DOES THE MODERN APPLICATION OF THE ISLAMIC FINANCIAL SYSTEM IS THE NEW RECOMMENDED ARCHITECTURE TO PROMOTE GROWTH AND PREVENT THE OUTBREAK AND SPREAD OF FUTURE CRISES?

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Abstract

Purpose - *There are sufficient theoretical and empirical studies on the nexus between conventional financial system and economic growth. However, only few theoretical and empirical studies have examined the relationship between Islamic financial system, in terms of banking sector and financial market, and economic development, in terms of economic growth and financial crisis. To fill this gap in literature, this study investigates importance of the modern application of the Islamic financial system in promoting growth and prevents the outbreak and spread of future crises, especially in Islamic countries.*

Design/methodology/approach *- This work reviews the importance of Islamic finance on economic development, examines the real effect of conventional financial system on economic growth and compares it with Islamic financial system.*

Findings *- The paper has three main results.*

First, Islamic finance system is the appropriate system to promoting economic development process, especially in Islamic countries. The second result, the international financial system has failed miserably in its mission to promote economic growth without creating financial crises. The third result, there are insufficient studies to provide theoretical and empirical evidences to support the modern applications of the Islamic financial system as the good alternative of conventional financial system in promoting economic growth without creating financial and economic crises.

Research limitations/implications – *There are insufficient empirical and theoretical studies that support the view of Islamic financial system as a good alternative for the conventional financial system. Moreover, the empirical analysis has strong impact on the role evaluation process of the Islamic financial development on the economic growth process especially in Islamic countries.*

Practical implications - *This study is helpful for the researchers and policy makers for formulating the future policy.*
Originality/value - *This paper explore the relationship between Islamic financial development and economic growth without ignoring the potential causal link between Islamic financial development and financial crisis.*

Keywords: Islamic Finance, Islamic Banking, Islamic Financial Market, Conventional financial system, Economic Growth, Economic Development, Financial Crisis.

1. Introduction

Economic development is actually comprised of economic thought and in this context economic development has been addressed by economic thinkers for centuries, where mainstream economists have often predominantly taken the lead over development theorists. Nevertheless, the recent increasing concern for the environment, societal culture, religion and institutions and their interrelationship with economic activities have led to the formation of a novel dimension to the development economics concept (Biswas, 2009).

In the 1940s and 1950s, a period known as the pioneering period, majority of economists viewed economic development as being growth per capita real income in the context of under-developed countries, whereas in other contexts, it is growth with change (in values and institutions)(Meier & Baldwin, 1957).

In relation to this, Krause (1961) stated that economic growth and economic development are synonymous and other authors were convinced that per capita output/per capita income is the appropriate measure to be used for the development index. Other studies, like Flammang (1979) and Hosseini (1999) stated that growth and development are complementary concepts, where economic growth refers to the process of simple increase indicating more of the same, and economic development refers to the process of structural change indicating something different rather than something more of the same. Moreover, Hosseini (1999) explained that economists often speak of economic growth when they are considering a quantitative and measurable increase in the economy, where GDP is concerned. On the other hand, the term economic development is often used to describe qualitative change. Nevertheless, growth and development complement each other, with each contributing to the achievement of the other.

More importantly, modern development economics should exert more effort into shedding an insight into the different growth objectives and paths where it could relate economic paradigms to the changes in the world brought about by globalization and regionalism, and uniformity and national identity. Also, economic development subject is increasingly becoming a valid social science, where the study of traditional institutions, community life, religious and ethnic aspects is not only significant but they form the core to the development of a novel social objective of economic growth and models dedicated to it (Piasecki & Wolnicki, 2004).

2. What happens for the conventional financial system?

The financial sector refers to a part of the economy providing financial services to other economic sectors although the general concept is that it is the supply-demand interaction in terms of providing capital and other financial services (Schmidt & Tyrell, 2003). In this regard, according to him, some economists view financial development as a growth driver, whereas others insisted that it is not a cause but the effect/outcome and it represents real economic development, while others contended that the financial markets and institutions development is a part and parcel of the process of growth, and that the financial systems play a key role in the countries' economies.

Based on the above, economists are of the consensus that the financial system has been playing an active role in the precipitated world economic development, especially following the World War II. This marked the birth of a continuous stream of financial innovations, with the inclusion of the ICT revolution that largely contributed to the development (Alam, 2010). Aligned with this, Levine (1997) explained the financial system and institution's role with the inclusion of loan and credit provisions for the process of production. He categorized the fundamental financial function of the economy into five namely facilitation of trade, hedging, diversification, risk pooling, resources allocation, monitoring of management and exerting corporate control, savings mobilization, and exchange of goods and services. According to him, the five functions indirectly impact economic growth via capital accumulation and technological innovation undergone by financial entities.

Along the same line of argument, owing to the integral position of the financial system in the country's economy, it is logical to state that a weak and ineffective financial system doesn't bode well for long-term economic sustainability and may even ultimately result in a financial crisis (Vaithilingam, Nair, & Samudram, 2006).

Current economic scholars expound on the reasons behind the international financial system today and they attributed it to interest rate, debts, inflation rate, and unemployment rate. They are of the consensus that the international financial system has failed to bring about stability in the financial flow around the globe, and thus worsening the situation. This begs to question as to what is going on in the conventional financial system.

In this day and age of unexpected economic changes, it has become a common occurrence for a country to suffer from economic crisis and as a consequence, there have been 100 crises in the past decade and a half, where the entire geographical area around the globe has been affected at one point or another by them. Even the countries who are safeguarded against them with their fiscal and monetary policies did not escape their wrath. It is thus evident that the international financial system has failed in its objective to bring about stability in the international financial flow and instead made matters worse (Alam, 2010; Stiglitz, 2003).

In an attempt to resolve financial crises, Chang and Velasco (1998) proposed a simple model to elaborate on the recent financial crises features in the emerging markets, with the international illiquidity in the context of the domestic financial system being the core of the problem. Such illiquidity is one of the primary reasons behind the financial crises – more elaborately, domestic financial liberalization and capital flows from abroad (particularly short-term) can add to the adverse effect on the banks' illiquidity and thus, leaving the banks exposed to exogenous expectations in terms of shocks and shifts.

More importantly, the most recent financial crises that began in 2007, appears the most severe crises compared to those in the past and it is still permeating the globe despite the bail of around three to four billion dollars forked out by the U.S., U.K. and Europe along with several other countries. It has debilitated money markets and results in the considerable decline in property and stock values, failures of banks and anxiety over the global economic fate and the financial system (Chapra, 2008).

In other words, the recent financial crisis negatively affected the whole world and the effects are increasingly being experienced in the real sector and ultimately causing economic recession. In this regard, the most broadly acknowledged and significant cause behind the crisis is excessive and irresponsible lending of banks. This has led to an unsustainable boom in the prices of assets and what appears to be a rise in consumption and speculative investment, and in this case, the greater the leverage, the more challenging to unwind in the downturn. Such unwinding resulted in an ending cycle of selling that consumes itself and ultimately forces asset prices to decline and financial crisis to occur.

The recent financial crisis is so pervasive and serious that even the considerable amounts spent to stave it off have left it unresolved as mentioned. Majority has attributed it to the defaulting of mortgages although this is just a symptom of a more serious problem, which is the erroneous pricing in the market of credit default swaps (Murphy, 2008).

Along the same line of explanation, the monetary policy and fiscal policy effectiveness both depend on the rate of interest and the inflation target to motivate the economy have now become a controversial debate among concerned researchers and authors (Barth & Bradley, 1988; Chong & Liu, 2009; Grier & Tullock, 1989; Kia, 2002; Subbarao, 2009) as most of them are attempting to determine solutions through the use of financial instruments that are better than interest rate, inflation and unemployment rate due to their ineffective role.

More importantly, the role of financial development towards bringing about growth in the economy and the relationship between the two has been examined in literature dedicated to development economics, but with mixed results. While some of the authors (King & Levine, 1993; Kunt & Maksimovi, 1998; Roja & Valev, 2003; Dimitris & Efthymios, 2004; Eita & Jordaan, 2007) found a significant positive effect of conventional financial development on economic growth, other studies, found a significant negative effect (e.g. Hermes & Lensink, 2013; Al-Malkawi, Arashdeh & Abdullah, 2012; Samargandi Fidrmuc & Ghosh, 2013).

Among the many research attempts conducted in this field, four kinds of causality relationships were found between financial development and economic growth that contrasts with the premise that financial development causes economic growth in long and short run;

The first causality relationship is supply-leading, where the financial development leads to economic growth as evidenced by Gregorio and Guidotti (1995) and Calderon and Liu (2003). The second one is demand-following where economic growth results in financial development as advocated by Robinson (1952), Odhiambo (2010), and Ang & Kibbin (2007). The next causality relationship is the bi-directional one where financial development results in economic growth and this relationship holds true the way around. This relationship is supported by Demetriades and Hussein (1996) and Abu-Bader and Abu-Qarn (2008).

The fourth and last causality relationship is the absence of causality between financial development and economic growth as advocated by Deidda and Fattouh (2002), Rioja and Valev (2004), Graff (1999), Lucas (1988) and Stern (1989).

In the quest of establishing what is primarily wrong with the international financial system, the need for a new architecture is highlighted where innovation can assist in preventing the crisis outbreak and the proliferation of future crises, or to lessen it in terms of severity and frequency. Such new architecture should guarantee that significant positive effect of financial development on economic growth with regards to growth and crisis in both short and long run. Added to this surface changes in the present system will not suffice as what is needed is a wholly innovative architecture that is effective (Alam, 2010).

3. Islamic Economic Development-Growth Approach

In some Islamic discussions, important economic principles have been provided, particularly from an Islamic perspective where it is believed that every resource is provided by God and is entrusted to people. This shows the importance of making efficient use of resource to in order to bring about the most superior outcome, and that human beings should achieve God's aim and facilitate the dissemination of good fortune and earth as well as the hereafter. This notion significantly affects wealth ownership and its generation and it motivates every Muslim to get involved in economic activity and to enhance their confidence with the goal accomplishment. Metwally (1997) stated that moral law may be difficult to use but the trusteeship it carries goes against the principle of self-interest that exists in free market economy.

The distinction between Islamic and convention economics is the notion that Islamic economics is Shariah-based where the overall conditions and rules for human living are enumerated as revealed to the Prophet Muhammed. Despite his state of being illiterate, the Prophet Mohammed was the person that God chose to reveal the Shariah to him and destine such law to the whole of mankind, not just the Muslims.

The importance of differentiating Islamic economics from traditional economics as the former is being examined as the latter's replacement. From the pioneering authors of Islamic economics, like Maududi to the current authors, the aspect of Islamic economic that have been emphasized is interest (riba), zakat in light of the Islamic economic distribution system and some Islamic economic norms (Kuran, 1995). These aspects are discussed in detail in the next paragraphs;

Prohibition of Interest Rate

In Islamic business, the beginning argument brought forward in Islamic economics and finance advocates is injustice/exploitation (zulm). In relation to this, Islamic laws and regulations do not allow any charges to be incurred on business dealings and it regards the practice as one that is repugnant because of the many injustices and exploitations attributed to it (Farooq, 2012).

Moreover, Islamic banks do not permit to distribute a portion of returns on deposits and to charge loans with interests. Theoretically, Islamic economics is interest-free and Islamic banking is not based on interest rate just as the conventional banking is. Added to this, PLS paradigm is among the primary characteristics of Islamic finance system products, specifically Mudarabah and Musharakah, what is respectively referred to as profit and joint ventures that are Islamic contracting products. Such a paradigm allows Islamic banks to share both profit and loss with the investors as well as the depositors (Khan & Mirakhor, 1990).

The Intelligent and Gentle Financial System

Zakat, referred widely as Islamic redistribution, is the second feature of the Islamic economy set up by the Islamic economic advocates. In Zakat, the system levies a tax on well-off Muslims in order to financially assist eight causes namely, the emancipation of slaves, poor relief and assistance to Muslims who serve Islam. However, the collection and distribution of Zakat are full of controversial opinions (Afzal-ur-Rahman, 1979; Ahmed, Iqbal & Khan, 1983).

Added to the above, zakat forms the core of the Islamic economy and it advocates the notion that every individual earning wealth is higher in level (nissab) and thus, every one of them should offer a portion of his/her wealth to those who are poor and needy. Literally, Zakat means purification while technically; it means that 2.5% of the wealthy individual's wealth is distributed to the poor every year. Meanwhile, modern terminology describes the underlying purpose of zakat as the tax collection from the well-off individuals and its distribution to poor Muslims. Zakat is different from progressive taxation based on different reasons (Metwally, 1997).

Islamic Economic Norms

Several methods of acknowledged production products are accepted in Islamic and these include private property. More specifically, Islam does not stress on strict private ownership right as the whole community has to gain some benefit from it. In other words, individuals cannot privately own a property if the government is inclined to own it for the public interests. To this end, community interest generally takes precedence over personal interests as elaborated by Shariah. Thus, in cases where the personal interest of an individual contradicts the state or community interests, the latter community's interest are satisfied and as such, the individual has to forego his.

Additionally, Islam does not permit the receiving of money from the manufacture and sale of alcoholic substances and pork products, gambling, usury money, litigation, black market, speculative buying, from businesses that bring about harm to other human beings, and it does not permit hoarding. In this context several researchers such as Kuran (1995), Maali, Casson and Napier (2006) showed if the profits are gained through the above prohibited ways, no individual can legitimately own them.

In Islam, public ownership management is ensured whereas in the free market economy of the West, greater control is exerted by private market over the market and the industry. This is because Islam has it basis on the Prophet's saying clarifying that people have common rights when it comes to water, pasturage and fire. Stated differently, extracting industries that are concerned with the production of water, mining and food should be undergone for the whole society's interests but at the same time, it should not be considered as a government-owned business. Added to this, domestic industries and fuels should not be privately owned as this could result in extensive private sector as exemplified by the Arab Gulf economies (Metwally, 1997). Moreover, a balance can be established between different sectors via the cooperative forces and not contrasting methods. Muslim entrepreneurs like buyers, sellers, wage-earners, profit makers and others, are urged to be vigilant of the words in the Quran that states, "Let there be amongst you traffic and trade, my mutual goodwill" (The Quran, 4: 29).

Furthermore, non-Islamic economies allow the adoption of several speculation methods as part of the economy and these include races, games of cards, gambling activities and forward business transactions. In this regard, Prophet Mohammed stated, "He who accumulates stocks of grain during shortages of it (with a view to profiteering later) is a great sinner (Qureshi, 1974).

Several decades following the collapse of the Islamic Caliphate in 1927, Islamic economy was exclusively practiced in an intellectual level. But currently, several changes have been experienced that make it suitable to practice these intellectual ideas. Most countries around the globe establish Islamic financial institutions based on interest-free loan and they are displaying better performance in comparison to their convention counterparts. Moreover, Islamic banking has achieved a distinctive status with regards to security after the financial crises in 2008. In fact, several Islamic banks have developed in terms of their profitability and they have proliferated around the globe.

In relation to this, the Prime Minister of the U.K., David Cameron declared on October 2013 that the U.K. will be the first non-Muslim country to deal with Islamic bonds. It is also notable that the Islamic investments in the country have undergone a 150% increase in the past 7 years and is expected to reach to 1.3 trillion in the coming year. The Prime Minister explained that this move may benefit the financial services in the U.K. (BBC, October, 2013).

In the context of Islamic economy, scholars, governments and financial institutions in the Islamic world have been attempting to explain economics and finance in such a way that it's divergence from the interest-bearing procedures and its basis on Islamic norms and guidelines are highlighted. This is particularly significant as Muslims make up one billion of the global population, with countries in the Arab and Asian region as predominantly Muslims and with Muslims being a large minority in Africa and Europe. For instance, in Malaysia and Nigeria, Muslims make up most of the total population, while in India, Philippines, South Africa and the U.K., Muslims are a large minority – despite of this fact, no country strictly adopts Shariah in its economy (Metwally, 1997).

Presently, a strict Islamic economy is difficult to adopt in the absence of a real Muslim society. The collapse of the Muslim Caliphate and the acceptance of non-Muslim ideologies have been related to the Muslims leaving the practice of Islam and adopting communism and capitalism as their ideologies. According to several scholars, Shariah is the only recourse as it is able to solve any and all economic and societal issues (Ali, 2001). Added to this, Muslims who are inclined towards adopting Islamic laws and teachings and modeling their way according to Islamic values are increasing, particularly those in Iran, Pakistan, Malaysia and Saudi Arabia (Metwally, 1997). Some other authors like Saleem (2007) and Tabelsi (2011) are convinced that Islamic economics is the future solution to the problems that are faced by traditional economy and the conventional financial system that have adopted in Islamic nations.

4. Does Islamic finance be the good alternative for conventional financial system?

Islamic finance refers to a financial system that primarily aims to achieve the Holy Quran's teachings rather than obtaining the highest returns on financial assets. The fundamental principle laid down by the Shariah is the notion that exploitative contracts that are based on interest/usury (riba) or unfair contracts involving risks/speculation (gharar) are not permissible to be enforced (Zaher & Hassan, 2001). Moreover, the Holy Quran does not condemn morally acceptable investments that provide fair-legitimate profit and economic/social value.

Added to the above, there are two other fundamental Islamic finance principles with the first being that the Islamic law represents the totality of God's commands that regulate all the life aspects of a Muslim and second, Islamic finance is directly related to spiritual values and social justice (Yahya, Muhammad & Hadi, 2012).

Another distinctive feature of Islamic finance is its prohibition of the creation of debt via direct lending and borrowing of money or other financial assets as explained by Alam (2010). In other words, debts can only be formed via the sale/lease of real assets through schemes developed for lease-based financing (i.e. Murabaha, Ijara and Sukuk). In this regard, it is important to ensure that the assets that are leased or sold should be real like building, property or physical infrastructure, and the transaction should be real and approved by both government regulators and religious experts of the Shariah board. The intention should be giving and taking charge in a way that the related risk or debt is non-transferable.

Furthermore, Islamic bank was described by Dusuki (2008) as a financial institution that functions by gathering financial resources and directing them towards effective use in order to achieve the general public's interests through the offered range of products and services. Along a similar line of contention, Khan and Bhatti (2008) contended that Islamic financing system concentrates on investment projects like industries, agriculture and services. Hence, it includes economic initiatives that add to the activities of production and development. More importantly, Islamic finance was developed to eradicate the interest rate system, particularly in the Islamic nations as interest violates the Shariah principles and as such it is illegal in the perspective of Islam (Meera & Larbani, 2009).

In relation to this, not all interest-free banking is known as Islamic financing as the latter should adhere to the Shariah principles (Chong & Liu, 2009; Goaied & Sassi, 2010). Therefore, Islamic financing should be free from interest and it should operate by adhering to some Islamic precepts and values namely honesty, integrity, benevolence, kindness and charity.

The above values attributed to Islamic principles is what facilitated its progress throughout the globe. According to the International Monetary Fund (IMF) report, Islamic banking is among the fastest growing segments in the financial industry as it had a 10-15% growth rate in the past ten years, with an estimated Islamic banking assets growth of approximately 15% yearly and is expected to reach $1 trillion by 2016 (Abduh & Omar, 2012).

Aligned with the above contentions, Hasan and Dridi (2011) stated that several factors have facilitated the considerable growth of Islamic finance and some of these factors are strong demand in several Islamic countries for Shariah-compliant products, reinforcement developments of the legal and regulatory framework for Islamic finance, increasing demand from conventional investors (e.g. diversification), development of several financial instruments to achieve the corporate and individual investors' needs.

To this end, all the financial systems in Iran and Sudan adhere to Islamic Shariah as described by the countries' local authorities. Such nations also own banking authorities governing the general system charges and returns level. In other nations, Islamic transactions and institutions constitute a minimal portion of the total financial institutions and they are in competition with their conventional counterparts (Hassan, 2006).

Majority of economists are of the consensus that in theory, Islamic finance appears to be a good alternative for conventional finance as it has a direct contribution to the economic recovery. Generally, economists are convinced that this current generated financial system does result in financial development and growth compared to the conventional system. Also, the Islamic financial system does not lead to financial crises and it is not vulnerable to the effects of the international financial crisis (Abduh & Chowdhury, 2012; Alam, 2010; Grais & Pellegrini, 2006; Khan, 2009; Khan & Bhatti, 2008; Warde, 2010; Ahmed, 2010).

Other authors like Al-Qardawi (1995) described Islamic economics to be ethical (akhlaqi), Godly (rabbani), humane (insani) and balanced (wasati). In a related study, Khan and Bhatti (2008) and Yahya, Muhammad & Hadi (2012) stressed on the fact that Islamic banking and financial system are not established merely to achieve profit-oriented goals but also to create societal wealth and ultimately enhance the country's economic growth. This is why it is important that Islamic banks should only mimic the practices and aims of conventional banks but instead embark on a more important role of enhancing the country's economic performance.

It is becoming clearer that conventional financial system is not appropriate to be adopted in an Islamic economy as it is based on interest rate and Islam prohibits interest. Also, Islam stresses moral values and promotes justice in every societal aspect with the inclusion of finance and thus, it comes to reason that the Islamic economy calls for institutional arrangements that are supported by the Islamic law objectives and in this regard, a financial system sans interest is one of the many distinctions of Islamic financial system (Saleem, 2007).

On the basis of the above argument, Ali (2011) stated that Islamic countries with their constitutions cannot develop unless they apply the Shariah principles in their economic development process. Majority of the Muslims attributed the humiliating collapse of the Islamic caliphate to the Arabs turning away from Islam and adopting foreign ideologies like communism and capitalism, whose principles go against those of Islamic principles and thus, their problems persist. As such, majority of Muslims urge the return to Shariah compliance financial institutions that are considered as solutions to all types of economies. In the words of Umar Ibn Al-Khattab (Radia-Allahu Anhu);

“We are the most humiliated people on earth and Allah gave use honor through Islam. If we ever seek honor through anything else, Allah will humiliate us again”.

However, literature dedicated to studying the impact of Islamic financial development and economic growth, and the relationship between the two reported mixed findings. For instance, some authors (Furqani & Mulyany, 2009; Majid & Kassim, 2010; Abduh & Omar, 2012; Yusof & Bahlous (2013) reported for a significant positive effect of Islamic banking upon the economic growth whereas Goaied and Sassi (2010) found a negative effect of financial development on the growth in the context of the MENA countries, and that Islamic banks has a weak relationship with growth.

Other empirical studies that focused on the relationship between Islamic financial development and growth revealed mixed proposed causality hypotheses; on one hand, Majid and Kassim (2010) supported a supply-leading hypothesis, Furqani and Mulyany (2009) supported a demand-following hypothesis, while other authors (Abduh & Omar, 2012; Abduh & Chowdhury, 2012; Yusof & Bahlous, 2013; Farahani & Dastan, 2013) supported a bi-directional causality hypothesis and Goaid and Sassi (2010) advocated no causality existence.

Other related empirical studies include Hasan and Dridi (2010), and Kassim and AbdMajid (2010) examined the impact of financial crisis on Islamic financial development and revealed that Islamic as well as conventional banking systems are susceptible to the negative effects of the financial shocks and this goes against the extensively acknowledged notion that the former system is not vulnerable to it owing to its prohibition of interest.

It is clear from the above contentions that a contradiction exists between the theoretical and empirical findings relating to the relationship between Islamic financial development, economic growth and financial crisis. For further elaboration, some theoretical studies indicated the positive effect of Islamic financial development on growth indicating that Islamic financial development is safe from the effects of financial crisis while others showed a negative effect of Islamic financial development on economic growth. Some other studies reported that financial crisis significantly and negatively affects the development of Islamic finance.

It is therefore reasonable to assume that owing to these contradictory findings between theory and empirical studies, the success/failure of modern Islamic financial system in the economic development process is unclear, particularly in light of the promotion of economic growth and the eradication of the negative impact of the financial crisis in the economic growth due to several reasons;

1. Lack of empirical studies dedicated to studying the effect of Islamic banking development on the economic growth as explained by Furqani and Mulyany (2009) and Farahani and Dastan (2013).

2. The rarity of empirical studies that addressed the relationship between Islamic financial market development, economic growth and financial crisis.

3. Majority of the studies regarding the relationship between Islamic financial development and financial crisis are based solely on theory.

4. Three decades of experience undergone by the Islamic finance system is not sufficient to consider whether it would be successful or not.

5. Although over 57 countries in the world adopted constitutions that declared Islam as the state religion, only Sudan and Iran have an actual overall Islamic financial system, with the financial transactions conducted according to the Islamic principles, whereas other countries like Malaysia and Jordan have certain Islamic banking laws and Islamic banks that are established along with conventional banks. In some other countries (e.g. Bangladesh) Islamic banks are operated based on conventional banks' laws through promulgations or through circulars of central banks (Hassan, 2006).

6. The assets of Islamic finance are only around USD1.6 trillion of the global assets, constituting a mere 1.6% of the global financial assets (Najeeb & Vejzagic, 2013).

7. Majority of the empirical works done on the field are unable to clarify the actual effect of the activities of Islamic banking on economic growth because of the single-country sample (Gudarzi, Farahani & Sadr, 2012).

Conclusion

Hence, the information regarding the application of the modern Islamic financial system on the promotion of economic development, particularly in Islamic countries, is still insufficient. Thus, this calls for further evaluation through empirical analysis to determine whether or not the Islamic financial system can replace the conventional system in the promotion of economic growth while staving off financial crisis and its adverse impacts. It is therefore recommended that future studies in this field empirically examine the short and long run causality and relationship between financial development, in terms of banking sector and financial market activity and size, and economic growth while considering the potential causal relationship between Islamic financial development and financial crisis that has been largely ignored in the extant analytical studies dedicated to the topic.

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