



Islamic Economics in the Contemporary Era: Principles, Challenges, and Future Prospects

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ABSTRACT

Islamic economics has emerged as a significant alternative economic system that integrates ethical and moral principles with economic activities. This article explores the fundamental principles of Islamic economics, its contemporary applications, and the challenges it faces in the modern global economy. By examining the theoretical foundations and practical implementations of Islamic economic principles, this study demonstrates how Islamic economics offers timeless solutions to persistent economic challenges such as inequality, financial instability, and unsustainable development. The article discusses key institutions within Islamic economics, including Islamic banking and finance, zakat systems, and halal industries, while addressing the tensions between traditional Islamic principles and modern economic practices. Through a comprehensive literature review, this research highlights the potential of Islamic economics to contribute to more equitable, stable, and ethically grounded economic systems. The findings suggest that Islamic economics, while facing implementation challenges, provides valuable insights for creating sustainable and inclusive economic development frameworks that can benefit both Muslim and non-Muslim economies alike.

Keywords: *Islamic economics, Sharia principles, Islamic finance, ethical economics, sustainable development*



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1. Introduction

The global financial crisis of 2008 and subsequent economic challenges have prompted economists and policymakers worldwide to reconsider fundamental assumptions about economic systems and financial practices. In this context, Islamic economics has gained increasing attention as an alternative framework that integrates ethical principles with economic activities. Islamic economics is not merely a set of financial prohibitions but represents a comprehensive worldview that seeks to balance material prosperity with spiritual well-being, individual interests with collective welfare, and economic efficiency with social justice (Ahmed, 2019; Hassan & Aliyu, 2018).

The relevance of Islamic economics extends beyond Muslim-majority countries, as its principles address universal concerns about inequality, financial stability, environmental sustainability, and ethical business practices. With over 1.8 billion Muslims worldwide and the rapid growth of Islamic financial assets, which have exceeded \$3 trillion globally, Islamic economics has become an important component of the international economic landscape (Mohieldin et al., 2020).

This article aims to provide a comprehensive analysis of Islamic economics in the contemporary context, examining its foundational principles, institutional frameworks, practical applications, and future prospects. The discussion is structured to address several key questions: What are the core principles that distinguish Islamic economics from conventional economic systems? How have these principles been implemented in modern economic institutions? What challenges does Islamic economics face in the contemporary global economy? And what contributions can Islamic economics make to addressing current economic and social challenges?

By exploring these questions, this article seeks to contribute to the ongoing dialogue about alternative economic systems and demonstrate the timeless relevance of Islamic economic principles in addressing contemporary economic challenges.

2. Foundational Principles of Islamic Economics

Islamic economics is built upon a set of fundamental principles derived from Islamic law (Sharia), which encompasses the Quran, the Sunnah (practices and teachings of Prophet Muhammad), and scholarly interpretations through *ijma* (consensus) and *qiyas* (analogical reasoning). These principles form a coherent framework that guides economic behavior and institutional design (Chapra, 2018).

2.1 Prohibition of Riba (Interest)

The prohibition of *riba*, commonly understood as interest or usury, is perhaps the most distinctive feature of Islamic economics. This prohibition is based on explicit verses in the Quran and is considered one of the major sins in Islamic jurisprudence. The rationale behind this prohibition extends beyond religious injunction to encompass economic and social considerations (Hanif, 2019).

From an Islamic economic perspective, *riba* is problematic because it creates a system where money generates money without productive activity, leading to the concentration of wealth among lenders and the exploitation of borrowers. The prohibition encourages risk-sharing rather than risk-transfer, promoting more equitable distribution of economic gains and losses. Instead of predetermined interest rates, Islamic finance employs profit-and-loss sharing mechanisms that align the interests of financiers and entrepreneurs (Ayub, 2019).

2.2 Risk Sharing and Asset-Backed Financing

Islamic economics emphasizes risk-sharing rather than risk-transfer as the basis for financial relationships. This principle manifests in various Islamic financial contracts such as *mudarabah* (profit-sharing partnership), *musharakah* (equity partnership), and *murabahah* (cost-plus financing). These mechanisms require that financial transactions be backed by real assets or productive activities, preventing speculative practices that can destabilize economies (Iqbal & Mirakhor, 2018).

The emphasis on asset-backed financing and real economic activity distinguishes Islamic finance from conventional finance, where much financial activity is divorced from the real economy. This characteristic has been cited as one reason why Islamic financial institutions demonstrated relative resilience during the 2008 financial crisis, as they had limited exposure to toxic derivative products and speculative instruments (Ahmed, 2020).

2.3 Ethical Investment and Prohibition of Haram

Islamic economics prohibits involvement in activities considered haram (forbidden) according to Islamic law. This includes businesses related to alcohol, pork products, gambling, pornography, conventional financial services involving interest, and certain forms of entertainment. This ethical screening process extends beyond negative screening to include positive criteria such as fair labor practices, environmental stewardship, and social responsibility (Wilson, 2019).

The ethical dimension of Islamic economics reflects a holistic approach to economic activity that considers not only financial returns but also moral and social impacts. This approach has parallels with environmental, social, and governance (ESG) investing and socially responsible investment (SRI) frameworks that have gained prominence in conventional finance, suggesting that Islamic economic principles address contemporary concerns about ethical capitalism (Platonova et al., 2018).

2.4 Zakat and Wealth Redistribution

Zakat, the obligatory charitable giving of a portion of one's wealth, is one of the five pillars of Islam and a central institution in Islamic economics. Zakat serves as a systematic wealth redistribution mechanism designed to reduce inequality and provide for the needs of vulnerable populations. The traditional zakat rate is 2.5% of accumulated wealth annually, with proceeds designated for specific categories of recipients including the poor, the needy, and those in debt (Bashir et al., 2020).

Beyond its role as a poverty alleviation tool, zakat embodies the Islamic economic principle that wealth is a trust from God and that property rights come with social obligations. The institutionalization of zakat in modern Islamic economics represents an attempt to operationalize this principle through formal collection and distribution mechanisms, though implementation varies significantly across different countries and contexts (Kasri & Yuniar, 2021).

2.5 Balanced Economic Objectives

Islamic economics seeks to balance multiple objectives rather than focusing solely on efficiency or growth. The concept of *maqasid al-shariah* (objectives of Islamic law) provides a framework for evaluating economic policies and institutions based on their contribution to protecting and promoting religion, life, intellect, lineage, and wealth. This multidimensional approach to economic well-being encompasses material prosperity, social justice, environmental sustainability, and spiritual development (Laldin & Furqani, 2018).

This balanced approach challenges the conventional economic assumption that unlimited growth is desirable and that efficiency should be pursued without regard to distributional consequences. Instead, Islamic economics promotes moderation in consumption, equitable distribution of resources, and sustainable use of natural resources as integral components of economic success.

3. Contemporary Applications and Institutions

The principles of Islamic economics have been operationalized through various institutions and practices in the contemporary world. These applications demonstrate both the adaptability of Islamic economic principles and the challenges of implementing them in modern contexts.

3.1 Islamic Banking and Finance

Islamic banking and finance represent the most visible and developed application of Islamic economic principles. Islamic banks operate on the fundamental principle of avoiding interest-based transactions while providing financial services through Sharia-compliant contracts and mechanisms. The industry has experienced remarkable growth since the establishment of the first modern Islamic bank in the 1970s, with Islamic financial assets now present in over 80 countries (Ozili, 2020).

Islamic banks employ various financing modes to replace interest-based lending. Murabahah (cost-plus sale) involves the bank purchasing an asset and reselling it to the customer at a marked-up price payable over time. Ijarah (leasing) allows customers to use assets owned by the bank in exchange for rental payments. Mudarabah and musharakah involve profit-and-loss sharing partnerships where the bank and customer share risks and returns according to agreed ratios (Rashid et al., 2018).

The sukuk (Islamic bond) market has emerged as a significant component of Islamic finance, providing governments and corporations with Sharia-compliant alternatives to conventional bonds. Sukuk represent ownership in underlying assets or projects rather than debt obligations, with returns derived from asset performance or rental income rather than interest payments. The global sukuk market has grown substantially, offering investors diversification opportunities and issuers access to Islamic capital (Said & Grassa, 2020).

3.2 Takaful (Islamic Insurance)

Takaful represents the Islamic alternative to conventional insurance, based on principles of mutual cooperation and shared responsibility rather than risk transfer for profit. In takaful arrangements, participants contribute to a pool of funds used to support members who experience losses, with any surplus distributed among participants rather than accruing solely to the insurance company. This structure aligns with Islamic prohibitions against gharar (excessive uncertainty) and maysir (gambling) while maintaining the risk-pooling benefits of insurance (Biancone & Radwan, 2019).

The takaful industry has expanded globally, offering products ranging from family takaful (similar to life insurance) to general takaful (property and casualty coverage) and health takaful. The sector faces challenges in developing actuarial models compatible with Islamic principles and in educating consumers about the distinctions between takaful and conventional insurance.

3.3 Halal Industry

The halal industry encompasses the production and distribution of goods and services permissible under Islamic law. While traditionally focused on food products, the halal industry has expanded to include pharmaceuticals, cosmetics, fashion, tourism, and media. This expansion reflects both the growing purchasing power of Muslim consumers and

increased awareness of halal standards as markers of quality, hygiene, and ethical production (Elseidi, 2018).

The global halal market represents a significant economic opportunity, with estimates suggesting it exceeds \$2 trillion in value. Countries such as Malaysia, Indonesia, and the United Arab Emirates have developed comprehensive halal certification systems and positioned themselves as halal industry hubs. The standardization of halal certification across different jurisdictions remains a challenge, as interpretations of halal requirements can vary among Islamic scholars and regulatory authorities (Ali et al., 2021).

3.4 Islamic Microfinance and Social Finance

Islamic microfinance seeks to provide financial services to low-income populations while adhering to Islamic principles. This approach combines the poverty alleviation objectives of conventional microfinance with the ethical framework of Islamic economics. Islamic microfinance institutions employ profit-sharing arrangements, asset-backed financing, and zero-interest benevolent loans (*qard hassan*) to serve clients who might otherwise be excluded from formal financial systems (Obaidullah & Shirazi, 2019).

The integration of *zakat* and *waqf* (Islamic endowment) mechanisms with microfinance has created innovative social finance models. *Zakat* funds can provide capital for *qard hassan* schemes or serve as guarantees for profit-sharing arrangements, reducing the cost of financing for poor borrowers. *Waqf* institutions have been revitalized to fund educational, healthcare, and economic development initiatives, demonstrating the contemporary relevance of traditional Islamic institutions (Haneef et al., 2020).

4. Challenges and Critical Perspectives

Despite its growth and development, Islamic economics faces several significant challenges in theory and practice. Understanding these challenges is essential for assessing the current state and future prospects of Islamic economics.

4.1 Standardization and Harmonization

The absence of universally accepted standards for Islamic financial products and practices creates uncertainty for market participants and limits the integration of Islamic finance across jurisdictions. Different schools of Islamic jurisprudence and individual scholars may reach different conclusions about the permissibility of specific contracts or structures, leading to variations in practice across countries and institutions (Ahmed & Kayed, 2021).

Efforts to establish international standards through organizations such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) have made progress, but challenges remain in achieving widespread adoption and reconciling different interpretative approaches. This lack of standardization can increase transaction costs, complicate cross-border operations, and create confusion among consumers.

4.2 Form Versus Substance Debate

Critics argue that some Islamic financial products replicate conventional financial

instruments through complex legal structures without fundamentally altering the underlying economic relationships. For example, certain murabahah transactions may function similarly to interest-based loans, with the commodity purchase serving primarily as a legal device to generate permissible returns. This has led to debates about whether Islamic finance is achieving its substantive objectives or merely providing Sharia-compliant forms for conventional practices (Khan, 2019).

This challenge raises fundamental questions about the goals of Islamic finance: Is formal compliance with Sharia prohibitions sufficient, or must Islamic financial institutions also embody the broader ethical and social objectives of Islamic economics? The tension between commercial viability and ideological purity continues to generate scholarly debate and practical difficulties.

4.3 Limited Empirical Research

While Islamic economics has developed a substantial body of theoretical literature, empirical research on the actual impacts and performance of Islamic economic institutions remains limited relative to conventional economics. Questions about whether Islamic banks are more stable than conventional banks, whether zakat systems effectively reduce poverty, or whether Islamic economic principles lead to different economic outcomes require rigorous empirical investigation (Abdul-Majid et al., 2018).

The scarcity of data, methodological challenges in isolating the effects of Islamic principles from other factors, and the relative youth of many Islamic economic institutions complicate empirical research. Nevertheless, expanding the evidence base is crucial for refining Islamic economic theory and improving practical implementation.

4.4 Integration with Conventional Systems

Most Islamic economic institutions operate within predominantly conventional economic systems and regulatory frameworks. This necessitates adaptation and compromise, as Islamic institutions must comply with regulations designed for conventional financial systems while maintaining Sharia compliance. The dual regulatory burden can increase operational costs and complexity, potentially affecting the competitiveness of Islamic institutions (Ginena & Hamid, 2020).

Furthermore, the interconnection between Islamic and conventional financial systems raises questions about systemic risk and financial stability. While Islamic finance principles may reduce certain types of risk, the integration of Islamic institutions into global financial networks exposes them to conventional financial shocks and crises.

4.5 Human Capital Development

The continued growth of Islamic economics requires professionals who possess both Islamic knowledge and modern economic expertise. Shortages of Sharia scholars with financial expertise and financial professionals with deep understanding of Islamic jurisprudence create bottlenecks in product development, governance, and regulatory supervision. Developing educational programs that adequately prepare professionals for careers in Islamic economics remains an ongoing challenge (Waemustafa & Sukri, 2018).

5. Contributions to Contemporary Economic Challenges

Despite these challenges, Islamic economics offers valuable perspectives on several pressing contemporary economic issues, demonstrating its timeless relevance beyond specifically Islamic contexts.

5.1 Financial Stability and Crisis Prevention

The emphasis on asset-backed financing, prohibition of excessive speculation, and risk-sharing mechanisms in Islamic finance can contribute to financial stability. By requiring that financial transactions be linked to real economic activities and by promoting shared responsibility for risks and returns, Islamic finance discourages the accumulation of excessive leverage and speculative bubbles that have triggered financial crises (Kammer et al., 2019).

The resilience demonstrated by many Islamic financial institutions during the 2008 global financial crisis has attracted attention from policymakers and researchers seeking alternatives to conventional financial practices. While Islamic finance is not immune to economic downturns, its structural features may reduce certain types of systemic risk and provide models for more stable financial architecture.

5.2 Inequality and Social Justice

The principle of wealth redistribution through zakat, the emphasis on equitable distribution of gains and losses through risk-sharing contracts, and the ethical constraints on business activities position Islamic economics as a framework for addressing inequality. As wealth and income disparities have widened in many countries, the Islamic economic emphasis on social solidarity and collective responsibility offers alternatives to purely market-based approaches (Asutay & Yilmaz, 2021).

The integration of commercial activities with social objectives through institutions such as Islamic microfinance and social finance mechanisms demonstrates how economic systems can be designed to serve both efficiency and equity goals. This integrated approach challenges the conventional assumption that social objectives must be pursued primarily through government intervention or philanthropy separate from market activities.

5.3 Sustainable Development

Islamic economic principles of moderation in consumption, stewardship of natural resources, and consideration of intergenerational equity align with contemporary sustainable development goals. The concept of humans as khalifah (stewards) of the Earth implies responsibility for environmental protection and sustainable resource use, providing religious and ethical foundations for environmentally conscious economic policies (Hassan & Salman, 2019).

Islamic finance's emphasis on asset-backed transactions and real economic activity can support sustainable development by channeling capital toward productive investments in infrastructure, agriculture, and industry rather than speculative financial activities. Green sukuk and other Islamic sustainable finance instruments demonstrate the potential for combining Islamic principles with environmental objectives.

5.4 Ethical Business Practices

The comprehensive ethical framework of Islamic economics, which integrates moral considerations into all economic decisions, resonates with growing concerns about corporate social responsibility, stakeholder capitalism, and ESG considerations. The Islamic prohibition on harmful products and activities, emphasis on fair dealing, and concern for social impact provide principles for ethical business conduct that extend beyond profit maximization (Antonio et al., 2020).

As consumers, investors, and regulators increasingly demand ethical and socially responsible business practices, Islamic economic principles offer a well-developed framework for evaluating and guiding corporate behavior. The compatibility between Islamic finance and ESG investing has created opportunities for crossover appeal to both Muslim and non-Muslim investors seeking ethical investment opportunities.

6. Future Prospects and Recommendations

The continued development and impact of Islamic economics will depend on addressing current challenges while capitalizing on opportunities presented by technological innovation, changing consumer preferences, and global economic trends.

6.1 Technology and Innovation

Financial technology (fintech) presents significant opportunities for Islamic finance to expand access, reduce costs, and develop innovative products. Digital platforms can facilitate zakat collection and distribution, enable peer-to-peer Islamic financing, and provide Sharia-compliant investment opportunities to broader populations. Blockchain technology may enhance transparency and trust in Islamic financial transactions, addressing some concerns about the authenticity of Sharia compliance (Rabbani et al., 2020).

However, technological innovation also raises new Sharia compliance questions regarding cryptocurrencies, algorithm-based trading, and digital assets. Islamic scholars and financial professionals must engage with these technologies to develop frameworks for their permissible use while maintaining adherence to Islamic principles.

6.2 Research and Education

Expanding research on Islamic economics, particularly empirical studies examining the performance and impacts of Islamic economic institutions, is essential for evidence-based policy making and institutional development. Research should address both theoretical questions about the optimal design of Islamic economic systems and practical questions about implementation effectiveness (Mirakhor & Askari, 2019).

Strengthening educational programs in Islamic economics and finance at all levels will help develop the human capital necessary for the sector's continued growth. Curricula should integrate Islamic jurisprudence with modern economics, finance, and related disciplines, preparing graduates to navigate the complexities of contemporary Islamic economic practice.

6.3 International Cooperation and Standards

Greater international cooperation among Islamic finance jurisdictions, regulators, and standard-setting bodies can facilitate harmonization and reduce fragmentation in the industry. While respecting legitimate differences in jurisprudential interpretation, establishing common frameworks for key products, disclosure requirements, and governance practices can enhance market efficiency and consumer protection (Boulanouar et al., 2021).

Engagement with international financial institutions and incorporation of Islamic finance considerations into global financial regulations can support the integration of Islamic finance into the international financial system while preserving its distinctive characteristics.

6.4 Broader Implementation of Islamic Economic Principles

Moving beyond Islamic finance to implement other aspects of Islamic economics, such as comprehensive zakat systems, waqf revitalization, and ethical business practices, can demonstrate the full potential of Islamic economic principles. Pilot programs testing different approaches to integrating Islamic economic institutions into broader economic systems can provide valuable lessons for scaling successful models.

Collaboration between Muslim-majority and Muslim-minority countries, as well as between Islamic and conventional institutions, can facilitate knowledge sharing and create hybrid models that draw on the strengths of different approaches.

7. Conclusion

Islamic economics represents a comprehensive framework for organizing economic activity based on ethical principles and religious values. Its core principles—prohibition of interest, emphasis on risk-sharing, ethical investment criteria, systematic wealth redistribution, and balanced economic objectives—offer alternatives to purely profit-driven conventional economics. The contemporary applications of these principles through Islamic banking and finance, takaful, halal industries, and social finance institutions demonstrate both the viability and the challenges of implementing Islamic economics in modern contexts.

While Islamic economics faces significant challenges related to standardization, the balance between form and substance, empirical validation, integration with conventional systems, and human capital development, it also offers valuable contributions to addressing contemporary economic challenges. Its emphasis on financial stability through asset-backed financing, social justice through wealth redistribution, sustainability through stewardship principles, and ethical business practices provides frameworks relevant beyond specifically Islamic contexts.

The future of Islamic economics will depend on successfully navigating the tension between maintaining fidelity to fundamental Islamic principles and adapting to contemporary economic realities. This requires ongoing scholarly discourse to refine theoretical frameworks, rigorous empirical research to evaluate practical outcomes, innovation in product development and service delivery, and cooperation among diverse stakeholders to establish effective governance structures.

Islamic economics should not be viewed merely as a niche alternative for Muslim populations but as a source of principles and practices that can contribute to creating more equitable, stable, and ethically grounded economic systems globally. As the world grapples with persistent challenges of inequality, financial instability, environmental degradation, and

ethical concerns about economic practices, the timeless principles of Islamic economics offer insights and alternatives worthy of serious consideration by policymakers, researchers, and practitioners regardless of religious affiliation.

The continued development of Islamic economics requires commitment from multiple stakeholders: scholars to refine theoretical frameworks and provide religious guidance, policymakers to create enabling regulatory environments, practitioners to implement Islamic principles effectively and innovatively, educators to prepare future professionals, and researchers to generate evidence about what works and what needs improvement. By addressing current limitations while building on existing strengths, Islamic economics can fulfill its potential as a viable, ethical, and effective economic system for the contemporary world.

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