks. He employed bank size, ROAA, NIM, bank type, and asset quality for this, analyzing how each of these ratios significantly affected Malaysia's profitability.The result shows how closely the Islamic banking system and economic growth are related. Wasiuzzaman (2013) compared the performance of Islamic and conventional banking using the financial statements, annual reports, and corporate finance statements of both types of banks. For this aim, he looked at asset quality, bank size, bank type, ROAA, and NIM, and concluded that these factors had a significant influence on Malaysia's profitability.

Hamza (2014) analyzed the market strength of Islamic and non Islamic banks based on total assets, loan to total assets, returned on assets, and return on equity . the author acquired information by looking through bank balance sheets and revenue records. Other researchers like Farahani and Dastan (2013) looked at the impact of Islamic banking on economic growth. Between 2000 and 2010 was the period of data collection. It also uses the penal configuration approach for data analysis. The results show that it has long- and short-term positive and substantial effects on Islamic financial development and economic prosperity. Amar (2015) investigated how Islamic bank funding impacted the economic expansion of Malaysia. The error-correcting approach is used to measure the subjects. His fining shows that an Islamic banking's impact is less countable on economic growth over time than it is right now (Amar Hachicha, 2015).

3. METHODOLOGY

This study report provides an unbiased assessment of financial development's impact on the economic progress of Asian Islamic nations. Annual reports on the economy, the financial sector, and both conventional and Islamic banking were examined for this study. A variety of sources are used to get data. The researcher compiled data for the indices of Islamic financial development from central bank reports and the financial statements of Islamic banks. Additional financial development's data and control elements , like macroeconomic stability and trade openness, were acquired from the WDI database.(World Bank Database, 2012, 2014).

The core aim of this research is to compare how Islamic and traditional banking affects economic growth. Bank private credits and total assets are used to measure the financial development as an independent variable. In accordance with previous researchers' methods (see Zandi et al., 2022; Ghani et al., 2023) economic growth (the dependent variable) is calculated using trade openness as a proxy for a group of chosen nations during a certain time period and per capita GDP growth. Pakistan, Turkey, and Malaysia—three of the biggest Islamic Asian nations—have all participated in this research on the banking industry.

This investigation examines the cause and impact of factors understudied through a causal link based on time series data analysis (Galdeano et al., 2019; Salahuddin, Kashif & Rehman, 2020; Salahuddin, Kashif & Rehman, 2021). Three nations—Pakistan, Turkey, and Malaysia—were chosen as the research population for this study. The yearly financial reports of Islamic and conventional banks from 2008 to 2014 were examined in order to compile time series data from these nations. To analyse the variables and run a regression test to examine the link between the data, STATA software is utilised. Random Impact The influence of variables on Islamic development is examined using the GLS methodology. By analysing time series data, this study explores the origin and consequences of the investigated variables (Galdeano et al., 2019; Salahuddin, Kashif, & Rehman, 2020; Salahuddin, Kashif & Rehman, 2021). Pakistan, Turkey, and Malaysia were chosen as the research populations for the researcher's study. Through examining the yearly financial reports of Islamic and conventional banks from 2008 to 2014, time series data from these nations were gathered. The regression test is run using STATA software to examine the connection between the variables and the data. Random Influence The influence of variables on the evolution of Islam is examined using the GLS technique.

Growth in this context refers to economic growth, a dependent variable equal to the real per capita GDP growth experienced by these countries throughout the stated time period. Trade openness is proxied by the export-to-import ratio as a percentage of GDP. Private credit (CRE), which is the bank lending ratio to the private sector as a proportion of GDP, and the total assets to GDP ratio are the two measures used in the research to evaluate financial development. It is viewed as a symptom of financial intermediaries.

Table 1: Indicators of Financial Development

Used	Variables	Definition
Economic Growth	GDP Per Capita and Trade Openness	Total GDP / Total Population The financial ratio of Imports and Exports over GDP.
Non-Islamic Financial System	Private Credit Given by (Non-Islamic) Conventional Banks Total Assets	Equals Non-Islamic Banking Total Credit to Private Sector as percentage of GDP Total Assets / Ratio of GDP
Islamic Financial System	Private Credit Given by Islamic Banks Total Assets	Equals Islamic Banking Total Credit to Private Sector as a percentage of GDP Total Assets / Ratio of GDP

3.1 Hypotheses

In this study, theories are developed regarding how conventional and Islamic economic growth interact in Asian countries. the next theories

H1. The GDP per capita in Asian nations is more significantly impacted by Islamic banking's private lending and total assets as a percentage of GDP than by conventional banking.

H2. Islamic banking's total assets to GDP and private credit have a larger influence on trade openness in Asian nations than conventional banking financing does.

Using the common cross-sectional OLS Regression equation, the study calculated the model based on the hypothesis and research framework.

$$\text{GDP GROWTH}_{it} = \alpha_i + \beta FD_{it} + \Upsilon Z_{it} + e_{it} \quad (1)$$

where the dependent variable GROWTH is equal to the GDP(real per capita) growth in the ith nation for a specific time period. A matrix of control factors, such as trade openness, which has an unobserved influence on a certain nation, makes up FDit, whereas eit is the error term of each observation. FDit is made up of these variables to measure financial development.

4. RESULTS AND DISCUSSION

Three Asian Muslim nations' annual data on Islamic and conventional banks are gathered in relation to the GDP. The statistics from each nation are taken from 2007 to 2014 for further study. Data is based on the total amount of private market credit circulation and the bank's total assets.

Table 2 shows a detailed breakdown of how convention and the private sector calculated credit to the private sector. To gauge the effects of trade openness, yearly credit distribution and total asset comparisons against the each country's total GDP a re being considered. According to the report, private sector Islamic credit integration is growing and making a sizable contribution to the overall GDP.

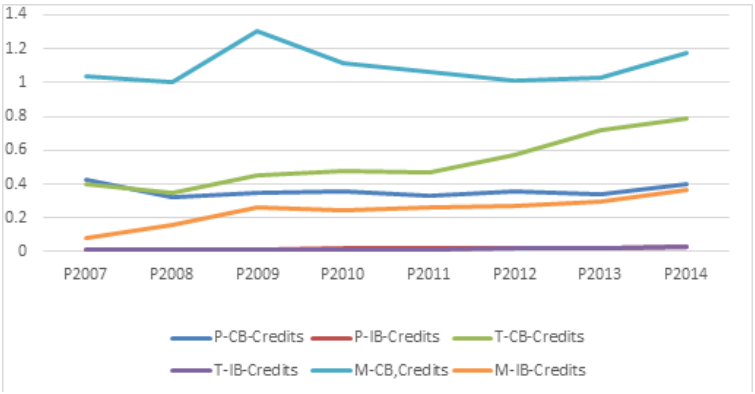
Table 2: Total Credit to Private Sector

PAKISTAN	***2007***	***2008***	***2009***	***2010***	***2011***	***2012***	***2013***	***2014***
Credit to Private Sector of Non Islamic Banks in 1000 PKR	**4,090,785,853**	**4,287,399,600**	**4,924,095,810**	**5,434,455,216**	**6,337,773,157**	**7,734,929,453**	**8,367,794,663**	**9,746,953,002**
Total Credit to Private Sector of Islamic Banks in 1000 PKR	**97,075,009**	**134,429,462**	**219,334,073**	**262,037,018**	**335,516,537**	**473,165,904**	**566,292,797**	**673,010,170**
GDP	**152,385,716,312**	**170,077,814,106**	**168,152,775,283**	**177,406,854,515**	**213,755,282,059**	**224,646,134,571**	**231,086,513,915**	**243,631,917,866**
TOTAL ASSETS of Conventional Banks in 1000 PKR	**9,567,168**	**7,245,590**	**5,808,123**	**5,157,953**	**5,735,238**	**4,546,879**	**2,887,921**	**3,321,386**
Total Asset of Islamic Banks in 1000 PKR	**118,726,288**	**162,518,840**	**226,665,757**	**318,116,214**	**407,757,865**	**533,227,748**	**637,985,304**	**769,382,412**

Malaysia	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*
Credit to Private Sector in Conventional Banks in Million RM	702,681.992	755,410.532	806,289.05	900,908.155	983,438.716	1,093,203.885	1,154,094.925581	1,261,942.978139
Credit to Private Sector in Islamic Banks in Million Rm	55,420.2	123,246.1	161,152.3	196,925.4	239,568.1	289,178.8	332,338.2	394,248.9
GDP	193,547,824,063	230,813,597,938	202,257,586,268	255,016,919,686	297,951,960,784	314,442,825,693	323,342,854,423	338,103,822,298
Total Asset in Conventional Banks in Million RM	1,094,371.0	1,120,753.659	1,171,661.493	1,260,007.779	1,423,879.253	1,514,646.409	1,631,835.442041	1,772,846.109893
Total Asset in Islamic Banks in Million RM	92,337.8	181,359.6	219,848.4	253,516.0	320,518.5	367,685.9	426,430.4	479,127.0

TURKEY	*2007*	*2008*	*2009*	*2010*	*2011*	*2012*	*2013*	*2014*
Credit to Private Sector in Conventional Bank in Million USD	257,911	255,352	275,647	348,708	365,298	448,538	593,605	629,701
GDP	647,155,131,936	730,337,495,736	614,553,921,806	731,168,051,903	774,754,155,284	788,863,301,670	823,242,587,404	798,429,233,036
Total Conventional Bank Asset in Million USD	484,061	463,839	536,901	625,570	614,491	730,278	764,953	801,689
Credit to Private Sector in Islamic Banks 1000 Tl	7618919.02	10333042.65	12636713.56	16099268.79	21717234.69	26528715.22	37858647.62	49521738.34
Total asset in Islamic banks in 1000 Tl	3,860,015	5,718,698	6,814,897	9,594,265	14,540,661	18,596,049	25,602,525	33,750,746

Figure 1: Total Credit to Private Sector in Given Islamic Nations



Association Between Non-Islamic Financial Development and Trade Openness

Table 4 : Development of Non-Islamic Financial Banks and Trade Openness

This outcome explains that there is no noticeable impact on trade openness since conventional credit to the private sector has a P-value of.387, is larger than the threshold value (.05). The outcome shows that there is no appreciable impact of Conventional Total Assets on Trade Openness since its P-value is greater than the threshold value (.05) at.947.

Relationship b/w Non Islamic Financial Development and GDP per capita

Table 5 Non Islamic Financial Development and GDP per capital

Pcgdp	Coeff.	P>|z|	[95% Conf. Interval]
Ccgdp	6267.322	0.285	-5300.027
			18034.87
Ctagdp	-10481.34	0.033	-20103.22
			859.4597
_cons	15364.54	0.009	3863.516
			26865.56

Since the outcome P-value, which is greater than the threshold value (.05), at.285, suggests that Non Islamic loans to the private sector have a considerable influence on GDP per capita. Since its P-value is below the threshold value (.05), the results demonstrate that Non Islamic total assets have a significant GDP per capita impact. According to the data, an adjustment to conventional lending to the private sector of just one unit will result in a 6367.422 unit adjustment to per capita GDP. The graph shows that the conventional Total Asset would fluctuate by one unit for every unit change in the per capita GDP. According to the findings, conventional total assets and conventional loans to the private sector both have an influence on per capita GDP of 48.32%.In accordance with Islamic Financial

Table 6: Trade Openness and Islamic System Financial Development

			[95% Con. Interval]
Eg	Coeff.	P>|z|	
Icgdp	80.22524	0	38.9851 121.4654
Itagdp	-57.45269	0	-89.40621 5.49917
_cons	0.4768669	0.311	-4.473424 1.398558

As a consequence of its P-value being bigger than the cutoff value (.05) of.000, Islamic Credit to the Private Sector does not significantly affect Trade Openness, according to the results. Islamic Total Assets do not substantially impact Trade

Openness, as shown by the result, where the P-value of Islamic Total Assets is.000, which is less than the threshold value (.05). According to the findings, trade openness changes by 80.22524 units for every unit that Islamic credit to the private sector changes by. The figure implies that for every unit change in Islamic Total Asset, Trade Openness will change by -57.45 units. The results show that GDP per capita is influenced by conventional Total Asset and Islamic Credit to the Private Sector by 51% each.

Association Between Non-Islamic Financial Development and GDP

Table 7: Non-Islamic Financial Development and GDP

Pcgdp	Coeff.	P>|z|	[95% Conf. Interval]
Icgdp	68560.49	0.306	-62599.62
			199720.6
			-169567 65957.16
Itagdp	-51804.94	0.389	
_cons	9812.195	0	4729.148
			14895.24

This outcome tells that traditional lending to the private sector has no substantial GDP per capita impact since its P-value, which is greater than the threshold value (.05), is.306, which is higher. The outcome shows that traditional total assets have a negligible impact on per capita GDP since their P-value is larger than the threshold value of.05, at.389.

5. CONCLUSION

In this study, the researcher looked at the relationship between the financial development of the banking systems in the major Islamic Asian countries and economic growth. This research essentially analyses how conventional and Islamic finance development impact economic growth and examines how financial development as a whole affects it. Our empirical findings unequivocally demonstrate the significant impact of conventional lending to the private sector on per capita GDP. nonetheless, have minimal impact on the openness of commerce. While Islamic finance of the private sector, on the other hand, has a significant impact on trade openness, it has little to no impact on per capita GDP. And Islamic financial development has a greater impact than traditional financial development. In light of this, the study comes to the conclusion that Islamic finance development boosts economic growth more than traditional financial development does. Additionally, Islamic banking will aid in lowering unemployment and poverty by offering lending facilities that are Riba-free. The country's GDP has grown as a result. The research findings lead to the conclusion that the scope or potential of Islamic financing performed better than those of conventional finance. Islamic finance has developed into a more efficient structure that can support more robust economic growth. This report suggests enhanced reform of the Islamic financial system and

improved efficiency of Islamic financial integration to promote investment and savings for long-term economic growth. This study can be useful to both the general public and financial policy makers. Policymakers can adapt the Islamic financial integration model to the new investment paradigm in Asia. Unlike conventional banking, Islamic banking and investment currently has a potential market, so the public should turn to it for return on investment. Due to certain banks' refusal to post their financial reports on their websites, the research's limitations are strictly related to data accessibility. Until the full audit report is issued, these reports won't be made public because they are secret. Time constraints are another obstacle. By adding more information and variables to the analysis, it will be possible to better understand the effects of the developing Islamic financial system.

DECLARATION OF INTEREST

It is declared that the authors of this research work have no competing interests.

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