


Chapter 7

Social Impact of Islamic Finance: The Paradox of Growth vs. Impact

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ABSTRACT

By 2022, the global Islamic financial services industry (IFSI) was estimated at USD 3.25 trillion in assets up from about USD 200 billion in 2003. Despite this impressive financial growth, the social outcomes envisioned by Islamic economic principles poverty alleviation, equitable access, and social justice remain largely unfulfilled. This paper examines the paradox of robust market expansion alongside limited social impact in Islamic finance. We analyze key success metrics such as asset growth, market penetration, financial inclusion, and product diversification, and we compare these with critical social indicators including poverty rates, gender gaps, and the nature of financing instruments. Using case studies from Sudan, Pakistan, Saudi Arabia (and the GCC), and Iran, we illustrate the disconnect between financial performance and social development. Finally, the paper offers policy recommendations designed to realign Islamic finance with its ethical and social objectives.

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1. INTRODUCTION

...So that it will not be a perpetual distribution among the rich from among you. And whatever the Messenger has given you – take it; and what he has forbidden you - refrain from it. And fear Allah; indeed, Allah is severe in penalty. (59:7)

In the past four decades, Islamic finance has become a powerful global development, changing from the theoretical work of Islamic economists to a real financial system that runs parallel to conventional finance in many countries. The industry has seen tremendous growth, with assets estimated to increase from about USD 200 billion in 2003 to USD 3.25 trillion by 2022 (IFSB, 2022). Islamic financial institutions currently operate in over 80 countries and have a particularly strong presence in the Middle East, Southeast Asia, and increasingly in Western financial centers (Thomson Reuters, 2021). The financial growth has been accompanied by the development of increasingly sophisticated products and regulatory environments and a growing awareness in the public mainstream. Islamic banking assets represent substantial portions of total banking assets in countries, such as Iran (100%), Saudi Arabia (65%), Malaysia (33%), and the UAE (30%) (S&P Global, 2021). The sukuk (Islamic bond) market is a crucial source of funding for sovereign and corporate entities, with issuances above USD 170 billion annually (IIFM, 2022). Islamic funds, takaful (Islamic insurance), and other Islamic financial services have established notable market positions within their respective markets.

However, these impressive market statistics raise a critical question is to what extent has this financial expansion translated into the social outcomes envisioned by the founding principles of Islamic economics. The underlying ethical framework of Islamic finance is based on considerations of justice (*adl*) and mutual support (*ta'awun*), alongside prohibitions against exploitation, wealth concentration and the promotion of shared prosperity. These principles were meant to lead to real social outcomes, less poverty and inequality, better financial inclusion, and extended human development consistent with Islamic law's goals (*maqasid al-Shari'ah*). All indications today seem to point to a large implementation gap between the operational notions of Islamic finance, and the original ethical principles. The major social welfare indicators of poverty, wealth concentration, and financial exclusion probably remain as candidates for a significant market presence of Islamic finance in multiple nations currently. Critics have suggested that Islamic finance has largely mimicked conventional banking serving the wealthy, mainly and having a *Shari'ah* technical compliance process in place that is purely formal, (Khan, 2010; Asutay, 2012; Choudhury, 2021).

On the other hand, economic development in many markets today is driven by the need to sustain growth, maximize profits, and expand markets (Figure 1). However, this drive often leads to externalizing social and environmental costs. In many cases,

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