

## **Analysis of The Influence of Sharia Financial Institutions on Economic Growth in The Top Global Islamic Economy Index (GIEI) Countries**

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### **ABSTRACT**

*The high level of Muslim growth has resulted in increased spending by Muslims on sharia goods or services. One of them is the increase in demand for sharia financial institutions in 2020/2021, which can be seen from the increase in performance, namely 17 billion or the equivalent of 246% from the previous year. The aim of this research is to determine and analyze the influence of sharia financial institutions on economic growth in 10 Global Islamic Economy Index (GIEI) countries. This research uses a descriptive quantitative research approach with spatial analysis in 2017-2022. The results of this research show that in the short and long term there is spatial dependence on economic growth in the 10 Global Islamic Index (GIEI) countries. The results of the spatial regression analysis show that the independent variables that have a significant influence are the asset value of sharia banks, the value of sukuk assets and the value of takaful assets with spatially correlated values between regions. The asset value of sharia banks and sukuk has a positive effect, this is due to the implementation of the sharia system and the investment made by sharia banks and sukuk which can increase productivity and investment is dominated by sustainable development while takaful has a negative effect on economic growth, this is because most of the assets takaful is invested in the capital market and the public's literacy level regarding takaful is still low.*

**Keywords:** Sharia Finance; Economy Growth, Spatial

### **ABSTRAK**

Tingginya tingkat pertumbuhan muslim menjadikan meningkatnya pembelanjaan umat muslim terhadap barang atau jasa syariah. Salah satunya peningkatan permintaan pada lembaga keuangan syariah pada tahun 2020/2021, yang dapat dilihat dari peningkatan performanya yaitu sebesar 17 miliar atau setara dengan 246% dari tahun sebelumnya. Tujuan penelitian ini untuk mengetahui dan menganalisis pengaruh lembaga keuangan syariah terhadap pertumbuhan ekonomi di 10 Negara Global Islamic Economy Indeks (GIEI). Penelitian ini menggunakan penelitian kuantitatif pendekatan deskriptif dengan analisis spasial pada tahun 2017-2022. Hasil penelitian ini menunjukkan pada jangka pendek dan panjang terdapat ketergantungan spasial pada pertumbuhan ekonomi di 10 Negara Global Islamic Indeks (GIEI). Hasil analisis regresi spasial menunjukkan variabel independen yang berpengaruh signifikan adalah nilai aset bank syariah, nilai aset sukuk dan nilai aset takaful dengan nilai spasial berkorelasi antar wilayah. Nilai aset bank syariah dan sukuk berpengaruh positif, hal tersebut dikarenakan penerapan sistem syariah serta adanya investasi yang dilakukan bank syariah maupun sukuk yang dapat meningkatkan produktivitas dan adanya penanaman modal yang didominasi pada pembangunan berkelanjutan sedangkan takaful

berpengaruh negatif terhadap pertumbuhan ekonomi hal ini dikarenakan sebagian besar *asset* takaful diinvestasikan ke pasar modal dan masih rendahnya tingkat literasi Masyarakat terhadap takaful.

**Kata Kunci:** Keuangan Syariah, Pertumbuhan Ekonomi, Spasial

## INTRODUCTION

The world's Muslim population in 2022 will be two billion people or the equivalent of 25% of the world's population (Bank Indonesia, 2021). The high level of Muslim growth has resulted in increased spending by Muslims on goods or services that apply sharia values. The 2021 Global Islamic Economic Index states that Muslim consumer spending is 2.02 trillion dollars in six real sectors (Dinar Standard & Salam Gateway, 2021). The value of consumption expenditure in 2021 in the halal food sector reached 1.27 trillion dollars, the sharia finance sector with a total asset value of 3.6 trillion dollars, expenditure in the halal tourism sector amounted to 102 billion dollars, expenditure in the Muslim fashion sector amounted to 295 billion dollars, spending on the halal pharmaceutical sector was 100 billion dollars, spending on the halal cosmetics sector was 70 billion dollars, and in the media and recreation sector was 231 billion dollars (Dinar Standard & Salam Gateway, 2022). Even though Muslim consumer spending has a high value, there are several halal industries which experienced a decline in the value of investment in several halal sectors, namely the halal food sector, the Muslim tourism sector, the Muslim fashion sector, and the Islamic media sector in 2020/21 which experienced a decline compared to previous year 2019/2020.

Different conditions were shown by the sharia financial sector which experienced a significant increase in performance, namely 17 billion or the equivalent of 246% from the previous year (Dinar Standard & Salam Gateway, 2022). This value reflects the number of people who are interested in investing in the sharia industry, especially in the sharia financial sector, which has caused this sector to experience significant growth. The system used in every activity or transaction in the sharia financial sector is using a profit sharing system or better known as Profit Loss Sharing (PLS), there are considerations regarding balance in the real and monetary sectors (Rabaa & Younes, 2016). This principle makes the sharia financial sector play a role as one of the driving sectors of the country's economy, with various mechanisms and activities carried out in the sharia financial sector (Ahmad et al., 2015). The contribution of sharia finance to economic growth in a country has been proven in 2021, sharia finance will contribute to the value of global Gross Domestic Product (GDP), namely six percent. This shows that sharia financial institutions globally are providing capital for the country, with the higher total assets of sharia financial institutions increasing investment or capital for the country.

Apart from that, this also shows that it is not only conventional financial institutions that contribute to a country's economic growth. There is a positive impact

on the contribution of sharia finance to economic growth (Rabaa & Younes, 2016). One of the reasons for the influence of the financial sector on economic growth is because the financial sector in a country can stabilize macroeconomic conditions and can reduce poverty levels (Jumaniyozov, 2018). Similar research results were also expressed by (Zirek et al., 2016), (Maamor & Abdullah, 2016), and (Belkhaoui, 2023), where the research results showed that Islamic finance contributed to economic growth. However, there are different results from previous research conducted by (Iskandar, 2023), (Zahra & Diana, 2023) in their research results, revealed that sharia finance does not significantly influence economic growth.

The results of these studies show that there are several studies which show that the Islamic financial institution sector has an important role in economic growth in a country and there are also several studies which show that Islamic finance has no influence on economic growth. Then there are several countries with the highest levels of Muslim population and good economic growth, but the development of sharia finance in these countries is still not optimal compared to other Muslim countries. Due to the differences in the results of several studies and several of the main problems that have been described, the author is interested in discussing sharia financial institutions that exist in several countries that are included in the Global Islamic Economy Index.

## LITERATURE REVIEW

### Harrod-Domar Theory of Economic Growth

This theory was developed by Roy F. Harrod (1948) in England and Evsey D. Domar (1957) in the United States. This theory is based on the assumptions, namely, the economy is closed, the desire to save is constant, the production process has a fixed coefficient and the growth rate of the labor force is constant and the same as the population growth rate. On the basis of this assumption, Harrod-Domar made an analysis that long-term growth where all increases in production can be absorbed by the market can only be achieved if the balance conditions are met, namely output ( $g$ ) = capital ( $k$ ) = labor force ( $n$ ). Based on this, to achieve a balance between savings ( $S$ ) and investment ( $I$ ) they must be interrelated and balance each other. Economic growth in a country can be measured using Gross Domestic Product (GDP) or Gross Domestic Product (GDP) per capita (Ahmad Ma'ruf, 2008).

## METHODOLOGY

### Data and Sources

This research is quantitative research using two time periods, namely the short term 2022 and the long term 2017-2022. The data used in this research is secondary data. Secondary data in this research was obtained from the World Bank,

Islamic Finance Development Report, and the internet. The sample in this study used 10 countries, namely Malaysia, Saudi Arabia, United Arab Emirates, Qatar, Indonesia, Kuwait, Bangladesh, Bahrain, Iran and Turkey. The variables used in this research are the value of economic growth which is described by the value of per capita income, the total assets of Islamic banks, total assets of sukuk and total assets of takaful. Data processing in this research uses Geoda and Stata software.

### **Spatial Analysis Method**

In this research there are several stages, namely first, the formation of the W weighting matrix in this research using the economic growth variable using the queen method, namely by the intersection of side and corner areas or vertices. The selection of the weighting matrix W is used to find out how many neighbors there are in each country (Anselin, 1988). After that, a matrix of the order of 10 x 10 was created, where the results of the weighting matrix W will later be used in forming values for the spatial regression model.

Secondly, carry out the next spatial effect test, namely the spatial dependency test with the Moran Index using economic growth variables in 10 countries. The Moran Index with a weighting matrix (W) in normality form is as follows:

$$I = \frac{e' W e}{e' e}$$

The expected value of the Moran Index is:

$$E(I) = I_0 = -1/(n-1)$$

If I is greater than  $I_0$ , then the autocorrelation value is positive, this means that the data pattern forms groups (clusters), I is the same as  $I_0$ , meaning there is no spatial autocorrelation, and I is smaller than  $I_0$ , meaning the autocorrelation value is negative, this means data patterns spread out. Apart from that, the Moran index value indicates whether the model used has autocorrelation between regions or not, which if there is regional autocorrelation means that an area approach must be used to create spatial regression modelling.

Lastly, if there is autocorrelation between regions, the next step is to select spatial regression which includes estimating parameters and carrying out significant tests from the results of the spatial regression model, to find out which independent variables have a significant effect on the dependent variable by looking at the Z-value or p-value -value which if the p-value is smaller than  $\alpha$  by 10 percent, then this variable has a significant effect on the dependent variable. The formulation of spatial regression is as follows

Spatial Error Model (SEM) regression model is as follows(Anselin, 1988):

$$y_i = \beta_i X_i + \lambda W_{ij} u_i + \varepsilon$$

Where:

- $y_i$  : dependent variable  
 $\beta_i$  : coefficient parameter  
 $X_i$  : independent variable  
 $W_{ij}$  : element of the spatial weighting matrix  
 $\varepsilon$  : error at location  $i$   
 $u_i$  : error at location  $i$   
 $\lambda$  : spatial error coefficient parameter

Spatial Autoregressive Model (SAR) regression model is as follows:

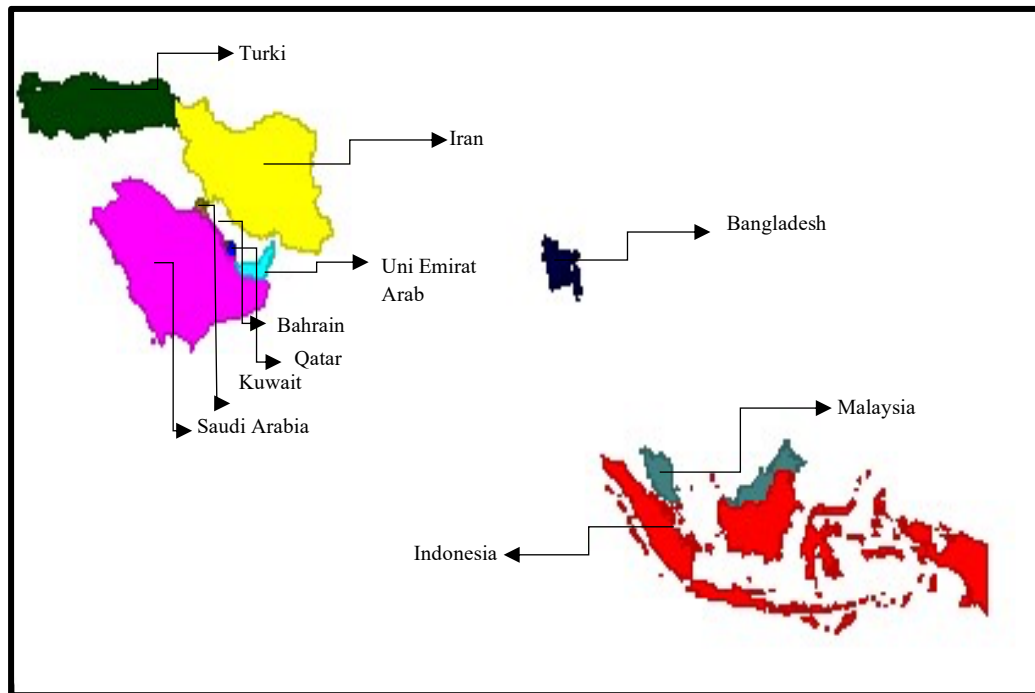
$$y_i = \rho W_{ij} y_i + \beta_i X_i + \varepsilon$$

Where:

- $y_i$  : dependent variable  
 $\rho$  : spatial lag coefficient parameter  
 $W_{ij}$  : element of the spatial weighting matrix  
 $\beta_i$  : regression coefficient parameter  
 $X_i$  : independent variable  
 $\varepsilon$  : error

## RESULT AND ANALYSIS

Figure 1 shows a map of the 10 countries sampled in this study. These 10 countries are countries where the majority of the population is Muslim. The countries included in the Global Islamic Economy Index are countries that excel in the sharia sector, including halal food, sharia finance, halal pharmaceuticals, sharia media, sharia fashion and halal tourism. In 2022, based on the Global Islamic Economy Index, Malaysia will rank first in the halal sector, followed by Saudi Arabia, the United Arab Emirates, Indonesia, Turkey, Bahrain, Kuwait, Iran, Qatar and Bangladesh.

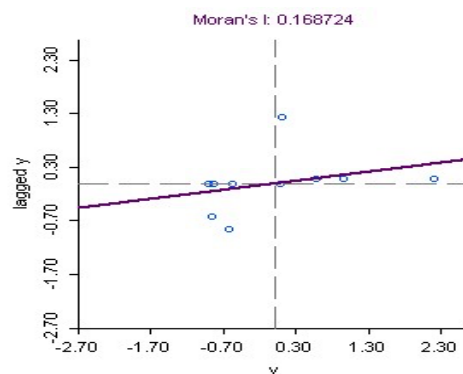


**Figure 1. Mapping 10 Country**

Source: Geoda, 2024

### Moran Index Results Short Term Data

The Moran Index test is a local statistical test used to view spatial autocorrelation, helping to identify the location of spatial clustering or the presence of spatial autocorrelation. If the Moran Index Expectation ( $I_0$ ) value is greater than the Moran Index ( $I$ ) value, this indicates negative autocorrelation, indicating a data spread pattern. Conversely, if  $I$  is greater than  $I_0$ , this indicates positive autocorrelation, indicating data patterns in groups (clusters), and if  $I$  is equal to  $I_0$ , this indicates the absence of spatial autocorrelation. The Moran Index results can be seen in Figure 2 as follows.



**Figure 2. Indeks Moran 2022**

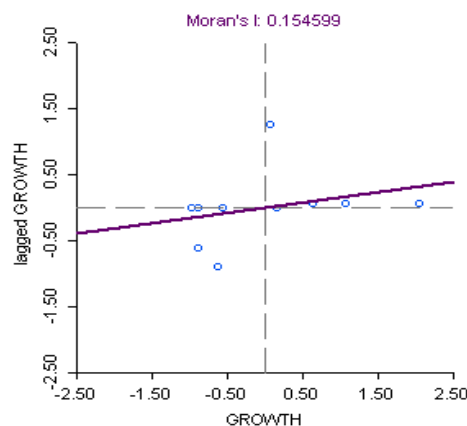
Source: Geoda, 2024

Figure 2 shows the Moran Index ( $I$ ) = 0.168724, with the calculated  $I_0$  value being -0.11111. This shows that the Moran Index value is greater than  $I_0$ , indicating the level of spatial dependence in the form of positive autocorrelation. This positive autocorrelation illustrates that economic growth in 10 countries in 2022 tends to cluster. Although the Moran Index value is far from +1, this pattern indicates the potential for a spatial clustering pattern.

The influence of economic growth in a country on the economic growth of neighboring countries in the short term is due to several factors including changes in demand or commodity prices in a country where neighboring countries collaborate in international trade (Vilarrubia, 2006), fluctuations in capital flows (Park & Yang, 2021) and cooperation in development of infrastructure projects (Asian Development Bank, 2012). Such as the construction of infrastructure projects that will be carried out in 2022 by Saudi Arabia and Qatar, where these neighboring countries have good economic growth which encourages them to collaborate to build a railway network infrastructure project, which connects four other neighboring countries, namely Kuwait, United Arab Emirates, Bahrain and Oman. This project not only increases the economic growth of Saudi Arabia and Qatar but also provides a short-term economic boost to neighboring countries through increased investment and job creation.

### Moran Index Results Long Term Data

The results of the Moran Index from using economic growth data in 10 countries for the period 2017-2022 can be seen in Figure 3 as follows:



**Figure 3. Indeks Moran 2017-2022**

Source: Geoda, 2024

Figure 3 shows the Moran Index ( $I$ ) = 0.154599, with the calculated  $I_0$  value being -0.0169. This shows that the Moran Index value is greater than  $I_0$ , indicating the level of spatial dependence in the form of positive autocorrelation. This positive autocorrelation illustrates that economic growth in 10 countries in 2017-2022 tends

to cluster. Although the Moran Index value is far from +1, this pattern indicates the potential for a spatial clustering pattern.

The influence of economic growth in a country on the economic growth of neighboring countries in the long term is due to several factors including international trade, savings levels and investment (Amidi & Fagheh Majidi, 2020). A country's savings level can increase economic growth because healthy domestic savings are better able to support investment in projects that have the potential to increase productivity and long-term economic growth (King & Levine, 1993). Large domestic savings can strengthen a country's financial system, increase access to capital for companies to make productive investments and support long-term economic growth, and countries with high savings rates tend to have larger reserves of funds to overcome possible economic pressures. arising from changes in global conditions, such as fluctuations in commodity prices or instability of global financial markets (Lane & Milesi-Ferretti, 2007).

**Spatial Error Regression Results**

Spatial Error Model (SEM) which shows the existence of spatial dependencies between errors in the model. The Spatial Error Model (SEM) regression results can be seen in Table 1, as follows:

**Table 1. Spatial Error Model (SEM)**

Source: *Geoda*, 2024

Variable	coefficient	Std.Error	z-value
Probability			
Constanta	5437,79	9966,84	0,545589
X1	3,13266	7,33418	4,27131
X2	-1,06274	2,34688	-4,52832
X3	1,93349	6,35812	3,04098
R <sup>2</sup>	: 0,645590		
Log likelihood	:-110,866205		
Akaike Info Criterion	:229,732		

From Table 1, the Spatial Error Model regression equation model is obtained, namely:

$$y = 5437.79 + 3.13266X1 - 1.06274X2 + 1.93349X3 - 0.285164W_{ij} + \epsilon_i$$

In general, the Spatial Error Model (SEM) model can be interpreted, that if other factors are considered constant then when the total assets of Islamic banks increase by 100 US\$ it will increase economic growth in 10 countries by 313 US\$. If total takaful assets increase by 100 US\$, it will reduce economic growth in 10 countries by 106 US\$, and total sukuk assets increase by 100 US\$, which will increase economic growth in 10 countries by 193 US\$ with correlated spatial errors between regions.

Islamic banks can increase economic growth in a country because they have good asset quality and risk reduction. In the short term, Islamic banks tend to have better asset quality because transactions are based on real assets and profit sharing principles, the results of this research are in line with research conducted by Fristy & Inas (Bella & Inas, 2023), and Ahmad Khaliq & Hassanudin (Khaliq & Thaker, 2017). Basically, short-term sukuk are widely used by countries to overcome the problem of liquidity shortages that occur, especially in Islamic banks. This problem will make customers worry about their funds stored in the bank, thereby allowing customers to withdraw their money which will result in sharia banks going bankrupt, The results of this research are in line with research conducted by Siti Saroh & Noraziah (Mohd Zaki Fadzil & Che Arshad, 2019). Then, sharia insurance has a negative impact on economic growth due to financial market instability and takaful assets which are mostly invested in the sharia capital market (Febby Rhamadhani & Fanani, 2023).

### Spatial Autoregressive Model (SAR) Results

Spatial Autoregressive Model (SAR) which shows the existence of spatial dependencies between independent variables in the model. The results of the Spatial Autoregressive Model (SAR) regression can be seen in Table 2,

**Table 2. Spatial Autoregressive Model (SAR)**

Source : *Stata*, 2024

Variable	coefficient	Std.Error	z-value
Probability			
constant	13248,03	4998,735	2,65
0,008			
X1	4,40e-08	2,32e-08	1,90
0,057			
X2	-1,33e-06	6,90e-07	-1,92
0,055			
X3	3,98e-08	2,25e-08	1,77
0,076			
<i>Log likelihood</i>	:-625.9658		
<i>Akaike Info Criterion</i>	:1255.932		

From Table 2, the Spatial Autoregressive Model regression equation model is obtained, namely:

$$Y = 13248.03 + 0.241167W_{ij} + 4.40X_1 - 1.33X_2 + 3.98X_3 + \epsilon_i$$

In general, the Spatial Autoregressive Model (SAR) model can be interpreted to mean that if other factors are considered constant then when the total assets of Islamic banks increase by 10 US\$ it will increase economic growth in 10 countries by 40 US\$. Total takaful assets increase by 10 US\$, which will reduce economic growth in 10 countries by 13 US\$, and total sukuk assets increase by 10 US\$, which will increase economic growth in 10 countries by 39 US\$ with independent variables spatially correlated between countries.

Increasing the total value of Islamic bank assets in a country will increase economic growth in the long term, this is because Islamic banks have an important role in sustainable economic growth by encouraging long-term investment and infrastructure projects. Equity-based financing and profit-sharing principles create closer ties between capital providers and capital users, which can increase economic efficiency and productivity. Apart from that, it has a more stable mechanism in dealing with financial crises because it does not rely on excessive interest and speculation. Thus, the Islamic banking system is more resistant to economic shocks and can help maintain long-term economic stability (Gani & Bahari, 2021).

The total value of sukuk assets in a country will increase economic growth in a country, this is because sukuk have an important role in developing economic activities in a country, especially by providing funding to parties who need funds, such as for infrastructure development, where sukuk are often used to fund projects. infrastructure projects in developing and developed countries. Similar research results were also expressed by (Novitasari & Arundina, 2023), (GediKli et al., 2020), and (Abrorov, 2020). Then, the negative impact on the total value of takaful assets on long-term economic growth in this study is due to several factors, including unbalanced allocation of funds and funds, as well as regulatory burdens. The unbalanced allocation of funds and regulations that occur in takaful will have a negative impact on economic growth, this is because the unbalanced allocation of funds causes takaful to not be able to increase returns so that it will be difficult to increase takaful assets, so that asset values tend to persist which will cause Declining economic growth and lack of regulation in a country will result in a high risk of misuse of funds (A. et al., 2021).

## CONCLUSION AND RECOMMENDATION

The research results show that in the short term and long term, the results of spatial autocorrelation testing show that there is a spatial relationship in the form of positive spatial autocorrelation in economic growth in the 10 GIEI countries. The better a country's economic growth, the demand for goods and services or commodity

prices and capital flows will increase. This will indirectly increase the income of neighboring countries which will have a positive impact on economic growth. then in the spatial regression results, both in the short and long term, sharia banks, sukuk and takaful have an influence on economic growth, where sharia banks and sukuk have a positive influence, this is due to the provision of capital or investment which increases economic growth. Meanwhile, takaful has a negative influence, this is due to the high number of takaful assets invested in the capital market and the low level of public literacy regarding takaful, which means that takaful does not have a positive influence on economic growth in the 10 GIEI countries. It is hoped that with this research the government of each country can create policies that support the development of takaful institutions so that takaful can have a positive role in economic growth and for future researchers, it is recommended to study sharia financial institutions using comparisons with Islamic minority countries.

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