IJNRD.ORG ISSN : 2456-4184
INTERNATIONAL JOURNAL OF NOVEL RESEARCH AND DEVELOPMENT (IJNRD) | IJNRD.ORG
An International Open Access, Peer-reviewed, Refereed Journal

Impact of Islamic Finance on Economic Growth: A Study of the SAARC Nations and Key Takeaways for India

[1]Dheenabhandhan S, [2]Sunil MP, [3]Rebecca Ann Saji

[1]Research Scholar, [2]Assistant Professor, [3]Research Scholar
Department of Commerce,
Christ University, Bangalore, India

Purpose: This paper is a quantitative study of the relationship between the development of Islamic Finance and economic growth in the SAARC nations wherein Islamic Finance is adopted and established.

Design/Methodology: Annual time-series data of Gross Domestic Product (GDP) growth rate and Gross Fixed Capital Formation (GFCF) growth rate was taken from the World Bank, whereas Islamic Finance Development indicator was taken from Zawya and IBFinancing for the period between 2005 to 2022. GDP growth rate and GFCF growth rate were variables taken as proxies for economic growth and Islamic Finance Development indicators as proxies for development in Islamic Finance. For the analysis, the Johansen Co-integration test and Granger Causality test were conducted.

Findings: The results from Johansen's Co-integration test proved that there exists a long-term correlation between the Islamic Finance Development variable and economic growth variables, and hence, they are co-integrated with each other. The results of the Granger tests showed that the growth in Islamic Finance caused growth in the economy, too. Furthermore, the results suggested that Islamic Finance also contributed to higher investments in the SAARC nations.

Research Limitations: The study presents its suggestions by testing the Islamic Development indicator and economic growth variables of the countries following Islamic Finance in SAARC nations, which may or may not be true for India or the rest of the world. Hence, this study is only indicative and remotely conclusive for India.

Originality/Value: The results of the study will be of importance to economists and policymakers striving to achieve countries' economic growth.

Index Terms - Islamic Finance, economic growth, Granger Causality, Johansen Co- integration, Financial Inclusion

1. INTRODUCTION

Islamic finance refers to how individuals and institutions raise capital in accordance with the Shariah, or Islamic law. Shariah is the Islamic law based out of the Holy Quran, prescribing both religious and secular duties and sometimes retributive penalties for lawbreaking. According to El-Gamal (2001), the concept of Islamic Finance was idealized during the tumultuous political years of independence from Britain during the nineteenth century by thinkers from India, Pakistan and the Middle Eastern Countries. However, the Middle Eastern Countries are the current leaders when it comes to practicing the Islamic Financing model and is accelerated by the successful adoption of the model by many non-Muslim countries as well Hesse *et al.* (2008) states that, "The Islamic finance industry is in the midst of a phenomenal expansionary phase, exhibiting average annual growth rates of about 15 percent in recent years. This rapid growth has been fueled not only by surging demand for Shariah compliant products from financiers from the Middle East and other Muslim countries, but also by investors around the world, thus rendering the expansion of Islamic finance a global phenomenon". This universal Financial ideology has four key practices: It outlaws the practice of charging interest; it strictly conforms to the ethical principles of investment and financing, promotes investing that has its roots in moral and social values with a culture of endorsing shared risk policies. This method helps in providing businesses finance through ethical means and at the same time improves financial Inclusion in several countries of the world. Adding on, there is mutual risk sharing and thus there are higher chances of profits and lesser individual losses which curbs the non-performing Assets (NPA) which is considered as the most important problem of modern day Financing and Banking. Islamic banks are preferred over conventional banks because of its insulation to any crisis. The products provided by Islamic finance are less risky and assets prove to be of a high quality which are better capitalized than the conventional banks. In opposition, Islamic Banks are not cost efficient which reduces its profit margins compared to the latter (Baber and Zaruova, 2018). The model suffers from certain challenges to grow further and to be widely accepted in all the countries of the world. Governance and regulation is not as effective as its conventional counterpart which makes it tougher for implementation in countries in the developing world, primarily Southern Asia.

As discussed earlier, countries like India and Pakistan have been pioneers in introducing Islamic Finance to the modern world, but it has not made its way like the middle east. Some of India's neighbours, sharing the economic block (SAARC), have implemented Islamic Finance as a mode of financing alongside the conventional method. The South Asian Association for Regional Cooperation (SAARC) is the intergovernmental and geopolitical association of countries in South Asia. Its member states are Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka. "They have similar levels of human and economic development. They also share the unusual feature of having a common border with one another member country" (Iqbal, 2006). Moreover, all these eight nations were a colony of the Britain empire and had to start their independent economies post-independence. Although the date of independence is different for these countries, the economic growth and country's development is still a challenge. In the past three decades, the organisation has collectively worked towards eliminating poverty, improving literacy, enabling social welfare etc. However, 'Compared with other regional groups, most South Asian countries lag well behind in socio economic development.' (Fernando *et al.*,2018), the financial stability and financial inclusion is still a challenge for these countries. Relying only on the conventional method of banking would not lead to prospective and stabilised growth, adding to the existing stringent competition from the western and much developed world. Thus, to avoid all the disadvantages that modern financing imposes on developing nations, these countries have to come up with a collective alternative mechanism, and Islamic Finance is one of the best alternatives available.

Hence it is crucial to evaluate the amount of impact Islamic finance has on the economic growth which might lead to implementation of the same in other countries which is the purpose of this study as well. If implemented effectively, it improves the stability and equality in the economy which leads to sustainable development in the long run. Understanding the outcomes and effective implementation of Islamic Finance leads to mutual risk sharing and thus eliminates the threat of non-performing Assets in the banking sector of developing countries. Out of the eight SAARC nations, Afghanistan, Bangladesh, the Maldives, Pakistan and Sri Lanka have adopted and are following the Islamic mode of Financing alongside the conventional form of Financing. This paper aims to study the economic relationship between Islamic Finance and the economic growth in these countries and derive meaningful and practical suggestions for implementation in India and consequently seeks to fill the literature gap by quantitatively analysing the relationship between Islamic Financial Indicators and the Economic Growth & development indicators.

2. THEORETICAL DEVELOPMENT

Over a period of 20 years, Islamic Finance has witnessed different phases from implementation to complete establishment. Studies pertaining to this model display its evolution from understanding the model and then gradual implementation and testing if the Islamic Finance model had any effect on the economic growth and financial inclusion in the countries that adopted this model. Naz and Gulzar (201 established through Patrick's Hypothesis that the development in Islamic Finance and economy witnesses a bi-causality relationship in the long run. Financial Inclusion has always been a challenge in the developing countries of the world especially in the South and Southeast Asian countries. "Inclusive financial sector development makes two complementary contributions to poverty alleviation: it drives economic growth, which indirectly reduces poverty and inequality, and, by creating appropriate, affordable, financial services for poor people, it can improve their welfare. In advanced economies, financial inclusion is more about knowledge of fair and transparent financial products, while, in emerging economies, it is a question of both access to financial products and financial literacy." (Zulkhibri, 2016). Further in the paper titled "Financial Inclusion: Islamic Finance Perspective", Mirakhor *et al.* (2019) concludes that Islamic finance provides a comprehensive avenue to improve financial inclusion through the principle of risk-sharing and through Islam's redistributive channels which are grossly under-utilized in Muslim countries.

Shinkafi *et al.* (2014) adds to the literature by providing for measures that can be implemented to achieve financial inclusion for women and economically weaker sections. He suggested that cutting edge technology, acceleration in microfinance services, commitment of the policymakers of Islamic Financial Institutions, knowledge and understanding of the products of Islamic Finance and efficient financial infrastructure will help build a more inclusive economy. Baber *et al* (2019) found that in countries where Islamic mode of finance is developed, rates of inclusivity is higher and women are financially more empowered in those countries. The understanding and benefits of Islamic Finance model has been adopted by many countries and many researchers have recorded the impact this implementation has created in economic growth and financial inclusion. Yusof and Bahlous (2013), in a study conducted in GCC countries and select East Asia countries prove that, both in the long run and short run, Islamic Banking contributes to economic growth. Further, Majid and Kassim (2015) evaluate the impact of Islamic Finance to economic growth IBFIs played a crucial role in the Malaysian economy and expedited the process of economic growth in the country as it showed a significant unidirectional causality between growth in Islamic Finance and the economy. A positive impact of Islamic Finance was also experienced in communist countries like China as Sarker *et al.* (2019) found that for establishing an efficient infrastructure for Islamic Finance to prosper, independent regulatory bodies such as Shariah Supervisory Board, local and central rules and regulations and an expertise in Islamic Finance is crucial. Lawal and Imam (2016) also concluded that there is a positive relationship between Islamic banks' financing and economic growth in Nigeria, which restates the theory that an effective banking system fosters economic growth.

Keeping in view the Indian scenario, researchers believe that India is only going to benefit from the implementation of this model. Beg *et al.* (2017) finds that the financial products in Islamic Finance are safer as they possess lower risk than the other conventional financial products. When India is witnessing high rates of farmer suicides, interest-free solutions offered by Islamic Banking may bring in hopes to the marginalised groups. Hence, Islamic Banking is seen as a potential tool for financial inclusion. Siddiqui *et al.* (2020), adds that Islamic financial system was chosen by those, particularly Muslims, who did not have employment and a sustainable income. Interest free loans and microfinance tools are the only way to help the below poverty line population to raise their income level by theoretical and conceptual literature reviews.

Even though there are many benefits of the model that, if implemented, can completely uproot the problems of the economy, there are also some challenges and limitations that Islamic Finance model faces which makes it difficult for some of the countries to adopt the same. Majeethia and Bose (2014) analyses the scope of funding infrastructure through Islamic Finance in India. They evaluate that, by using the conventional modes of financing alone, it was nearly impossible to meet the demand and the budgetary allocations would not suffice. They conclude that, introduction of Islamic Finance would bring in the right mix and quantity of

funds required for infrastructure development. Ahangar *et al.* (2013) emphasizes on why the model would be successful in India and states that, because the country is home to the second highest Muslim population in the world, their inclusion can accelerate the economic growth due to higher investments and circulation of money. Unfortunately, they fail to fall under the financial ambit because the practices of conventional financial system do not draw a parallel with their religious principles of prohibition of receiving and charging interest and other ideologies. Hence adoption of the said model would be the best way to bring maximum population in the financial services bracket.

There is literature on the possible challenges that the model would face especially in India. Fasih (2012) describes that there is a huge challenge involved in putting this model to practice because of the following two reasons. Primarily, there is a lack of unanimity among the Shariah scholars and secondarily, it is very tough for the people to switch from a system which is prevalent for centuries. Munuswamy *et al.* (2013) tries to capture India's perception about the model wherein it is found that there lies a significant gap between the Muslim and the non-Muslim population with regard to their awareness, suggestions, and willingness to accept the model and both are generally not aware of the benefits of the model. However, people are ready to invest after knowing the benefits of the model.

From the development of literature, it is evident that Islamic Finance is a model of financing which until recent years was in its inception stage. The area of study has not been explored to its maximum and the practices of Islamic Finance are still alien to many economies and the advantages untapped. In addition, there has been a gap in terms of the study being done in India backed by empirical evidence. The scope of Islamic Finance is far and wide and there are still many unexplored aspects which has not come to light due to lack of awareness and easy availability of data.

3. OBJECTIVES

- To examine the existence of the relation between Practices of Islamic Financing and the Economic Growth of the SAARC nations.
- To evaluate the impact of Practices of Islamic Financing in Economic Growth of the SAARC nations.

3.1 HYPOTHESIS

The primary objective of the study is to determine the existence of relationships and its impact between Islamic Finance and economic growth indicators through Quantitative methods. Therefore, to achieve the objectives, the following Hypothesis are hereby formulated for validation: -

$H_0$1- There is no long term relationship between Islamic Finance Development Indicator and economic growth variables

$H_0$2- There is no impact of Islamic Finance Development indicator on the economic growth variables

4. MATERIALS AND METHODS

For the purpose of the study and to test the hypothesis, quantitative methods were used. The Real Gross Domestic Product (GDP) growth rate and the Gross Fixed Capital Formation (GFCF) growth rate were taken from the data released by the World Bank as proxies for economic growth in the countries adopting Islamic Finance among the SAARC nations. The Islamic Finance Development indicator (IFDI) was used as a proxy for Islamic Finance development in the countries from IBFinancing and Zawya. The GDP is a common yardstick used to compare nations and assess the economic growth as it incorporates all the three approaches of assessing economic growth- the consumption approach, the expenditure approach and the income approach. GDP gives a bird's eye view to assess the economic health of the country and hence the annual time series data of Real GDP growth rate was adopted as one of the proxies of economic growth. Similarly, GFCF growth rate is taken as a measure of economic growth as it assesses the level of investment in a country. The study revolves around the concept of Islamic Finance and by its nature of calculation, measuring the level of business activity and evaluating the new pool of investments is prima facie. Hence for any finance-growth nexus, the aforementioned variables which are quantitative in nature, are used for further introspection to ascertain any future trends or pattern. Since the nature of the study revolves around analyzing the characteristics of the variables, this paper can be classified as a descriptive research.

The annual time series data of IFDI is used as a barometer of the development of Islamic Finance. The index encompasses an overall assessment of the development by assessing countries on the Quantitative development, knowledge, CSR, governance and Awareness of the practices of Islamic Finance and hence is an all-inclusive measure of evaluating Islamic Finance development indicator.

To serve the purpose of the study, the first step is to determine if there exists a long term relationship between the economic growth variables and the Islamic Finance Development variable. To test this relationship between the financial deepening and economic growth, Johansen Co-integration test was used. The test is used to test co-integration relationship between two variables. If the trace statistic value exceeds the critical value or in other words if the probability is equal to or below 0.05, the null hypothesis can be rejected and it should be understood that there exists a long term relationship between the two variables at study.

Further, to test the causality between the variables, Granger Causality test was used. The Granger Causality is a statistical tool that is applied to determine if one-time series data can be used to forecast the other. Through this test both uni-directional and bi-directional relationship can be established. If the probability values are below 0.05 the null hypothesis can be rejected and understood that the independent variable 'Granger causes' the dependent variable.

To conduct the aforementioned tests, EViews 8 software was used. The software helps in various statistical analysis and forecasting of data.

5. ANALYSIS AND FINDINGS

The World Bank, in its report stated that India along with other SAARC nations are set to record the worst growth in 40 years. In this backdrop, it is important to understand various methods, models and strategies that the Governments have to implement to stabilize the economic growth for a sustainable future. Keeping the 'extraordinary' situation of the ongoing pandemic aside, it is important to analyse the models used before that helped in economic growth and try to incorporate the same in a much larger scale

to lessen the adverse effects of the pandemic on the economy. One such system has been the incorporation of Islamic Finance by many countries, the results of which can be understood by the following tests.

A. Descriptive Statistics

Table 1 shows the descriptive statistics of SAARC Nations following Islamic Finance.

Country	Indicators	Mean	Median	Minimum	Maximum	Std Deviation	Skewness	Kurtosis	Observations
AFGHANISTAN	GDP	6.86	3.93	0.43	21.39	6.25	1.08	-1.01	15
	GFCF	19.21	18.96	16.68	26.41	2.53	2.00	-1.01	15
	IFDI	12.97	8.64	4.32	30.01	8.87	0.76	-1.01	15
BANGLADESH	GDP	6.60	6.54	5.05	8.15	0.82	0.16	0.10	15
	GFCF	8.87	9.56	5.37	10.57	1.52	-0.98	0.31	15
	IFDI	18.39	16.54	10.53	32.96	6.67	0.83	-0.01	15
MALDIVES	GDP	5.83	7.27	-13.13	26.11	8.45	-0.09	3.29	15
	GFCF	19.77	13.00	-2.65	151.00	37.19	3.57	13.31	15
	IFDI	21.69	17.25	10.28	37.31	9.03	0.66	-1.07	15
PAKISTAN	GDP	4.09	4.68	0.99	6.52	1.75	-0.47	-1.06	15
	GFCF	3.70	2.58	-12.79	15.77	8.87	-0.34	-0.82	15
	IFDI	32.66	25.55	15.34	58.57	14.82	0.80	-0.79	15
SRI LANKA	GDP	5.51	5.01	2.28	9.15	2.14	0.25	-1.19	15
	GFCF	6.71	5.95	-1.68	16.56	5.65	0.29	-0.62	15
	IFDI	20.39	18.46	15.55	30.65	4.80	1.33	0.67	15

Source: Author Developed

From the above descriptive statistics tables, the characteristics of the data can be determined wherein the measures of central tendency and measures of variability are listed. The data so extracted has largely no outliers and can be further put for testing.

B. Johansen Co- Integration Test

The Johansen Co- integration test helps in establishing whether the data sets are co-integrated and if there exists a long term relationship between them.

5.1 Afghanistan

Table 2: Johansen Co- integration Test for Afghanistan

Series: REAL_GDP ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.77451	20.32241	15.49471	0.0086
At most 1	0.071128	0.959191	3.841466	0.3274
Series: GROSS_FIXED_CAPTIAL_FORM ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.751384	18.24028	15.49471	0.0188
At most 1	0.011191	0.146298	3.841466	0.7021

* denotes rejection of the hypothesis at the 0.05 level ** MacKinnon-Haug-Michelis (1999) p-values

Table 2 shows the Johansen Co- Integration Test for the long term relationship between the economic growth variables and the Islamic Finance growth variable. The trace test would reject the null hypothesis if the trace statistic value is more than the critical value. It can be seen that for both the economic growth variables the trace test value is higher at 20.32241 and 18.24028 to its

critical value of 15.49471 respectively. Thus, the null hypothesis of there being no Co- integration is rejected and hence it can be established that there exists a long term relationship between the economic variables and Islamic finance variables that is GDP & IFDI and GFCF & IFDI.

5.2 Bangladesh

Table 3: Johansen Co-Integration Test for Bangladesh

Series: REAL_GDP ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.648165	17.00035	12.3209	0.0077
At most 1	0.231356	3.420658	4.129906	0.0763
Series: GROSS_FIXED_CAPTIAL_FORM ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.628391	14.75165	12.3209	0.0192
At most 1	0.134829	1.882763	4.129906	0.2001

* denotes rejection of the hypothesis at the 0.05 level ** MacKinnon-Haug-Michelis (1999) p-values

The above table shows the Johansen Co- Integration Test for long term relationship between the economic growth variables and the Islamic Finance growth variable. The trace test would reject the null hypothesis if the trace statistic value is more than the critical value. It can be seen that for both the economic growth variables the trace test value is higher at 17.00035 and 14.75165 to its critical value of 12.3209 respectively. Thus, the null hypothesis of there being no Co- integration is rejected and hence it can be established that there exists a long term relationship between the economic variables and Islamic finance variables that is GDP & IFDI and GFCF & IFDI.

5.3 Maldives

Table 4: Johansen Co- integration Test for Maldives

Series: REAL_GDP ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.585163	12.44773	12.3209	0.0476
At most 1	0.07471	1.009423	4.129906	0.3657
Series: GROSS_FIXED_CAPTIAL_FORM ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.510331	12.99187	12.3209	0.0385
At most 1	0.248248	3.709539	4.129906	0.0642

* denotes rejection of the hypothesis at the 0.05 level ** MacKinnon-Haug-Michelis (1999) p-values

The above Table shows the Johansen Co- Integration Test for long term relationship between the economic growth variables and the Islamic Finance growth variable. The trace test would reject the null hypothesis if the trace statistic value is more than the critical value. It can be seen that for both the economic growth variables the trace test value is higher at 12.44773 and 12.99187 to its critical value of 12.3209 respectively. Even though there is a minor difference between the trace value and critical value, there still exists a co integration as the difference is not material to the study. Thus, the null hypothesis of there being no Co- integration is rejected and hence it can be established that there exists a long term relationship between the economic variables and Islamic finance variables that is GDP & IFDI and GFCF & IFDI.

5.4 Pakistan

Table 5: Johansen Co- integration Test for Pakistan

Series: REAL_GDP ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.657667	13.9921	12.3209	0.026
At most 1	0.004336	0.056489	4.129906	0.8455
Series: GROSS_FIXED_CAPTIAL_FORM ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.835398	25.67477	20.26184	0.0081
At most 1	0.156976	2.219878	9.164546	0.7336

* denotes rejection of the hypothesis at the 0.05 level ** MacKinnon-Haug-Michelis (1999) p-values

Table 5 shows the Johansen Co- Integration Test for the long term relationship between the economic growth variables and the Islamic Finance growth variable. The trace test would reject the null hypothesis if the trace statistic value is more than the critical value. It can be seen that for both the economic growth variables the trace test value is higher at 13.9921 and 25.67477 to its critical value of 12.3209 and 20.26184 respectively. Thus, the null hypothesis of there being no Co- integration is rejected and hence it can be established that there exists a long term relationship between the economic variables and Islamic finance variables that is GDP & IFDI and GFCF & IFDI.

5.5 Sri Lanka

Table 6: Johansen Co- integration Test for Sri Lanka

Series: REAL_GDP ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.77451	20.32241	15.49471	0.0086
At most 1	0.071128	0.959191	3.841466	0.3274
Series: GROSS_FIXED_CAPTIAL_FORM ISLAMIC_FINANCE_DEVELOPMENT				
Lags interval (in first differences): 1 to 1				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.751384	18.24028	15.49471	0.0188
At most 1	0.011191	0.146298	3.841466	0.7021

* denotes rejection of the hypothesis at the 0.05 level ** MacKinnon-Haug-Michelis (1999) p-values

Table 6 shows the Johansen Co- Integration Test for the long term relationship between the economic growth variables and the Islamic Finance growth variable. The trace test would reject the null hypothesis if the trace statistic value is more than the critical value. It can be seen that for both the economic growth variables the trace test value is higher at 20.32241 and 18.24028 to its critical value of 15.49471 respectively. Thus, the null hypothesis of there being no Co- integration is rejected and hence it can be established that there exists a long term relationship between the economic variables and Islamic finance variables that is GDP & IFDI and GFCF & IFDI.

5.6 GRANGER CAUSALITY TEST

The Granger Causality test is undertaken to evaluate if there exists a unidirectional or bidirectional relationship between the data sets.

Table 7: Granger Causality Test for the SAARC Nations

PAIRWISE GRANGER CAUSALITY TESTS			
Null Hypothesis:	Obs	F-Statistic	Prob.
AFGHANISTAN			
A_IFDI does not Granger Cause A_GDP	14	8.28136	0.015
A_GDP does not Granger Cause A_IFDI		0.92981	0.3556
A_IFDI does not Granger Cause A_GFCF	14	7.13672	0.0217
A_GFCF does not Granger Cause A_IFDI		0.96213	0.3477
BANGLADESH			
B_IFDI does not Granger Cause B_GDP	14	5.31378	0.0417
B_GDP does not Granger Cause B_IFDI		2.25468	0.1614
B_IFDI does not Granger Cause B_GFCF	14	5.49879	0.0388
B_GFCF does not Granger Cause B_IFDI		0.89415	0.3647
MALDIVES			
M_IFDI does not Granger Cause M_GDP	11	29.6985	0.0328
M_GDP does not Granger Cause M_IFDI		0.77945	0.6289
M_IFDI does not Granger Cause M-GFCF	11	20.0672	0.048
M-GFCF does not Granger Cause M_IFDI		0.75137	0.6395
PAKISTAN			
P_IFDI does not Granger Cause P_GDP	11	41.8532	0.0235
P_GDP does not Granger Cause P_IFDI		0.80712	0.6187
P_IFDI does not Granger Cause P_GFCF	11	38.2217	0.0257
P_GFCF does not Granger Cause P_IFDI		0.93236	0.5763
SRI LANKA			
S_IFDI does not Granger Cause S_GDP	14	5.43749	0.0397
S_GDP does not Granger Cause S_IFDI		0.46222	0.5106
S_IFDI does not Granger Cause S_GFCF	14	5.82565	0.0344
S_GFCF does not Granger Cause S_IFDI		0.5153	0.4878

Afghanistan- It can be observed from the above table that there exists a causal relationship between the economic variables and the Islamic development indicator. With the probability at 0.015 which is at 5% significance level, there exists a uni-directional relationship between GDP and IFDI. Since the probability stands at 0.0217 at 5% significance level, it can be inferred that the variables GDP and IFDI are positively related to each other. Hence, the null hypothesis can be rejected and it can be established that there exists a uni-directional relationship between the economic variables an Islamic development indicator. The probability values evaluated by Granger Causality Tests under the null hypothesis of non-causality is presented in Table 7.

Bangladesh- It can be observed from the above table that there exists a causal relationship between the economic variables and the Islamic development indicator. With the probability at 0.0417 which is at 5% significance level, there exists a uni-directional relationship between GDP and IFDI. Since the probability stands at 0.0388 at 5% significance level, it can be inferred that the variables GDP and IFDI are positively related to each other. Hence, the null hypothesis can be rejected and it can be established that there exists a uni-directional relationship between the economic variables an Islamic development indicator. The probability values evaluated by Granger Causality Tests under the null hypothesis of non-causality is presented in Table 7.

Maldives- It can be observed from the above table that there exists a causal relationship between the economic variables and the Islamic development indicator. With the probability at 0.0328 which is at 5% significance level, there exists a uni-directional relationship between GDP and IFDI. Since the probability stands at 0.048 at 5% significance level, it can be inferred that the variables GDP and IFDI are positively related to each other. Hence, the null hypothesis can be rejected and it can be established

that there exists a uni-directional relationship between the economic variables an Islamic development indicator. The probability values evaluated by Granger Causality Tests under the null hypothesis of non-causality is presented in Table 7.

Pakistan- It can be observed from the table that there exists a causal relationship between the economic variables and the Islamic development indicator. With the probability at 0.0235 which is at 5% significance level, there exists a uni-directional relationship between GDP and IFDI. Since the probability stands at 0.0257 at 5% significance level, it can be inferred that the variables GDP and IFDI are positively related to each other. Hence, the null hypothesis can be rejected and it can be established that there exists a uni-directional relationship between the economic variables an Islamic development indicator. The probability values evaluated by Granger Causality Tests under the null hypothesis of non-causality is presented in Table 7.

Sri Lanka- It can be observed from the table that there exists a causal relationship between the economic variables and the Islamic development indicator. With the probability at 0.0397 which is at 5% significance level, there exists a uni-directional relationship between GDP and IFDI. Since the probability stands at 0.0344 at 5% significance level, it can be inferred that the variables GDP and IFDI are positively related to each other. Hence, the null hypothesis can be rejected and it can be established that there exists a uni-directional relationship between the economic variables an Islamic development indicator. The probability values evaluated by Granger Causality Tests under the null hypothesis of non-causality is presented in Table 7.

6. RECOMMENDATION AND SUGGESTIONS

If the practices of Islamic Finance are put under the scanner, it can be understood that, "Islamic finance theory promotes economic development in three main ways: its direct link to the real economy and physical transactions, its prohibitions against harmful products and activities, and its promotion of economic and social justice" (Tabash and Dhankar, 2018). The practices of Islamic Finance can be used as a measure of not only attaining financial inclusivity but also curbing prohibited activities, speculation and equally distributing profits or losses. The adoption of such practices can lead to the upliftment of those not falling under the financial ambit by achieving financial inclusivity and also by its very nature of risk sharing and interest free loans, the borrower alone does not have to bear all the risk alone. This boosts the confidence of the borrower in the system by curtailing any exploitation against the borrower. In addition, with the help of the practices of Islamic Finance, the growing NPAs can witness a deceleration and improve the state of banking in any country. Hence the adoption of the practices of Islamic finance can pose a panacea for the problems faced by countries across the world.

"When India is witnessing a large number of farmer suicides, interest-free solutions offered by Islamic Banking may bring in hopes to the marginalised groups" (Beg and Mullick, 2016). India can significantly combat the problem of farmer suicides due to non-repayment of loans instead of loan wavering that negatively impacts the economy and worsens the economic health of the country. In addition, tapping the Muslim community of the country which is home to the second highest Muslim population in the world, increases the prospects of faster economic growth, poverty alleviation and attracting investments from many Gulf countries. In a report of the Committee on Financial Sector Reforms, released by the Planning Commission of India (2005), made the following recommendations, "Another area that falls broadly in the ambit of financial infrastructure for inclusion is the provision of interest-free banking. The non-availability of interest-free banking products results in some Indians, including those in the economically disadvantaged strata of society, not being able to access banking products and services due to reasons of faith. This non-availability also denies India access to substantial sources of savings from other countries in the region".

Although the NBFCs and other cooperatives strive to provide interest-free banking to some extent, measures have to be adopted to make the interest-free model penetrate the financial system on a wider scale. The measure of interest-free banking without any adverse systemic risk impact can be incorporated by following the practices of Islamic Finance and hence it will benefit India in the long run.

The tests result of the impact between the Islamic Finance Development indicator and the economic growth variables in India's neighboring countries show a positive relationship between the two. India having similar demographics to some extent, can expect a similar trend if the practices of Islamic Finance is adopted in the country. In addition, by adopting the practices, India will have higher prospects of attracting foreign investments from Gulf Countries which compulsorily follows the Islamic Finance model of banking and finance increasing the multiplier effect and thereby boosting economic growth.

Hence, enjoying the benefits of this untapped model of financing in the country would reap a lot of benefits if seen as a measure to boost economic growth minus the religious roots that the model conceives to have. By changing the nomenclature, spreading the word and building necessary infrastructure, the challenges in adoption of the practices can be resolved. Hence, this study through its empirical tests can recommend that India should adopt the practices of Islamic Finance as it is a measure to boost economic growth.

7. CONCLUSION

This paper makes an attempt to determine whether there exists a relationship between Islamic Financial Indicator and the proxies of economic growth in the long run in the SAARC Nations and evaluate the extent of the relationship between the two. The paper empirically analysed both the quantities and thus proved that there is a long term relationship through the Johansen's Co- Integration Test. This test helps in establishing that the two data sets have a long term relationship between GDP & IFDI and GFCF & IFDI which is true for the tests conducted for all the 5 countries taken for the test. Furthermore, the paper also proves that there is a unidirectional relationship between the IFDI and Economic growth variables in the countries taken for the study which means that when Islamic Finance Development indicator increases, the economic growth variables also rise. But on the contrary, the study could not prove a bi-directional relationship between the variables which means that a growth in the economy may or may not lead to an increase in the IFDI growth rate. It also states that with the improvement in Islamic Finance there is higher capital investments by the producers in the overall economy which is a welcoming factor in developing countries. The study moves ahead in suggesting the adoption of the practices of Islamic finance in the Indian Subcontinent where Financial Inclusion and NPAs are still a challenge. If these principles are put into practice effectively, the Indian Financial Health will dramatically improve and at the same time stabilize to a greater extent.

In addition, by adopting the practices, India will have higher prospects of attracting foreign investments from Gulf Countries which compulsorily follows the Islamic Finance model of banking and finance increasing the multiplier effect and thereby boosting

economic growth. In the initial stage of adoption, the model can be first implemented in a state in the country and tested for its scope and feasibility in the country.

Therefore, the benefits of this untapped model of financing must be utilised and experienced to achieve economic growth and attract capital investments from the neighbouring countries that follow the Islamic Finance model for example, the Gulf countries. By changing the nomenclature, spreading the word and building necessary infrastructure, regulations and governance, the challenges in adoption of the practices can be resolved. Hence, this study through its empirical tests recommends that India should adopt the practices of Islamic Finance as it is a measure to boost economic growth, Capital Investment and Financial Inclusion.

REFERENCES

1) Ahangar, G.B., Padder, M.U. and Ganie, A.H., 2013. Islamic banking and its scope in India. *IRACST–International Journal of Commerce, Business and Management*, *2*(5), pp.2319-2828.
2) Baber, H., 2018. How crisis-proof is Islamic finance? Qualitative Research in Financial Markets.
3) Baber, H., 2019. Financial inclusion and FinTech: A comparative study of countries following Islamic finance and conventional finance. *Qualitative Research in Financial Markets*.
4) Beg, S.A.N.A. and Mullick, N.H., 2016. Increasing financial inclusion through Islamic banking in India. *International Journal of Business Management & Research*, *6*(1), pp.27-34.
5) Dhankar, R.S., 2019. *Risk-Return Relationship and Portfolio Management*. Springer India.
6) Fasih, F., 2012. Inclusive growth in India through Islamic banking. *Procedia-Social and Behavioral Sciences*, *37*, pp.97-110.
7) Fernando, S. and Nizar, M., 2018. SAARC nations need compromise, shared vision.
8) Government of India 2007, *A Hundred Small Steps Report of the Committee on Financial Sector Reforms*, SAGE Publications India Pvt Ltd, https://faculty.iima.ac.in/~jrvarma/reports/Raghuram-Rajan/cfsr_all.pdf
9) Hesse, H., Jobst, A. and Solé, J., 2008. Trends and challenges in Islamic finance.
10) Iqbal, M.J., 2006. SAARC: origin, growth, potential and achievements. Pakistan Journal of History and Culture, 27(2), pp.127-140.
11) Lawal, I.M. and Imam, U.B., 2016. Islamic Finance and Economic Growth: Empirical Evidence from Nigeria. *Journal of Economics and Sustainable Development*, *7*(16).
12) Majeethia, Y. and Bose, T., 2014. Islamic Financial Instruments an Opportunity for Financing Infrastructure in India. *Journal of Business Management & Social Sciences Research*, *3*(5).
13) Majid, M.S.A. and Kassim, S.H., 2015. Assessing the contribution of Islamic finance to economic growth. *Journal of Islamic Accounting and Business Research*.
14) Mirakhor, A. and Iqbal, Z., 2012. Financial inclusion: Islamic finance perspective.
15) Munuswamy, S., Soundararajan, G. and Ramasamy, R., 2013. Islamic Finance in India: A study on the perception of College Teachers in Chennai. *Journal of Islamic Economics, Banking and Finance*, *113*(915), pp.1-18.
16) NAZ, S.A. and GULZAR, S., 2020. Impact of Islamic finance on economic growth: An empirical analysis of Muslim countries. *The Singapore Economic Review*, pp.1-21.
17) Sarker, M.N.I., Khatun, M.N. and Alam, G.M., 2019. Islamic banking and finance: potential approach for economic sustainability in China. *Journal of Islamic Marketing*.
18) Shinkafi, A.A., Yahaya, S. and Sani, T.A., 2019. Realising financial inclusion in Islamic finance. *Journal of Islamic Marketing*.
19) Siddiqui, T., Naushad, M. and Farooque, M., 2021. A study on Islamic finance as an approach for financial inclusion in India. *Accounting*, *7*(2), pp.487-496.
20) Yusof, R.M. and Bahlous, M., 2013. Islamic banking and economic growth in GCC & East Asia countries: A panel cointegration analysis. *Journal of Islamic Accounting and Business Research*.
21) Zulkhibri, M., 2016. Financial inclusion, financial inclusion policy and Islamic finance. *Macroeconomics and Finance in Emerging Market Economies*, *9*(3), pp.303-320.