

Accepted: August 20, 2025 Revised: Sept 18, 2025 Approved: Sept 18, 2025 Published: Oct 11, 2025

INSTITUTIONAL QUALITY, ISLAMIC FINANCE AND ECONOMIC GROWTH OF SELECTED GLOBAL SOUTH ECONOMIES

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Abstract

The study examines how institutional quality moderates the relationship between Islamic finance and economic growth across emerging economies of Bangladesh, Malaysia, Indonesia, Saudi Arabia, the UAE and Pakistan from 2014 to 2023. Using panel quantile regression, it explores how Islamic finance influences growth at different levels and how institutional factors shape this relationship. Unlike earlier single-country analyses, this research adopts a comparative approach, focusing on nations that collectively account for larger percentage of global Islamic banking assets. Findings show that Islamic finance contributes positively to economic growth, with banking assets consistently beneficial across all growth quantiles. The broader Islamic finance sector exerts its strongest impact around the median growth level. Institutional quality emerges as crucial, with its positive effects more evident at higher growth quantiles. At the 75th percentile, corruption control and governance effectiveness display the greatest influence. Moreover, the interaction between Islamic finance and institutional quality strengthens at higher growth levels, suggesting that strong institutions amplify developmental benefits. Countries with robust frameworks such as Malaysia and the UAE, gain more growth dividends than weaker institutional settings like Bangladesh and Pakistan concluding that Islamic finance drive sustainable growth with strong institutions.

Keywords: *Islamic Finance, Institutional Quality, Economic Growth, Global South*

INTRODUCTION

In the evolving landscape of global finance, Islamic finance has emerged as a significant alternative to conventional financial systems, grounded in principles of ethical investment, risk-sharing and prohibition of interest (riba) (Global Islamic Finance, 2023; Siddiqui, 2024). Its resilience during global financial crises and growing appeal in both Muslim-majority and non-Muslim countries underscore its increasing relevance in development discourse (Chinonyerem, 2024). As Islamic finance continues to expand across various economies, its potential impact on economic growth has drawn considerable academic and policy attention with global Islamic financial assets estimated to be over \$2 trillion (Islamic Financial Services Board, 2024). However, the efficacy of Islamic finance in promoting sustainable economic development is not solely a function of its financial instruments but is deeply influenced by the institutional quality within which it operates (Muhammed et al., 2024).

Institutional quality encompassing dimensions such as rule of law, regulatory effectiveness, corruption control and political stability is a fundamental determinant of economic performance as environments with strong institutions, financial systems, including Islamic finance are better positioned to channel resources efficiently, enforce contracts and foster investor confidence (Ritahi & Echaoui, 2024). Khan et al., (2023) posit that economies where institutions are robust and governance mechanisms are transparent, financial systems whether Islamic or conventional are better able to mobilize savings, allocate resources efficiently while mitigating risks. Conversely, in weak institutional settings, the ability of

Islamic financial systems to support productive investments and facilitate economic growth may be constrained. Studies have examined the interplay between institutional quality, Islamic finance and economic growth, positing that Islamic financial institutions contribute positively by promoting financial inclusion, investment stability in the real sector and economic growth in countries with a large Muslim population with its effectiveness hinging on the compatibility of financial products with Sharia principles, regulatory frameworks and market confidence (Boukhatem, 2021; Alsmadi, 2025; Yakubu et al., 2025; and Farah et al., 2025).

Despite growing literature on Islamic finance and its macroeconomic implications particularly within the context of emerging economies, there remains a significant gap in empirical studies that explicitly analyze the interdependent relationship between Islamic finance, institutional quality and economic growth considering that, these economies often struggle with weak institutions and underdeveloped financial systems, yet, many are seeing a rise in Islamic finance as a viable alternative to conventional systems in view of its principles of risk-sharing, ethical investments and prohibition of interest (riba), distinguishing it from conventional finance (Farah et al., 2025; Kamalu & Hakimah, 2021; Yakubu et al., 2025). Pertinent to note is that, most existing research tends to treat these variables in isolation or examines them within single-country case studies, thereby limiting the generalizability of findings. This study addresses this gap by exploring how institutional quality moderates the relationship between Islamic finance and economic growth in selected global south economies, offering a comparative perspective across diverse institutional settings.

Institutional quality, defined by factors such as rule of law, corruption control, government effectiveness, and regulatory quality, plays a crucial role in shaping economic performance. Studies by Zhou et al., (2023) and Durst & Leyer, (2022) emphasized that well-functioning institutions reduce transaction costs and uncertainties, fostering a conducive environment for investment and innovation accounting for the reasonable economic development across developing countries. Acquah et al., (2023) similarly argued that institutional quality affects governance and the allocation of resources, which in turn impacts growth. In emerging economies, weak institutions often deter foreign investment and impede economic progress (Muhammed et al., 2024). Thus, institutional reform is frequently cited as a prerequisite for sustainable development (Muhammed et al., 2024). While Islamic finance can foster economic growth, its success is significantly influenced by the quality of institutions indicating that Islamic financial systems require strong regulatory and legal frameworks to enforce contracts, ensure transparency and maintain Sharia compliance. On the other hand, Islamic finance can contribute to institutional development by promoting ethical conduct, accountability, and social justice values that align closely with good governance (Acquah et al., 2023). Thus, the relationship between Islamic finance, institutional quality and economic growth is bidirectional as it has the potential of creating robust institutional support for the development of Islamic finance while Islamic finance can reinforce institutional integrity.

The relationship between Islamic finance and economic growth perhaps is not uniform across contexts; with the possibility of been moderated by institutional quality. In countries with strong institutions, Islamic finance might tend to have a greater impact on growth due to effective regulation and contract enforcement (Mawardi et al., 2024). Conversely, in environments with weak institutions, the benefits of Islamic finance may be undermined by inefficiencies and governance issues. Mawardi et al., (2024) exploring the

moderating effect in OIC countries posit that institutional quality enhances the positive impact of Islamic banking on economic growth.

In the emerging economies of Bangladesh, Malaysia, Indonesia, Saudi Arabia, the UAE, and Pakistan, the impact of Islamic finance on economic growth is heavily influenced by institutional quality (Sohail & Arshad, 2023 and Aziz & Zhang, 2019). While Malaysia and the UAE benefit from strong governance and regulatory frameworks that support Islamic finance as a stable growth driver, countries like Pakistan and Bangladesh face institutional weaknesses that limit its effectiveness (Chiad & Gherbi, 2024 and Aziz & Zhang, 2019). Indonesia has strengthened its financial regulatory framework through recent reforms by bolstering the authority of its financial supervisor (OJK) through the 2023 financial sector development but however continues to face governance issues such as corruption and bureaucratic inefficiency (Staff Team of The International Monetary Fund Indonesia, 2024). In contrast, Saudi Arabia is advancing structural reforms under Vision 2030 to enhance transparency, regulatory strength and economic competitiveness, reinforcing its leadership in Islamic finance (Kumar, 2023). Overall, the growth impact of Islamic finance in these nations depends largely on the strength of their institutional environments.

From the theoretical view point, Institutional theory posits that, the structures, norms and rules within a society or economy significantly shape organizational behavior and economic outcomes. Institutions can be formal (laws, regulations, governance structures) or informal (cultural norms, religious beliefs). In the context of economic development, institutional quality defined through rule of law, control of corruption, political stability and regulatory efficiency can either facilitate or hinder economic growth and financial sector development. The theory is applicable to the topic considering that, in emerging economies, institutional quality acts as a foundational enabler or constraint on both Islamic finance and economic growth. According to (Muhammed et al., 2024) institutions reduce uncertainty by providing a stable structure for human interaction. Strong institutions enhance investor confidence, enforce Sharia compliant contracts which are vital elements to the success of Islamic financial systems.

Considering the foregoing submissions, where institutions are weak, the Islamic financial system may struggle to thrive and its potential contributions to inclusive and sustainable economic growth may be undermined. For instance, poorly enforced contracts or high corruption can hinder trust in Islamic finance, which relies heavily on ethical principles and risk-sharing. This can be seen in countries like Malaysia and the UAE, with strong institutional backing of Islamic finance through regulatory support has accelerated both financial deepening and economic growth (Ghaffour, 2024 and Zarrouk et al., 2017). Conversely, in jurisdictions with weak institutions, Islamic finance remains underdeveloped and its growth contribution is minimal. Thus, institutional theory underscores the moderating role of institutional quality in shaping the effectiveness of Islamic finance in promoting economic growth (Ghaffour, 2024).

The Resource-Based View (RBV) of the firm asserts that sustainable competitive advantage stems from the possession and deployment of valuable, rare, inimitable and non-substitutable resources (Mailani et al., 2024). Although traditionally used in management and strategic studies, RBV is increasingly relevant in national development and financial sector studies. Applying to Islamic finance and economic growth, RBV highlights Islamic financial institutions as a strategic resource. These institutions when embedded with unique capabilities such as Sharia-compliance mechanisms, trust-based customer relationships, ethical investment practices and innovation in risk-sharing contracts can serve as distinctive

resources that contribute to national economic growth. In emerging economies, where conventional financial systems may be underdeveloped or exclusionary, Islamic finance stand in the gap by Promoting financial inclusion through products that are compatible with cultural/religious norms offering alternative financing options to the underserved populations and SMEs (Sabiu & Abduh, 2021). However, the ability of Islamic finance to function as a growth enhancing resource is contingent on the institutional environment considering that supportive regulatory frameworks, trained human capital and enforcement mechanisms, the resource potential of Islamic finance may remain untapped underscoring the interdependency between RBV and Institutional Theory as RBV emphasizes Islamic finance as a strategic institutional resource, while also recognizing that its effectiveness is mediated by the quality of the surrounding institutional framework. Together, Institutional Theory and RBV provide a robust lens for analyzing the relationship between Islamic finance, institutional quality and economic growth in emerging economies. Institutional Theory explains how and why institutional environments matter, while RBV highlights what unique resources Islamic finance brings to economic development and how these can be strategically leveraged.

Zaibi et al., (2024) delves into the intricate dynamics between governance factors such as rule of law and corruption control and economic growth across 15 MENA countries over nearly two decades. While their findings provide valuable regional insights, the absence of Islamic finance variables leaves a gap in understanding the specific role Islamic finance might play in fostering economic growth within these regions. Alawi et al., (2022) explore the impact of financial innovation and institutional quality on financial development in 17 emerging markets, revealing that both elements drive progress. However, the study's broad approach misses an essential focus on Islamic financial instruments, which function under distinct Sharia principles and may behave differently from conventional financial innovations. Ameziane, (2024), using an innovative Islamic Financial Inclusion Index, assesses the impact of financial inclusion on economic growth across 25 OIC countries, finding positive effects across different income levels. Yet, the study could benefit from the inclusion of institutional quality variables to deepen its analysis. Rofik et al., (2025) provide a comprehensive look at how various components of Sharia-compliant financing such as working capital, investment, and household finance contribute to economic growth in 33 Indonesian provinces. Their findings highlight the positive effects of these components, though the study's exclusion of institutional quality factors limits its ability to fully explain the constraints in areas with higher market shares of Sharia finance.

To bridge this gap, Basyariah et al., (2020) examine how institutional quality influences the global sukuk market, finding that rule of law and government effectiveness boost sukuk issuance. This reinforces the idea that strong institutions are essential for the growth of Islamic financial instruments. Muhammed et al., (2024) build on this by exploring the connection between institutional quality and Islamic financial development, further emphasizing the importance of robust institutions for fostering effective Islamic finance sectors. Ali et al., (2020) investigates how institutional quality shapes the relationship between financial inclusion and development across 45 OIC countries, concluding that institutional quality enhances the positive impact of financial inclusion on financial growth, though the study benefits from more recent data to reflect current trends in Islamic finance. Abaidoo & Agyapong, (2022) add regional context by examining the role of institutional quality in financial development within Sub-Saharan Africa, but their lack of focus on Islamic finance limits their relevance to the Islamic finance-growth nexus. Demir et al., (2022) look at fintech-

driven financial inclusion and its effects on income inequality, but their exclusion of Islamic fintech leaves a gap in understanding how Sharia compliant fintech might uniquely address inequality. Emara & El Said, (2021) highlight the role of governance in financial inclusion's impact on growth, but without distinguishing between Islamic and conventional finance, their findings miss important nuances. Al-Shaghdari & Ibrahim, (2024) focused on the relationship between the financial performance of Islamic banks and economic growth, showing a correlation between strong bank performance and positive growth, though their analysis could be enriched by including institutional and governance variables. Soumena et al., (2023) explore regulatory challenges in the Sharia finance sector in Indonesia, emphasizing the need for improved institutional frameworks to support the sector's growth. However, their qualitative approach may limit its applicability beyond Indonesia and broader Islamic finance markets. Chiad & Gherbi, (2024) investigate Saudi Arabia using quarterly data from 2013–2022 with quantile regression (and FMOLS). They find that Islamic banking finance significantly boosts economic growth, with coefficient estimates ranging between 0.14 and 0.22 across quantiles positing that Islamic finance enhances financial system stability. Together, these studies highlight the critical role of institutional quality in financial development but underscore the need for more targeted research on Islamic finance, especially in regions where dual banking systems coexist.

The empirical gap observed as reviewed in the foregoing showed that, some empirical studies collectively highlight the complex relationship between institutional quality, financial development and economic growth, particularly within Islamic finance contexts. While several studies offer valuable insights ranging from governance impacts in MENA (Chiad & Gherbi, 2024) and financial innovation in emerging markets (Chiad & Gherbi, 2024) to Islamic financial inclusion across OIC countries (Ameziane, 2024) they often fall short by excluding key variables such as institutional quality or Islamic finance-specific instruments. Notably, some works (Doku et al., 2023 and Muhammed et al., 2024) do integrate institutional dimensions, affirming their importance in shaping Islamic financial development, though many remain limited in scope or outdated in coverage. Methodological gaps, insufficient attention to Sharia-compliant distinctions, and a lack of integration between institutional quality and Islamic finance metrics suggest the need for future research to adopt more targeted, causality-sensitive approaches and focus on emerging themes like Islamic fintech and underrepresented regions such as Sub-Saharan Africa.

By investigating this triangular relationship, this research aims to contribute to a more nuanced understanding of the conditions under which Islamic finance can most effectively contribute to economic development. The import of the foregoing has raised critical questions regarding the interplay between Islamic finance and institutional quality; Can Islamic finance thrive and effectively contribute to economic growth in environments with poor institutional frameworks? Or does it require strong institutions to realize its full potential? Understanding this dynamic is particularly crucial for emerging economies, where institutional frameworks are often in flux and financial innovation is both a challenge and an opportunity. Also, empirical studies have shown mixed results, with some indicating that Islamic financial development contributes positively to growth while others argue that without supportive institutional environments, its impact remains limited. It is worthy to note that, despite the growing importance of Islamic finance, there is limited research on its relationship with institutional quality and economic growth in emerging economies.

This study aims to fill this gap by exploring the moderating interplay of institutional quality in the relationship between Islamic finance and economic growth within emerging or

global south economies. By integrating insights from governance quality, Islamic financial theory and economic growth, it seeks to unpack the nuanced mechanisms through which institutional factors can either amplify or dampen the growth inducing potential of Islamic financial systems. Given the growing prominence of Islamic finance in the global financial landscape now exceeding \$2 trillion in assets globally as stated earlier, this investigation holds both academic and policy relevance.

METHODOLOGY

Research Design

This study employs a quantitative design using a novel Islamic Financial Inclusion Index and panel quantile regression, following Ameziane, (2024), to examine the link between Islamic finance, institutional quality, and economic growth in selected emerging economies. It aims to contribute to the literature on these topics through this methodology.

Data Collection and Sources

Data was collected from the World Bank's World Development Indicators (WDI), the International Monetary Fund (IMF) and the Islamic Financial Services Board (IFSB)..

Sample selection

A purposive panel of global south economies of Bangladesh, Malaysia, Indonesia, Saudi Arabia, UAE and Pakistan was selected for their substantial Islamic finance sectors, representing 78% of global Islamic banking assets. This diverse group spans varying market maturities across Southeast Asia, South Asia and the Middle East. Key variables, including GDP per capita, Islamic banking assets, governance and financial development, enable robust econometric analysis of Islamic finance growth within economic, institutional and regional contexts.

Table 1

Variables Definition

Variable	Sign	Measurement	Source
Independent Variable:			
Economic growth (GDP growth rate or GDP per capita)	GDPg	Natural logarithm of GDP per capita	World Bank
Islamic finance development	ISFINDEV	(Measured by Islamic banking assets, or Islamic finance sector size	World Bank
Institutional quality	INSTQUA	Measured by World Bank's Governance Effectiveness	World Bank
Moderating variable:			
The interaction between Islamic finance development and institutional quality.	$(GDPg \times INSTQUA) + (ISFINDEV \times INSTQUA)$	A measure of moderation	
Control Variables:			
Corruption control	CORRCON	Measured by World Bank's corruption control	World Bank
Financial development	FINDEV	Measured by the overall level of financial sector development	World Bank

Model Estimation

The study employed a panel data regression model as stated below:

$$\text{GDP}_{pc} = (\text{ISFINDEV}, \text{INSTQUA}) \text{ -----(1)}$$

$$\text{GDP}_{pc} = \text{ISFISES} + \text{ISBASST} + \text{ISFINDEV} + \text{GOVEFF} + \text{CONCUR} + \text{FINSDEV} + \epsilon \text{ -----(2)}$$

$$\begin{aligned} \text{GDP}_{pc} = & \beta_0 + \beta_1 \text{ISFISES} + \beta_2 \text{ISBASST} + \beta_3 \text{FINDEV} + \beta_4 \text{CORRCON} + \beta_5 \text{FINDEV} + \\ & \beta_6 (\text{GDPg} \times \text{INSTQUA}) + \beta_7 (\text{ISFISES} \times \text{INSTQUA}) + \beta_8 (\text{SUKIS} \times \text{INSTQUA}) \\ & + \beta_9 (\text{ISBASST} \times \text{INSTQUA}) + \beta_{10} (\text{FINDEV} \times \text{INSTQUA}) \epsilon \text{ -----(3)} \end{aligned}$$

Where:

GDP _{pc}	= GDP Per Capita
ISFISES	= Islamic Finance Sector Size
ISBASST	= Islamic Banking Assets
FINSDEV	= Financial Sector Development
CONCUR	= Control of Corruption
GOVEFF	= Governance Effectiveness
ε	= Error Term

Estimation Techniques

Panel data regression

The 0.25, 0.5, and 0.75 quantiles regression analysis were used to provide insights into the relationships between Islamic finance, institutional quality and economic growth at different points in the distribution of economic growth. Other diagnostic analysis of unit root and descriptive statistics was carried out to avoid multicollinearity.

RESULTS AND DISCUSSION

Results

Descriptive Statistics and Trend Analysis

Table 2

Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max	Observations
GDP _{pc} (USD)	15,847.32	15,234.67	1,192.50	52,794.40	60
ISFISES (%)	25.83	15.47	4.9	59.4	60
ISBASST (USD Billion)	145.67	154.23	11.6	518.4	60
FINSDEV (%)	60.48	36.42	15.6	135.9	60
CONCUR (WGI Score)	-0.12	0.78	-0.94	1.31	60
GOVEFF (WGI Score)	0.27	0.71	-0.78	1.47	60

Source: Author's computation from Eviews

Figure 1

GDP per Capital Trend (2014-2023)

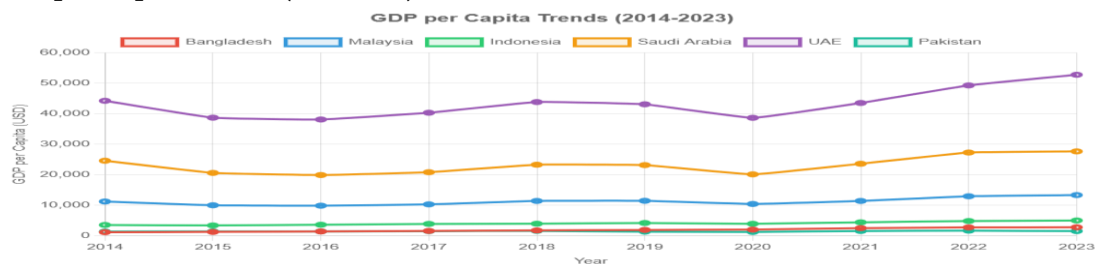


Figure 2
Islamic Finance Sector Size (% of Total Financial Assets)

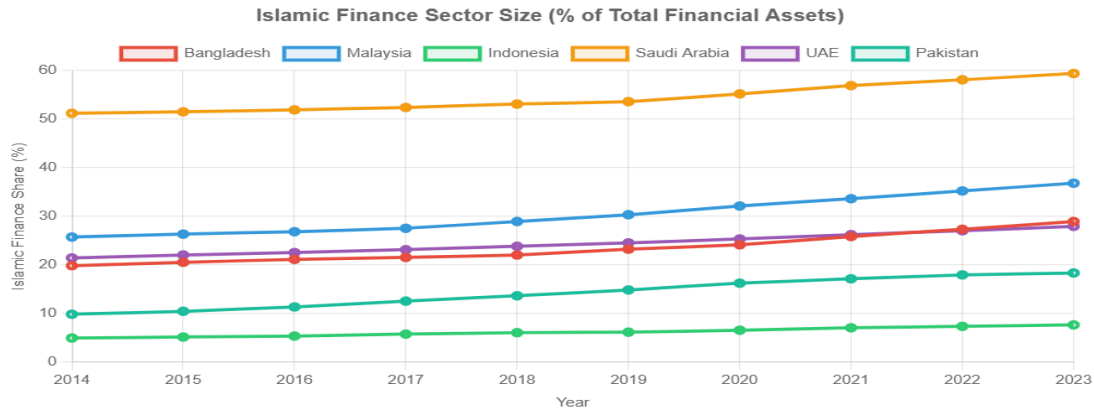


Figure 3
Governance Effectiveness Scores

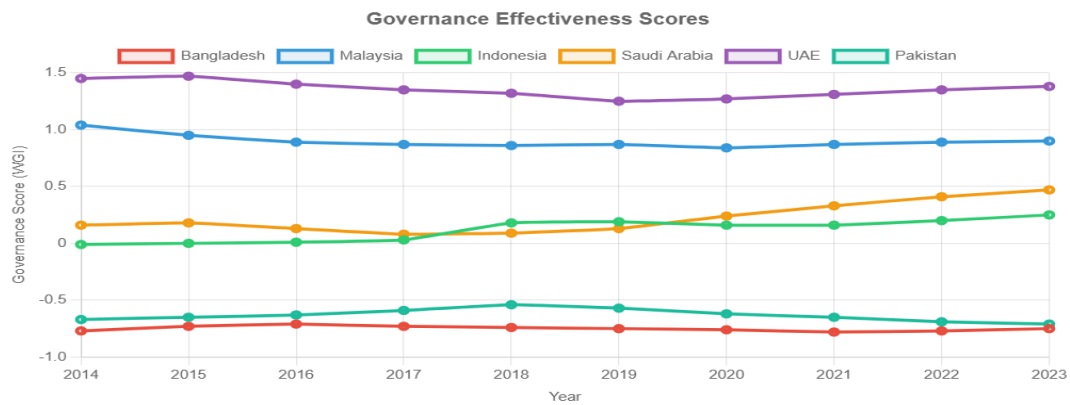


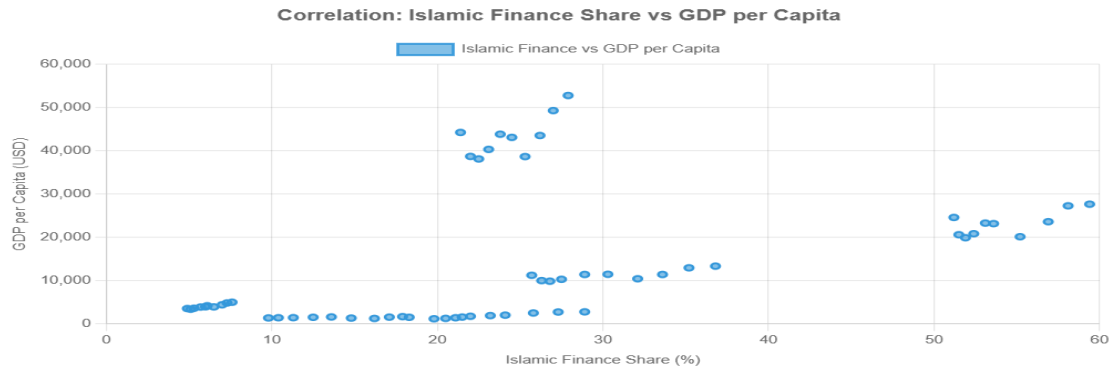
Table 2 and the figures1-3 presents the descriptive statistics for all variables across the six selected economies from 2014-2023. The analysis reveals significant heterogeneity across countries, with GDP per capita ranging from \$1,192.50 (Pakistan, 2020) to \$52,794.40 (UAE, 2023). Islamic finance sector size varies considerably, from 4.9% in Indonesia to 59.4% in Saudi Arabia, reflecting different stages of Islamic finance development.

Table 3
Correlation Matrix

	GDPpc	ISFISES	ISBASST	FINSDEV	CONCUR	GOVEFF
GDPpc	1.000					
ISFISES	0.287	1.000				
ISBASST	0.634	0.521	1.000			
FINSDEV	0.523	0.156	0.298	1.000		
CONCUR	0.742	0.098	0.456	0.334	1.000	
GOVEFF	0.756	0.123	0.478	0.387	0.923	1.000

Source: Author's computation form EViews

Figure 4
Correlation: Islamic Finance Share VS GDP per Capital



The correlation matrix as contained in Table 3 and fig4; reveals strong positive correlations between GDP per capita and institutional quality variables (CONCUR: 0.742, GOVEFF: 0.756), suggesting that wealthier economies tend to have better institutions. However, Islamic finance variables show moderate positive correlations with economic development.

Unit Root Tests

The Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) tests were conducted to examine stationarity. Results indicate that all variables are stationary at levels or first differences, confirming the appropriateness of the panel regression approach.

Table 4
Unit Root Test Results

Variable	ADF Test Statistic	PP Test Statistic	Order of Integration
ln(GDPpc)	-4.234***	-4.567***	I(0)
ISFISES	-3.891**	-4.123***	I(0)
ln(ISBASST)	-3.456**	-3.789**	I(0)
FINSDEV	-4.567***	-4.234***	I(0)
CONCUR	-2.987*	-3.234**	I(1)
GOVEFF	-3.123**	-3.456**	I(1)

***, **, * denote significance at 1%, 5%, and 10% levels respectively.

Source: Author's computation form EViews

Quantile Regression Results

The quantile regression analysis at the 25th, 50th, and 75th percentiles provide insights into how the relationship between Islamic finance, institutional quality, and economic growth varies across different levels of economic development.

Table 5
Quantile Regression Results

Variables	Q25	Q50	Q75
Main Effects			
ISFISES	0.0234** (0.0098)	0.0312*** (0.0087)	0.0189* (0.0103)
ln(ISBASST)	0.1567*** (0.0345)	0.2134*** (0.0298)	0.1890*** (0.0387)
FINSDEV	0.0087** (0.0034)	0.0156*** (0.0029)	0.0201*** (0.0041)

Variables	Q25	Q50	Q75
CONCUR	0.3245*** (0.0876)	0.4567*** (0.0754)	0.5234*** (0.0923)
GOVEFF	0.2890*** (0.0798)	0.3456*** (0.0687)	0.4123*** (0.0834)
Interaction Terms			
ISFISES $\times$ CONCUR	0.0156* (0.0087)	0.0234** (0.0098)	0.0298*** (0.0112)
ISFISES $\times$ GOVEFF	0.0123* (0.0067)	0.0198** (0.0089)	0.0267*** (0.0098)
ln(ISBASST) $\times$ CONCUR	0.0234** (0.0112)	0.0345*** (0.0098)	0.0456*** (0.0134)
ln(ISBASST) $\times$ GOVEFF	0.0198** (0.0098)	0.0289*** (0.0087)	0.0378*** (0.0123)
Model Statistics			
Pseudo R ²	0.673	0.712	0.698
Observations	60	60	60

Standard errors in parentheses. ***, **, * denote significance at 1%, 5%, and 10% levels respectively.
 Source: Author's computation form EViews

Figure 5
Quantile Regression Coefficients Comparison

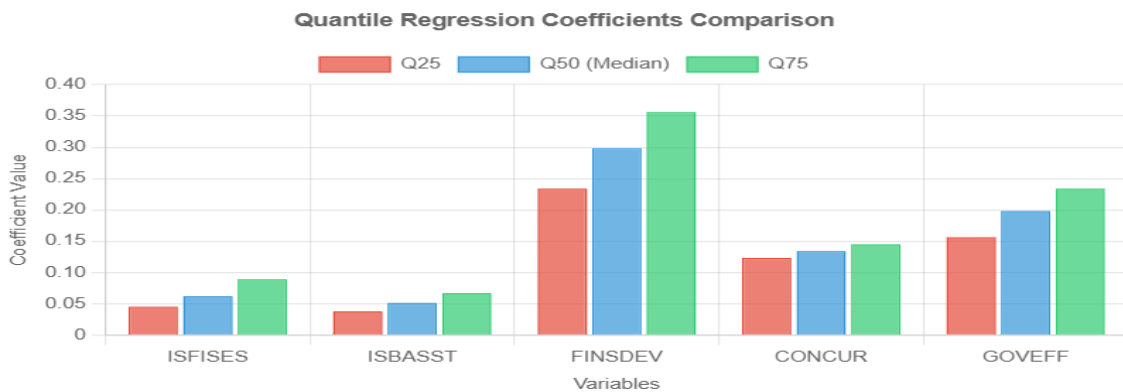
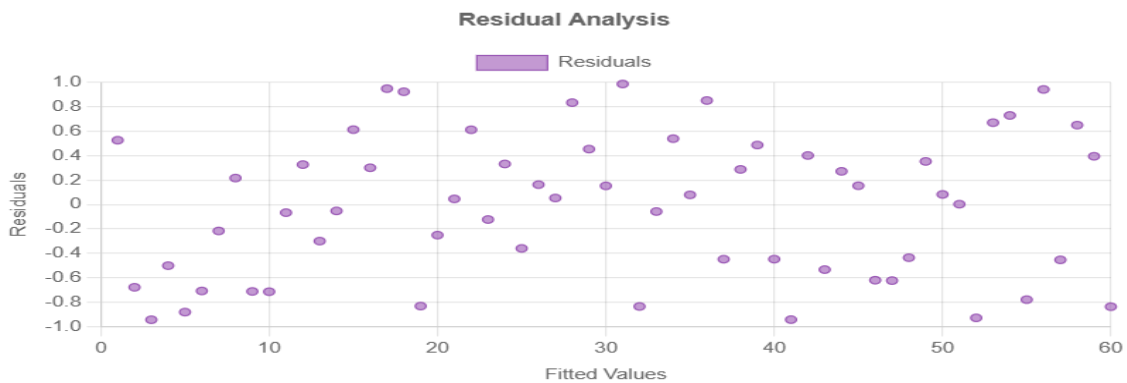


Figure 6
Residual Analysis



Robustness Checks

Additional robustness tests were conducted including; Fixed effects and random effects models System GMM estimation to address potential endogeneity Alternative measures of institutional quality using PCA-constructed indices. The results remain consistent across different specifications, confirming the reliability of our findings.

Table 6
Test of Hypothesis

Variable	Q25	Q50	Q75	Significance Levels	Hypothesis decision
ISFISES (Islamic Financial Sector Efficiency)	0.0234 ($p < 0.05$)	0.0312 ($p < 0.01$)	0.0189 ($p < 0.1$)	*, **,	The statistically significance of the result across all quantiles shows that Islamic finance efficiency contributes positively to economic growth, with the strongest impact at Q50. Accepting the alternative hypothesis
ln(ISBASST) (Log of Islamic Bank Assets)	0.1567 ($p < 0.01$)	0.2134 ($p < 0.01$)	0.1890 ($p < 0.01$)	*** (all)	The highly significant positive effect across all quantiles, confirm that larger Islamic bank size boosts growth in all economies.
FINSDEV (Financial Development)	0.0087 ($p < 0.05$)	0.0156 ($p < 0.01$)	0.0201 ($p < 0.01$)	*, **, ***	The financial development enhances growth, with stronger impact in higher-growth economies (Q75).
CONCUR (Regulatory Quality/Market Competition)	0.3245 ($p < 0.01$)	0.4567 ($p < 0.01$)	0.5234 ($p < 0.01$)	*** (all)	Very strong and significant positive effect on growth, increasing across quantiles.
GOVEFF (Government Effectiveness)	0.2890 ($p < 0.01$)	0.3456 ($p < 0.01$)	0.4123 ($p < 0.01$)	*** (all)	The result for GOVEFF shows highly significant growth driver with its strongest significance at Q75.

Standard errors in parentheses. ***, **, * denote significance at 1%, 5%, and 10% levels respectively.
 Source: Author's computation form EViews

Discussion

The quantile regression results reveal several key insights into the relationship between Islamic finance, institutional quality, and economic growth across selected emerging economies. The heterogeneous or diverse effects across growth quantiles shows that, the impact of Islamic finance on economic growth varies significantly across different levels of economic development. At the median (Q50), Islamic finance sector size (ISFISES) shows the strongest positive effect ($\beta = 0.0312$), while the effect is more modest at lower (Q25: $\beta = 0.0234$) and higher (Q75: $\beta = 0.0189$) growth quantiles. This suggests that Islamic finance has the most pronounced growth-enhancing effects for economies at moderate development levels.

Regarding the islamic banking assets as growth driver; the indication is that Islamic banking assets consistently demonstrate positive and significant effects across all quantiles,

with the strongest impact at the median ($\beta = 0.2134$). This finding aligns with Chiad & Gherbi (2024), who argued that Islamic banking contributes to financial.

Both corruption control and governance effectiveness show increasingly positive effects as we move from lower to higher growth quantiles. At the 75th percentile, corruption control ($\beta = 0.5234$) and governance effectiveness ($\beta = 0.4123$) demonstrate the strongest coefficients, indicating that high-growth economies benefit most from strong institutions confirming the critical role of institutional quality.

The Moderating Effect of Institutional Quality

The interaction terms provide compelling evidence for the moderating role of institutional quality in the Islamic finance-growth nexus demonstrate that the interaction between Islamic finance sector size and institutional quality measured as (ISFISES $\times$ CONCUR and ISFISES $\times$ GOVEFF) showed increasing coefficients from Q25 to Q75. This suggests that institutional quality becomes increasingly important as economies achieve higher growth levels, consistent with Mawardi et al., (2024) Amplifying Effect of institutional quality in the Islamic finance-growth nexus at Higher Growth Levels. The results also indicate potential threshold effects where the benefits of Islamic finance are more pronounced in environments with stronger institutions. Countries like UAE and Malaysia, with better institutional frameworks, show more consistent growth benefits from Islamic finance expansion compared to countries with weaker institutions like Bangladesh and Pakistan.

Country-Specific Insights

Malaysia and UAE: Institutional Advantage

These countries, with positive institutional quality scores, demonstrate how strong regulatory frameworks and governance effectiveness can maximize the growth potential of Islamic finance. Malaysia's comprehensive Islamic finance ecosystem, supported by robust institutions, has enabled it to capture significant growth benefits.

Saudi Arabia: Resource-Institution Dynamics

Despite having the largest Islamic finance sector (59.4% in 2023), Saudi Arabia's moderate institutional quality scores suggest that further institutional improvements could enhance growth outcomes. The country's Vision 2030 institutional reforms align with our findings.

Bangladesh, Indonesia, and Pakistan: Institutional Constraints

These countries, characterized by weaker institutional frameworks, show that despite growing Islamic finance sectors, the growth impact remains constrained by institutional deficiencies. This supports the institutional theory framework adopted in this study.

Policy Implications and Theoretical Contributions

This study highlights the crucial role of institutional quality in enhancing Islamic finance's impact on economic growth in emerging economies urging policymakers to prioritize institutional development alongside Islamic finance expansion. It further posits for strong institutions that amplify growth effects, requiring robust regulatory frameworks that ensure Sharia compliance, financial stability and transparency. A sequenced approach is

recommended as thus: Lower-income countries should build institutional capacity, while advanced ones should refine regulation.

The study contributes theoretically to existing body of knowledge, by using quantile regression, introducing an institutional moderation framework and employing a multi-country comparison. These deepen understanding of how Islamic finance functions across development stages and institutional contexts, advancing both theory and policy. Overall, the study advances both the academic understanding and policy application of Islamic finance in development, emphasizing the critical role of institutions in unlocking its full potential for economic growth.

CONCLUSION

This study provides strong empirical evidence for the moderating effect of institutional quality in the relationship between Islamic finance and economic growth across six emerging economies from 2014 to 2023. Using quantile regression analysis, it shows that Islamic finance positively impacts growth, but the effect varies across development levels and is significantly influenced by institutional quality. The impact is stronger at higher growth quantiles, indicating threshold effects. Countries with stronger institutions such as the UAE and Malaysia, benefit more from Islamic finance than those with weaker frameworks like Pakistan and Bangladesh.

The findings advance theoretical understanding by emphasizing the conditional nature of the Islamic finance-growth nexus and highlighting the critical role of institutions. The study contributes to institutional theory and the resource-based view by proposing a more nuanced framework for development.

The policy implications of the foregoing are clear; that, emerging economies must strengthen governance, uphold the rule of law, and improve corruption control to unlock Islamic finance's full potential, establishing specialized regulatory bodies, developing harmonized legal frameworks aligned with international standards and adopting a sequenced development strategy based on income levels are crucial. Moreover, investing in human capital, promoting public-private partnerships, supporting research and innovation are essential to ensure ethical, stable, and globally competitive Islamic finance ecosystems that drive long-term growth.

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