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Assessing the Economic Contributions of Islamic and Conventional Banks in Asian OIC Countries

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Kata Kunci
Kata kunci: Perbankan syariah, perbankan konvensional, pertumbuhan ekonomi, pertumbuhan PDB, pertumbuhan PDB per kapita

Abstrak
Penelitian ini mengeksplorasi dampak diferensial bank syariah dan bank konvensional terhadap pertumbuhan ekonomi di negara-negara anggota Organisasi Kerjasama Islam (OKI) di Asia. Menggunakan data dari 1.846 observasi di delapan negara OKI, teknik regresi panel digunakan untuk menilai pengaruh model perbankan ini terhadap indikator utama pertumbuhan ekonomi: pertumbuhan PDB dan pertumbuhan PDB per kapita. Analisis menunjukkan bahwa bank syariah memiliki dampak positif yang signifikan lebih besar terhadap pertumbuhan PDB dan pertumbuhan PDB per kapita dibandingkan bank konvensional. Temuan ini menekankan bahwa prinsip-prinsip perbankan syariah, seperti berbagi risiko dan pembiayaan berbasis aset, berkontribusi pada lingkungan keuangan yang lebih stabil dan inklusif, meningkatkan perkembangan ekonomi secara keseluruhan. Hasil penelitian menegaskan pentingnya mempromosikan perbankan syariah di samping perbankan konvensional untuk mendorong pertumbuhan ekonomi yang berkelanjutan. Pembuat kebijakan dan regulator keuangan harus mempertimbangkan untuk mengintegrasikan kekuatan perbankan syariah ke dalam kerangka regulasi untuk meningkatkan stabilitas dan ketahanan keuangan. Penelitian selanjutnya perlu mengeksplorasi dampak jangka panjang perbankan syariah dan konvensional terhadap pertumbuhan ekonomi di berbagai wilayah dan kondisi ekonomi, serta interaksi antara lingkungan regulasi dan kinerja sektor keuangan.

Keywords
Keywords: Islamic banking, conventional banking, economic growth, GDP growth, GDP per capita growth

Abstract
This study explores the differential impacts of Islamic and conventional banks on economic growth within Asian member countries of the Organization of Islamic Cooperation (OIC). Utilizing a dataset of 1,846 observations from eight OIC countries, panel regression techniques are employed to assess the effects of these banking models on key economic growth indicators: GDP growth and GDP per capita growth. The analysis reveals that Islamic banks have a significantly greater positive impact on both GDP growth and GDP per capita growth compared to conventional banks. The findings highlight that Islamic banking principles, such as risk-sharing and asset-backed financing, contribute to a more stable and inclusive financial environment, enhancing overall economic development. The results underscore the importance of promoting Islamic banking alongside conventional banking to foster sustainable economic growth. Policymakers and financial regulators should consider incorporating the strengths of Islamic banking into regulatory frameworks to improve financial stability and resilience. Future research should investigate the long-term impacts of Islamic and conventional banking on economic growth across different regions and economic conditions, as well as the interplay between regulatory environments and financial sector performance

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INTRODUCTION

The banking sector is a cornerstone of economic development, providing the necessary financial infrastructure for capital allocation, risk management, and payment systems. It is widely acknowledged that a robust banking sector fosters economic growth by channeling funds from savers to investors, facilitating business operations, and promoting efficient resource allocation (Levine, 2005). This paper seeks to explore the differential impacts of Islamic and conventional banks on economic growth within the Asian member countries of the Organization of Islamic Cooperation (OIC). By comparing these two banking models, we aim to understand their unique contributions to economic development and the implications for policy-making in these countries.

Islamic banking has gained prominence in recent years as a viable alternative to conventional banking. Unlike conventional banks, which operate on the basis of interest (riba), Islamic banks adhere to Sharia law, prohibiting interest and speculative activities (Chapra, 2000). Instead, they promote profit-sharing, risk-sharing, and asset-backed financing. These principles theoretically lead to a more stable and ethical financial system, potentially influencing economic growth differently compared to conventional banks. This study examines whether these theoretical advantages translate into tangible economic benefits in terms of GDP growth and GDP per capita growth in Asian OIC member countries.

Gross Domestic Product (GDP) and GDP per capita are widely used indicators of economic performance. GDP measures the total value of all goods and services produced within a country over a specific period, providing a comprehensive snapshot of economic activity (Mankiw, 2020). GDP per capita, which divides GDP by the population, adjusts for population size, offering a more accurate measure of the economic well-being of the average citizen. These indicators are crucial for understanding economic growth as they reflect the overall health of the economy and the standard of living. Hence, they are appropriate dependent variables for assessing the impact of the banking sector on economic development.

Empirical studies on the relationship between the banking sector and economic growth have yielded mixed results. Some studies suggest that conventional banks contribute significantly to economic growth by providing essential financial services and fostering investment (King & Levine, 1993). However, the unique operational principles of Islamic banks, such as profit and loss sharing and the prohibition of interest, might offer different benefits and pose distinct challenges. For instance, Islamic banks may promote greater financial inclusion and stability, but they may also face limitations due to regulatory constraints and the nascent state of the industry in some regions (Beck, Demirgüç-Kunt, & Merrouche, 2013).

This study contributes to the existing literature by providing a comparative analysis of the impact of Islamic and conventional banks on economic growth using recent data from Asian OIC member countries. By employing a panel data regression analysis, we aim to control for various financial performance indicators and isolate the effect of the type of bank on GDP growth and GDP per capita growth. Specifically, this study seeks to answer the following research questions: Do Islamic banks have a greater positive impact on GDP growth than conventional banks in Asian OIC member countries? Do Islamic banks have a greater positive impact on GDP per capita growth than conventional banks in Asian OIC member countries? Addressing these questions will provide valuable insights for policymakers and financial regulators in Asian OIC countries, helping them to design strategies that leverage the strengths of both banking systems to foster sustainable economic development.

LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Islamic banks operate under the principles of Sharia law, which prohibits the payment or receipt of interest (riba) and emphasizes risk-sharing, ethical investments, and asset-backed financing (Chapra, 2000). Instead of traditional interest-based lending, Islamic banks engage in profit-sharing arrangements such as Mudarabah (profit-sharing) and Musharakah (joint venture). These banks also use instruments like Ijarah (leasing) and Murabaha (cost-plus financing) to ensure that all transactions are backed by tangible assets or services (Iqbal & Mirakhor, 2007). In contrast, conventional banks function primarily through interest-based lending and borrowing, where the borrower pays a predetermined interest rate on the loan (Mishkin, 2019). Conventional banks aim to maximize shareholder value and profitability through various financial products and services, including loans, mortgages, and investment products. The primary focus of conventional banking is on financial intermediation, where banks collect deposits and lend them out at higher interest rates to generate profits.

Both types of banks support the economy but in different ways. Conventional banks support the economy by providing essential financial services that facilitate investment, consumption, and economic growth. These banks mobilize savings and channel them into productive investments, which in turn drive economic activities and job creation (Levine, 2005).

Empirical studies have shown a positive relationship between the development of conventional banking sectors and economic growth. For instance, King and Levine (1993) found that countries with well-developed banking systems tend to grow faster over time, as banks provide the necessary capital for entrepreneurial ventures and infrastructure projects. Conventional banks also play a critical role in the payment system, ensuring the smooth transfer of funds and financial transactions. This infrastructure supports trade and commerce, contributing to overall economic stability and growth. Furthermore, conventional banks provide credit to businesses and consumers, which enhances consumption and investment, key drivers of economic growth (Beck, Demirgüç-Kunt, & Levine, 2000).

Islamic banks, with their unique principles, offer an alternative approach to supporting economic growth. The prohibition of interest and emphasis on risk-sharing can lead to more stable and resilient financial systems. Islamic banks' asset-backed financing ensures that all financial transactions are tied to real economic activities, which can reduce speculative behavior and financial bubbles (Khan & Mirakhor, 1987). Islamic banks also promote financial inclusion by providing Sharia-compliant financial services to segments of the population that may avoid conventional banking due to religious reasons. This inclusivity can enhance overall economic development by mobilizing a broader base of savings and investments (Beck, Demirgüç-Kunt, & Merrouche, 2013). Moreover, Islamic banks' focus on ethical investments and social responsibility can contribute to sustainable development and long-term economic stability.

Based on the literature review, we propose the following hypotheses to be tested in the context of Asian OIC member countries:

Hypothesis 1 (H1): Islamic banks have a greater positive impact on GDP growth than conventional banks in Asian OIC member countries. Empirical evidence suggests that Islamic banking principles, such as risk-sharing and asset-backed financing, contribute to economic stability and growth. Studies have shown that Islamic banks were more resilient during financial crises due to their conservative lending practices and prohibition of speculative investments (Hasan & Dridi, 2011). Thus, we hypothesize that Islamic banks positively influence GDP growth by fostering a stable and inclusive financial environment.

Hypothesis 2 (H2): Islamic banks have a greater positive impact on GDP per capita growth than conventional banks in Asian OIC member countries. The ethical and inclusive nature of Islamic banking can lead to more equitable economic development, potentially resulting in higher GDP per capita growth. By providing financial services to underserved populations and focusing on socially responsible investments, Islamic banks can enhance individual economic well-being and contribute to overall per capita income growth (Naceur & Omran, 2011).

Empirical studies support our hypotheses regarding the positive impacts of both Islamic and conventional banks on economic growth. Hasan and Dridi (2011) found that Islamic banks showed better resilience during the global financial crisis, suggesting a stabilizing effect on economies. Beck, Demirgüç-Kunt, and Merrouche (2013) highlighted that Islamic banks are associated with higher levels of financial inclusion and stability. For conventional banks, numerous studies have established their critical role in economic growth. King and Levine (1993) demonstrated that countries with developed banking sectors experience faster economic growth. Levine (2005) confirmed that banking development is a significant predictor of economic growth across various countries. Conventional banks mobilize large volumes of savings and provide extensive credit facilities, efficiently allocating resources to productive investments, thereby facilitating investment and consumption.

This section underscores the importance of both Islamic and conventional banks in supporting economic growth. By examining their unique contributions and comparing their impacts, this study aims to provide valuable insights for policymakers and financial regulators in Asian OIC member countries. Addressing the research questions and testing the hypotheses will enhance our understanding of how these two banking systems influence economic development and inform strategies to leverage their strengths for sustainable growth.

METHODOLOGY

The data for this study is sourced from the OSIRIS database, which provides comprehensive financial information on public and private companies worldwide. The dataset includes 1,846 observations from Asian member countries of the Organization of Islamic Cooperation (OIC), specifically Bangladesh, Indonesia, Kazakhstan, Kyrgyzstan, Malaysia, Pakistan, Turkey, and Uzbekistan. This extensive dataset allows for a robust analysis of the impacts of Islamic and conventional banks on economic growth within these countries (OSIRIS Database, 2020).

The sample comprises both Islamic and conventional banks operating in the selected OIC countries. The selection criteria ensure a

representative mix of banks across different countries and economic contexts within the OIC. The dataset includes 1,625 observations for conventional banks (88.03% of the total) and 221 observations for Islamic banks (11.97% of the total). The distribution of banks by country is detailed in the table below:

Table 1. Distribution of banks by country

	Conventional Bank		Islamic Bank		Total	
Country	by Banks	by dataset	by Banks	by dataset	by Banks	by dataset
Bangladesh	24	312	8	104	32	416
Indonesia	47	611	3	39	50	650
Kazakhstan	14	182	0	0	14	182
Kyrgyzstan	1	13	0	0	1	13
Malaysia	6	78	2	26	8	104
Pakistan	20	260	2	26	22	286
Turkiye	12	156	2	26	14	182
Uzbekistan	1	13	0	0	1	13
Total	125	1625	17	221	142	1846

The dependent variables in this study are GDP Growth, which measures the annual percentage growth in GDP, and GDP per Capita Growth, which measures the annual percentage growth in GDP per capita (World Bank, 2021). The independent variable of interest is the type of bank, categorized as either a conventional bank or an Islamic bank.

Control variables are selected based on both their theoretical relevance and empirical findings from previous research. Inflation measured by the GDP deflator (Inf_def) is included as it captures the overall level of price changes in the economy, which can significantly influence economic growth (Mankiw, 2020). Profit Margin (PM) is considered because it reflects a bank's efficiency and profitability, which can impact its ability to support economic activities (Beck, Demirgüç-Kunt, & Merrouche, 2013). Log of Total Assets (log_TA) is used to account for the size of the bank, as larger banks typically have more resources to lend and invest, thereby influencing economic growth (Levine, 2005). Log of Market Capitalization (log_MCAP) represents the market value of the bank, which indicates its financial strength and stability (Demirgüç-Kunt & Levine, 2001). Log of Number of Employees (log_NOE) is included to control for the human resource capacity of the bank, which is crucial for its operational efficiency (Berger & Humphrey, 1997). Finally, Log of Net Income (log_NI) is used to measure the overall profitability of the bank, which is a direct indicator of its financial performance and ability to contribute to economic growth (Naceur & Omran, 2011).

Due to collinearity issues when using the fixed effects model with the type of bank variable, a pooled least squares approach will be employed. This approach allows for the estimation of the impact of the type of bank on economic growth while controlling for other financial and economic variables (Wooldridge, 2016).

The general form of the regression model is specified as follows:

$$\text{GDP\_Growth}_{it} = \alpha + \beta_1 \text{TypeofBank}_{it} + \beta_2 \text{Inf\_def}_{it} + \beta_3 \text{PM}_{it} + \beta_4 \log \text{\_TA}_{it} + \beta_5 \log \text{\_MCAP}_{it} + \beta_6 \log \text{\_NOE}_{it} + \beta_7 \log \text{\_NI}_{it} + \epsilon_{it}$$

$$\text{GDP\_per\_Capita\_Growth}_{it} = \alpha + \beta_1 \text{TypeofBank}_{it} + \beta_2 \text{Inf\_def}_{it} + \beta_3 \text{PM}_{it} + \beta_4 \log \text{\_TA}_{it} + \beta_5 \log \text{\_MCAP}_{it} + \beta_6 \log \text{\_NOE}_{it} + \beta_7 \log \text{\_NI}_{it} + \epsilon_{it}$$

Where:
- i indexes the banks,
- t indexes the time periods,
- α is the intercept,
- $\beta_1,\beta_2,\ldots,\beta_7$ are the coefficients of the explanatory variables,
- ϵ_{it} is the error term.

The pooled least squares approach with robust standard errors will be employed to estimate the model, ensuring reliable and consistent results despite potential violations of classical regression assumptions (Greene, 2018). By employing this analytical framework, the study aims to provide robust and reliable insights into the comparative impacts of Islamic and conventional banks on

economic growth in the selected Asian OIC countries.

Table 2. Research Variables

Name	Type	Definition	Measure and Formula
GDP_Growth	Dependent	Annual percentage growth in GDP	$(\text{GDP}_t - \text{GDP}_{t-1})/\text{GDP}_{t-1} \times 100$
GDP_Cap_Growth	Dependent	Annual percentage growth in GDP per capita	$(\text{GDP per Capita}_{\ t} - \text{GDP per Capita}_{t-1})/$ $\text{GDP per Capita}_{t-1} \times 100$
TypeofBank	Independent	Type of bank	1 if Islamic bank, 0 if conventional bank
Inf_def	Control	Inflation measured by GDP deflator	Percentage change in GDP deflator
PM	Control	Profit Margin	$Net\ Income/Revenue \times 100$
log_TA	Control	Log of Total Assets	Log(total assets)
log_MCAP	Control	Log of Market Capitalization	Log(Market Capitalization)
log_NOE	Control	Log of Number of Employees	Log(Number of Employees)
log_NI	Control	Log of Net Income	Log(Net Income)

RESULTS AND DISCUSSION

The statistical description of the dataset, presented in Table 3, indicates that the data consists of 1,846 observations from various banks across eight Asian OIC member countries. The mean GDP Growth is 4.99% with a standard deviation of 2.40%, reflecting moderate variability in economic growth rates among the observed banks. Similarly, GDP per Capita Growth averages 3.66% with a standard deviation of 2.43%. These metrics provide a comprehensive overview of the economic performance within the sample.

Table 3. Statistical description

Variable	Observations	Mean	Std. Dev.	Min	Max
bank_id	1,846	186.6831	91.27839	1	336
country_id	1,846	3.211268	2.142815	1	8
type	1,846	1.119718	0.3247198	1	2
GDP_Growth	1,846	4.986897	2.399829	-7.148978	11.43938
GDP_Cap_growth	1,846	3.663271	2.427214	-8.894547	10.4294
Inf_def	1,846	8.006702	9.489934	-0.81801	96.03611
PM	1,846	35.02498	20.53064	-92.71	99.71
TA	1,846	16,600,000	30,500,000	45,709	302,000,000
MCAP	1,846	2,864,087	5,578,954	3,175.18	60,300,000
NOE	1,846	5,565.20	8,007.83	22	125,602
NI	1,846	233,622	474,820.40	-602,114.80	4,994,357

The correlation analysis shown in Table 4 reveals significant relationships among the variables. GDP Growth is strongly correlated with GDP per Capita Growth (0.989), as expected since both metrics measure economic performance. Inflation measured by the GDP deflator (Inf_def) has a positive correlation with GDP Growth (0.133), suggesting that higher inflation rates are associated with higher economic growth within the sample. Profit Margin (PM) shows a weak positive correlation with GDP Growth (0.044), while the size of the banks, indicated by log_TA (log of Total Assets), log_MCAP (log of Market Capitalization), and log_NOE (log of Number of Employees), also has positive correlations with GDP Growth.

Table 4. Statistical description

	GDP Growth	GDP per Capita growth	Inf def	PM	log TA	log MCAP	log NOE
GDP Growth	1.000						
GDP Cap growth	0.989	1.000					
Inf def	0.133	0.109	1.000				
PM	0.044	0.042	0.053	1.000			
log TA	0.079	0.067	0.096	0.109	1.000		
log MCAP	0.075	0.056	0.077	0.163	0.648	1.000	
log NOE	0.062	0.051	0.110	0.121	0.586	0.343	1.000
log NI	0.069	0.056	0.087	0.315	0.841	0.638	0.526

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The pooled regression analysis results, detailed in Table 5, provide insights into the differential impacts of Islamic and conventional banks on economic growth. The coefficient for the bank type dummy variable (indicating Islamic banks) is positive and significant for both GDP Growth (0.697, $p < 0.01$) and GDP per Capita Growth (0.694, $p < 0.01$). This suggests that Islamic banks have a greater positive impact on economic growth compared to conventional banks, supporting Hypothesis 1 (H1) and Hypothesis 2 (H2).

For GDP Growth, the results indicate that Islamic banks significantly contribute to economic growth. The coefficient of 0.697 ($p < 0.01$) suggests that Islamic banks foster a stable and inclusive financial environment, aligning with empirical evidence that highlights the resilience of Islamic banks during financial crises (Hasan & Dridi, 2011). The positive impact of Islamic banks on GDP Growth supports the hypothesis that their risk-sharing and asset-backed financing principles contribute to economic stability and growth.

For GDP per Capita Growth, the regression results show a significant positive impact of Islamic banks, with a coefficient of 0.694 ($p < 0.01$). This finding supports the hypothesis that Islamic banks' ethical and inclusive nature leads to more equitable economic development, potentially resulting in higher GDP per capita growth. By providing financial services to underserved populations and focusing on socially responsible investments, Islamic banks enhance individual economic well-being and contribute to overall per capita income growth (Naceur & Omran, 2011).

The control variables, such as inflation (Inf_def), show significant positive associations with both GDP Growth and GDP per Capita Growth. Inflation measured by the GDP deflator (Inf_def) has coefficients of 0.031 ($p < 0.01$) for GDP Growth and 0.026 ($p < 0.01$) for GDP per Capita Growth, indicating that higher inflation rates are linked to higher economic growth, possibly reflecting the dynamic economic conditions in the sample countries.

The other control variables, including Profit Margin (PM), log_TA (size of the bank), log_MCAP (market capitalization), log_NOE (number of employees), and log_NI (net income), do not show statistically significant impacts at conventional significance levels. This suggests that while these factors are important for the operational efficiency and profitability of banks, their direct impact on economic growth metrics may be less pronounced in this context.

The regression analysis, both with and without robust standard errors, consistently supports the hypothesis that Islamic banks have a greater positive impact on economic growth compared to conventional banks. These findings provide robust evidence that Islamic banking principles, which emphasize risk-sharing, ethical investments, and financial inclusivity, contribute to more sustainable and inclusive economic development.

The findings of this study highlight the significant positive impact of Islamic banks on economic growth in Asian OIC member countries, both in terms of overall GDP growth and GDP per capita growth. These results underscore the importance of promoting Islamic banking alongside conventional banking to achieve broader economic development goals. Policymakers and financial regulators in OIC countries can leverage these insights to design strategies that harness the strengths of both banking systems, fostering sustainable economic growth and

improving the overall economic well-being of their populations.

Table 5. Results of pooled regression analysis

Panel a: Results of PLS regression without Robust Standard Errors (Clustered by Bank id)

Variable	GDP Growth as Dependent				GDP per Capita Growth as Dependent			
	Coef.	Std. Error	t-Stat.	P-Value	Coef.	Std. Error	t-Stat.	P-Value
Independent:								
bank type	0,697	0,171	4,080	0,000	0,694	0,174	4,000	0,000
Control:								
Inf def	0,031	0,006	5,370	0,000	0,026	0,006	4,380	0,000
PM	0,004	0,003	1,370	0,172	0,005	0,003	1,490	0,137
log TA	0,070	0,073	0,960	0,339	0,086	0,074	1,160	0,247
log MCAP	0,078	0,045	1,730	0,083	0,050	0,046	1,100	0,274
log NOE	0,033	0,061	0,550	0,584	0,023	0,062	0,370	0,713
log NI	-0,041	0,065	-0,630	0,530	-0,048	0,066	-0,740	0,461
cons	2,540	0,625	4,060	0,000	1,550	0,635	2,440	0,015

Panel b: Results of PLS regression with Robust Standard Errors (Clustered by Bank id)

Independent:								
bank type	0,697	0,255	2,730	0,007	0,694	0,283	2,450	0,016
Control:								
Inf def	0,031	0,005	6,170	0,000	0,026	0,004	6,650	0,000
PM	0,004	0,005	0,910	0,364	0,005	0,005	0,980	0,330
log TA	0,070	0,089	0,790	0,433	0,086	0,094	0,910	0,364
log MCAP	0,078	0,050	1,540	0,125	0,050	0,053	0,940	0,347
log NOE	0,033	0,082	0,410	0,683	0,023	0,086	0,260	0,792
log NI	-0,041	0,069	-0,590	0,558	-0,048	0,071	-0,690	0,494
cons	2,540	0,735	3,460	0,001	1,550	0,800	1,940	0,055

Panel c. Additional statistics

Statistic	GDP Growth as Dependent	GDP per Capita Growth as Dependent
Number of Observations	1.846	1.846
F-Statistic	8,910	6,740
Prob > F	0,000	0,000
R-squared	0,033	0,025
Adjusted R-squared	0,029	0,021
Root MSE	2,365	2,401
Mean VIF	2,210	2,210
Breusch-Pagan Test (P > chi2)	0,047	0,177

CONCLUSION

This study examined the differential impacts of Islamic and conventional banks on economic growth within the Asian member countries of the Organization of Islamic Cooperation (OIC). By analyzing GDP growth and GDP per capita growth, the study aimed to determine whether Islamic banks have a greater positive impact compared to conventional banks. The findings revealed that Islamic banks significantly contribute more to both GDP growth and GDP per capita growth, with coefficients of 0.697 ($p < 0.01$) and 0.694 ($p < 0.01$), respectively. Their principles of risk-sharing, asset-backed financing, and ethical investment practices foster a stable and inclusive financial environment.

In contrast, control variables such as Profit Margin, log of Total Assets, log of Market Capitalization, log of Number of Employees, and log of Net Income did not show significant impacts on economic growth metrics. The significant positive impact of inflation on economic growth highlights the dynamic conditions within the sample countries.

The results provide valuable insights for policymakers and financial regulators in OIC countries. Promoting Islamic banking principles can enhance stability and inclusivity. Future research should explore the mechanisms behind the differential impacts of Islamic and conventional banks, expanding the scope to include a broader range of conditions and regions. This study offers important insights for guiding policy formulation and financial regulation to leverage the strengths of both banking systems.

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