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SUSTAINABLE DEVELOPMENT AND THE ROLE OF ISLAMIC AND SOCIAL BANKS

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Abstract

Islamic banking is a financial system that is based on Islamic law (Sharia) and is influenced by Islamic economics. The Islamic financial system is supported by four primary pillars: the Islamic banking system, the Islamic money market, Islamic insurance (takaful), and the Islamic capital market. These systems provide alternative funding sources. Conversely, social banks are established to utilize financial services to generate a positive impact on society and the environment. Consequently, consumers perceive Islamic banks, depositors, and the broader community as having both economic and social responsibilities. The fundamental principles of the United Nations Sustainable Development Goals (SDGs) are eradicating poverty and promoting sustainable development. The parallels between Islamic and social institutions will be the focus of this investigation. The significance of the two institutions in advancing the United Nations Sustainable Development Goals (SDGs) will be underscored in this research.

Keywords: SDGs, Islamic Banking, Islamic Finance, Social Banking, CSR, Charity Bank

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INTRODUCTION

Islamic finance is one of the most rapidly expanding sectors of the global financial industry. In some countries, it has become of paramount importance; in others, it is too substantial to be disregarded. At the conclusion of 2008, the Islamic banking industry was estimated to be approximately $820 billion in size on a global scale. The Gulf Cooperation Council countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates) are home to the largest Islamic banks. From 2015 to 2018, the Indonesian Islamic banking sector's total asset base increased by 43.43%, and there are currently 13 Islamic institutions, an increase from 12 in 2015. In 2015, Islamic banks' assets totalled 213.423 billion; however, by 2018, they had increased to 306.121 billion. The market proportion of Islamic banks in Indonesia increased from 0.25% in 2001 to 3.98% in 2011, 4.86% in 2015, and 5.74% in (2017).

Despite the fact that Islamic banks fulfill the same functions as conventional banks, the two institutions exhibit significant differences. The primary distinction between Islamic and conventional banks is that the former is following Shariah, the legal code of Islam. Justice is the fundamental principle of Islamic banking and finance, and it is primarily realized through the sharing of risks. Profits and losses are intended to be distributed among stakeholders, and interest is prohibited.

In this regard, Islamic banks are governed by the Sharia supervisory council, which guides the bank or Islamic window in the development and execution of its products and banking operations. Consequently, the three primary objectives of Shariah (Maqasid al-Shariah) are deconstructed into three primary objectives. Initially, the individual is educated to enhance their

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awareness and knowledge to achieve a more fulfilling life and maintain their well-being.

The second objective is to establish justice, which entails treating all members of our community equally. The third objective is to promote welfare that contributes to the development and evolution of individuals in our sphere of influence. As a result, the Council of Shariah must maintain a high level of transparency in its internal controls, as it serves a function similar to that of ethics committees, but in accordance with Islamic ethical-legal principles.

Conversely, social banks are obligated to indirectly contribute to the well-being of society and the environment by financing lending initiatives that assist impoverished and destitute individuals. Social banks indirectly generate influence through their lending activities, while social entrepreneurs directly generate influence through their business operations. In that regard, social banks are comparable to mainstream (conventional) banks in that they necessitate the financial stability of the project, but they do not prioritise profit maximisation as a singular objective. "Social banks are willing to accept higher risks or lower margins to encourage specific activities."

Due to their inability to provide collateral to pledge against potential risk and the challenges associated with evaluating their creditworthiness, conventional banks typically regard the impoverished as high-risk borrowers. Consequently, the formal establishment of the Islamic banking sector was primarily justified by the provision of services to the impoverished. In that regard, it is expected that Islamic institutions, which are known for managing substantial amounts of money, will contribute to the creation of such charitable donations. The shareholders of the bank and Islamic society have a

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right to be informed about the bank's contributions to the well-being of society by assisting the less fortunate, as well as whether the bank complies with these standards. The following information is required to be disclosed by Islamic banks: (a) the charitable and social activities they finance; (b) the amount spent on these activities; and (c) the sources of the funds used for charity, which may include the bank's funds and earnings from sources that are prohibited by Sharia.

Alternatively, the Islamic bond market has experienced a substantial increase in prominence over the past decade, even among traditional investors. This is primarily because these instruments are linked to tangible assets, which provide a high level of security. Despite their official adherence to Islamic principles, the financial crisis of 2008 was primarily caused by the circulation of instruments with unsafe mechanisms. Despite this, these securities are presently traded in the largest marketplaces due to their security features and ease of use. The success of Islamic banking was demonstrated through its consistent growth and resilience during crises. A recent study conducted by the International Monetary Fund (IMF) contrasted the performance of Islamic banks and conventional banks during the 2008 financial crisis. The study concluded that Islamic banks exhibited higher levels of resilience on average during the global financial crisis.

In contrast to conventional banks, Islamic banks utilize significantly less debt, necessitating an examination of Islamic banking's capital structure models. Nevertheless, the paradigm shift necessitates additional research, as certain studies have asserted that the products of Islamic and conventional institutions are comparable.

The return on average for assets was higher in Islamic banks than in

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conventional banks, as indicated by certain studies. The Islamic banks were more heavily invested in assets and less involved in debt contracts, even though the average equity return was consistent across both bank systems. This was the underlying reason. The Islamic banks exhibited higher revenue ratios, other operating income, net interest margin, and return on investment than the conventional banking system.

It is important to note that the first Islamic bank, Nasser Social Bank, was established as a social bank in 1971 to provide social services to the impoverished and low-income. The reason for this decision may have been political or to secure the necessary acceptance for the concept of establishing a bank that does not offer fixed interest rates on deposit accounts. Consequently, the fact that the first Islamic bank was established as a social bank does not necessarily imply that the two banks are identical; rather, it may suggest that the two banks share many common objectives.

The prohibition of all transactions in which any or all of the following components are present is a significant distinction between Islamic and conventional banks: Any return on money that is predetermined in quantity (or percentage) and, as a result, includes interest. (Riba) Uncertainty (gharar), is the prohibition of the sale of objects whose existence or characteristics are uncertain and are ambiguous in terms of contractual obligations.

The Qur'an and hadith explicitly identify economic, social, and environmental factors that facilitate sustainable development, including the development of capacity at both the individual and societal levels, the promotion of social justice, and the assistance of the impoverished and destitute. Environmental concerns, including the preservation of the environment and

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animals, are also addressed. Furthermore, Islamic ontology prohibited the squandering of natural resources, as they are considered a gift from Allah, thereby emphasizing a moral code for economic and social conduct.

This research will employ a comparative research approach to determine the mutual function of Islamic and social banks in advancing social development initiatives. Islamic finance is one of the most significantly expanding sectors in the global financial industry. In certain countries, it has achieved substantial significance; in others, it is too substantial to be disregarded. After 2008, it was anticipated that the global Islamic banking industry would reach an estimated $820 billion. Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates are the countries in the Gulf Cooperation Council where the most prominent Islamic institutions are located. The number of Islamic banks in Indonesia increased from 12 to 13 during this period, and the total assets of the sector increased by 43.43% from 2015 to 2018. The assets of Islamic institutions were 213.423 billion in 2015; however, by 2018, they had increased to 306.121 billion. The market share of Islamic institutions in Indonesia increased from 0.25% in 2001 to 3.98% in 2011, 4.86% in 2015, and 5.74% in 2017.

The two categories of banks differ fundamentally, even though Islamic banks perform functions similar to those of conventional banks. The primary distinction between Islamic and conventional banks is that the former adheres to Shariah, the Islamic legal framework. Fairness is the fundamental principle of Islamic banking and finance, which is primarily achieved through risk sharing. The imposition of interest is prohibited, and stakeholders are anticipated to distribute gains and losses.

Sharia supervisory boards oversee the development and execution of

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Islamic institutions' products and banking operations. The three principal objectives of Shariah (Maqasid al-Shariah) are categorized. Educating the individual is primarily concerned with the cultivation of awareness and comprehension in order to improve living conditions and promote long-term well-being.

The second objective is to ensure that all members of our community are treated fairly, which is a prerequisite for justice. The third objective is to encourage the development and advancement of individuals within our sphere of influence by promoting well-being. As a result, it is essential to ensure that the Council of Sharia, which operates similarly to ethics committees but in accordance with Islamic ethical-legal principles, maintains a high level of transparency in internal controls.

In contrast, social banks endeavor to indirectly contribute to the well-being of society and the environment by supporting indigent and disadvantaged individuals through lending initiatives. Social banks indirectly generate impact through lending operations, whereas social entrepreneurs directly generate impact through commercial endeavors. In this respect, social banks are comparable to traditional banks in that they require financial feasibility for projects, despite the fact that they do not prioritize profit maximization as their sole objective. Social banks are prepared to accept increased risks or reduced margins in order to advance particular activities.

The impoverished are generally perceived as high-risk debtors by conventional banks due to the difficulties associated with assessing their creditworthiness and the absence of collateral to mitigate potential risks. Consequently, the Islamic banking sector's legal establishment was primarily

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motivated by the provision of services to the indigent.

In this context, it is anticipated that Islamic institutions, which frequently manage substantial financial assets, will contribute to charitable causes. The bank's shareholders and Islamic society both have the right to ascertain whether the bank complies with these criteria and to comprehend the bank's contributions to societal welfare through its support of the underprivileged. The following information must be disclosed by Islamic banks: (a) the charitable and social initiatives they support; (b) the expenditure on these initiatives; and (c) the origins of the funds allocated for charity, which may include the bank's resources and revenues received from Sharia-prohibited sources.

In contrast, the Islamic bond market has seen a significant increase in prominence over the past decade, even among conventional investors. This is due to the fact that these instruments are associated with tangible assets, which offer a high level of security. Despite their nominal compliance with Islamic standards, the current trading of these assets on major markets is primarily due to their security attributes and simplicity of use, which was primarily caused by the proliferation of instruments with hazardous mechanisms during the 2008 financial crisis.

Islamic banking has demonstrated sustained expansion and stability in the face of crises, establishing itself as a success story. A recent study conducted by the International Monetary Fund (IMF) examined the performance of Islamic banks in comparison to conventional banks during the 2008 financial crisis. The study concluded that Islamic banks demonstrated a higher level of resilience on average throughout the global financial crisis.

In contrast to conventional banks, Islamic banks employ reduced levels of

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debt, which requires an assessment of the capital structure models in Islamic banking. However, the paradigm shift requires additional research, as certain studies have suggested that the offerings of Islamic and conventional institutions are comparable.

Comparatively to conventional banks, research suggests that Islamic institutions have a higher average return on assets. The rationale was that Islamic banks were more involved in asset investments and less in debt contracts, even though the average return on equity was equivalent for both banking systems. In contrast to the conventional banking system, Islamic banks demonstrated superior revenue ratios, ancillary operational income, net interest margin, and return on investment.

The "Nasser Social Bank," the first Islamic bank, was established in 1971 as a social institution to provide services to low-income and indigent populations. The political motivation or the intention to promote the adoption of a banking model that rejects fixed interest rates on deposit accounts may have been the motivation behind the establishment of the first Islamic bank as a social establishment. Thus, the fact that the initial Islamic bank was established as a social bank does not necessarily indicate equivalence; rather, it indicates that the two categories of banks have a plethora of shared objectives.

The prohibition of transactions involving any of the following components is a fundamental distinction between Islamic and regular banks: A return on investment that is fixed in quantity or percentage, thereby including interest. (Riba) Gharar, or uncertainty, is the prohibition of the sale of products whose existence or attributes are uncertain and ambiguous in contractual terms. The Qur'an and hadith explicitly address economic, social, and environmental

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elements that promote sustainable development, such as the promotion of social justice, the enhancement of capacity at both individual and societal levels, and the provision of assistance to the indigent and impoverished. Environmental issues, including the preservation of fauna and ecosystems, are frequently discussed. Additionally, Islamic philosophy forbids the exploitation of natural resources, considering them a divine gift from Allah. This implies a moral framework for economic and social behavior.

This study will utilize a comparative approach to clarify the mutual role of Islamic and social banks in the advancement of social development initiatives, emphasizing their primary similarities and differences. The potential of the two institutions to contribute to the realization of the United Nations Sustainable Development Goals (SDGs) will be underscored in this study. ach to elucidate the primary similarities and distinctions between Islamic and social banks. Additionally, this research will underscore the potential of the two institutions to assist in the realization of the United Nations Sustainable Development Goals (SDGs).

LITERATURE REVIEW

Corporations choose to include social and environmental issues in their business activities and interactions with stakeholders. This is called corporate social responsibility (CSR). Historically, the CSR method was based on three main ideas: making money, growing, taking care of the environment, and fair treatment of everyone. It worked as both an economic driver and a social organization. It covers both the sector of protecting the environment and improving the well-being of communities. There are different types of banks,

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according to Tok and Yesuf (2022): private banks, social banks, green banks, community banks, church banks, and development banks.

The idea behind social banking services is that banks work with a lot of different people in interactive social networks to provide full banking services that give them a lot of benefits over their competitors. Improving the bank's reputation as a leader in social networks; creating a long-term plan for sustainable development; creating a clear, consistent, and trustworthy online presence that boosts the bank's brand; and providing full and integrated banking services on a single social platform are some of these benefits.

In 2013, Bosheim and Aspevik found that social banks were connected to ethical banking, impact investing, corporate social responsibility (CSR), and socially responsible investment (SRI). As a business, social banks are set up to provide financial services with the triple bottom line (people, profit, and the earth) in mind. Making money is important, but it's not the only main goal. The missions of social banks stress that their clear business models have positive effects on people and the environment and lead to long-term growth. Similarly, San-Jose et al. (2009) said that ethical banking had two main characteristics: making money while also doing good in the world (social profitability) and making money while also making money (economic profitability).

Instead, the first Islamic banks, such as The Farmers' Credit Union (which opened in Pakistan in the late 1950s) and the Mit Ghamer Savings Bank (which opened in Egypt in 1963), were based on social projects that tried to achieve social goals. So, customers, investors, and people in the community as a whole see Islamic banks as serving both social and economic needs. Islamic banking has become more popular in the West because it is an option to traditional banks that

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follows moral business practices and is similar to socially responsible investments. It has also been able to attract investors, regulators, and financial institutions.

In 2018, Luthfi Hamidi and Worthington looked at the rules and methods of Islamic financial and social banks to see if it would be possible to combine some of these into a new type of banking called Islamic Social Banking (ISB). To turn the Islamic Bank into a Social Islamic Bank, the study found that three main roles must be looked at: Profit, Planet, and People. Relaño (2011) says that social banks have more assets related to transactions with clients, while traditional banks mostly have assets related to cash transactions.

This supports the theory because giving money to clients is the same thing as lending money to the real economy. The financial activities show that traditional banks are not linked to the real economy. In this situation, both banks say they are helping to make things better for people and the earth. Both companies insist on being open as a fundamental concept in how they run their businesses and use storytelling to share information about the projects they fund. Alwabel (2013) says that Islamic accounting depends on the Macro-Economy, while conventional accounting only depends on the Micro-Economy because it only looks out for individual economic interests and doesn't consider the bigger picture, so it can't deliver the expected benefits. The Islamic Sharia has achieved social justice at the household level with the "Nafakah" and "Mawareeth" systems, as well as in society through the "Zakah" system of giving alms. There is a clear line between social accounting and economic unity accounting when it comes to the change from community duty to individual obligation.

"Poverty alleviation" is a basic goal that both social banks and Islamic

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banks work towards. This is also likely to be a major goal in countries with lower Human Development Indicator (HDI) scores, which stresses the importance of keeping credit available and promoting human development.

In this regard, the majority of contemporary banks aim to enhance their social and environmental responsibility and are urged to adopt sustainable finance aligned with the Sustainable Development Goals (SDGs). Imperialism and global capitalism make it hard for Islamic banks and the Islamic financial system to follow the moral and religious rules of fairness that are part of Islamic beliefs. As a result, it is unrealistic to think that Islamic banks will eliminate poverty and support social justice on their own. They need to be an important part of a large network that makes the different options in the Islamic banking system work.

RESEARCH METHOD

This research uses a research methodology that will adopt a systematic and comprehensive approach to reviewing relevant academic and professional sources. The first step involves defining key concepts, including sustainable development, Islamic banking, and social banking, with particular attention to their intersections. Sustainable development will be framed within the context of economic, social, and environmental dimensions, while Islamic and social banking will be explored through their ethical finance models, such as risk-sharing, financial inclusion, and green finance. A thorough search will be conducted across multiple academic databases, including Google Scholar, JSTOR, ScienceDirect, and specialized repositories in Islamic finance. Search terms will focus on topics like "ethical banking," "green finance," "impact investing," and

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"ESG criteria," prioritizing peer-reviewed articles from the last 10-15 years. Inclusion criteria will be focused on empirical and theoretical studies discussing the role of Islamic and social banks in promoting sustainability, with exclusion of studies unrelated to sustainable development or conventional banking systems. The literature will be categorized into themes such as the role of Islamic banking in sustainable finance, social banking models, and financial products for sustainability, including green sukuk and social impact bonds. A thematic analysis will be performed to identify patterns, contradictions, and research gaps, followed by a comparative analysis of Islamic, social, and conventional banking systems in terms of their contribution to sustainability. The findings will be synthesized to offer a comprehensive overview of how Islamic and social banks promote sustainable development, and the literature review will conclude with recommendations for practice and directions for future research in the field of sustainable finance.

RESULTS AND DISCUSSION

How the Concept of Corporate Social Responsibility (CSR) Is Used in Islamic and Social Banking

From an Islamic viewpoint, personal, social, economic, and environmental growth are integral components of the circular economy model and are scientifically associated with Maqasid al-Shariah (Islamic principles). There is a lot of agreement between the goals of socially responsible investing and the beliefs of Islam, also known as Maqasid-al-Shariah. From an Islamic point of view, sustainable development means finding the best balance (Mizan) between social and economic progress and making good use of natural resources.

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In this way, both Islamic and conventional banking agree with the basic ideas behind corporate social responsibility (CSR). In addition, Islamic views encourage Muslims to be socially responsible by encouraging them to give to charity for the benefit of others and the community (Waqf). As a way for people and organizations to live up to these duties, Sharia law encourages giving to charity and doing specific acts of kindness.

According to Maali et al. (2006), social duty is one of the most important values in Islamic Sharia. This is why the word "brotherhood" (Akhowa) is used a lot in Islamic communities. Muslims see each other as brothers and must look out for each other. It is against the law to cheat or take advantage of others, no matter what. Muslims must care for others. The Prophet Mohammed said, "The Muslims in their compassion towards one another are like a body; if one part suffers, it affects the other parts" (Sahih Al-Bukhari-Ali, 1961).

In Islam, the idea of social responsibility is very broad. According to Islam, the rights of Allah come first, then the rights of society. Because of this, Muslims should act properly because they recognize Allah's rights. Muslims must always make sure that what they say and do is in line with Islamic beliefs. In this light, Muslims should keep their good relationships with each other and the rest of the Islamic society to protect their rights. To protect these rights, Muslims will push for people to take responsibility for their actions, including their duties to others. Ahmad (2021) says that the Qur'an, Sunnah, and common Muslim practices form the basis of the idea of Corporate Social Responsibility (CSR) in Islam. It is very important to look into CSR methods that come from Islamic values, especially for businesses in the Islamic banking field. In Islamic thought, Allah is the most important owner, so the idea of CSR is also a mirror of that. On the other hand,

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humans are just temporary guardians who receive trust. People have to try to stay alive, but not at the expense of their ultimate goals. Because of this, Allah tells people to give some of their wealth to those who deserve it. Islam stresses the importance of helping others, which makes it easier for a Muslim with extra money to show his feelings to people in his community, especially through zakat.

According to Aracil (2019), Islamic banks need a long-term plan that includes Corporate Social Responsibility (CSR) as a key part of Islamic financing to compete with traditional banks. In addition, Islamic banks have to deal with official institutional flaws, such as financial exclusion. In addition, Islamic banks may be able to improve people's lives in a way that is in line with Shariah by switching from giving money to specific types of corporate social responsibility that are related to their main business.

The goal of Social Finance (SF) was to help social businesses with their money problems. Social finance (SF) can be good for both businesses and people, and it makes it easier for corporate social responsibility (CSR) to grow and become more popular in the banking and finance industries. Krause and Battenfeld (2017) say that customers get a composite value return when they invest in social banking goods, which means they get both financial and social benefits. With its very different way of doing business, social banking goes beyond the usual framework of corporate social responsibility, which is sometimes used as a surface-level strategy to make as much money as possible. A lot of research (Cornée et al., 2022; Hussien et al., 2019) looked at how well Islamic and social banks did during the Global Financial Crisis of 2008. A growing body of research (Carè, 2018; Sadiq & Mushtaq, 2015; Dourtmes & Andrikopoulos, 2021) has shown that Islamic and social banks play a part in the

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idea of sustainable development. A lot of research (Kamdzhalov, 2022; Maali et al., 2006) has looked at how the two banks handle their social duty. Most of the study that have been done so far have focused on how Islamic or social banking can help with economic growth, social development, or sustainable development.

Core Values of Islamic and Social Banks

According to Mohd Nor (2016), the main differences between social banking and regular banking are shown in Table 1. Notably, a lot of the ways that social banking works are similar to the ways that Islamic banks work. For instance, Cornée et al. (2016) suggested that to increase openness, social banks should give complete lists of the projects they support so buyers have real proof.

Another thing is that social banks usually don't allow complicated financial deals. This shows their "internal interest rate channel" and how they handle assets and risks. So, Lahrechet et al. (2014) say that Islamic institutions usually follow the rules set by the Islamic Financial Services Board (IFSB). These rules let people in the financial market, like investors and other financial institutions, judge the main business activities of Islamic financial institutions while taking into account the profit-and-loss sharing (PLS) principle, which is necessary to follow Shariah rules. People who have profit-sharing investment accounts (PSIAHs) need better access to the risk and return measures they need to evaluate investments.

This is another reason why neither bank is involved in speculative operations on the financial market. Benedikter (2010) divides social banks into three groups based on how they decide which investments and loans to make: Profit (being financially responsible and making sure that losses don't hurt the bank's overall growth), Environment (managing natural habitats and resources in

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a way that doesn't harm them), and People (putting the well-being of the community and the fair progress of society as a whole first). So, Hussien et al. (2019) say that Sharīʿah law says Islamic Banks can't support actions that are morally wrong or are directly against Sharīʿah, like gambling, drinking, or speculation. When you do business with an Islamic bank, you start with bad knowledge, which is known as asymmetric information and moral hazard.

According to Dourtmes and Andrikopoulos (2021), the two banks looked at the social and environmental aspects of the projects they funded. Traditional banks focus on making as much money as possible, but social banks give loans with the goal of doing good for society or the earth. The two banking systems also focus on tasks that have an impact on the real economy. Cornée et al. (2022), for example, said that the financial operations of social banks put helping the real economy ahead of trading on speculative markets. This was especially clear during the financial crisis of 2007–2008, when many traditional banks were found to lack cash and needed help from taxpayers after taking too many risks. Gani et al. (2021) looked into how the Islamic banking sector affected the Malaysian real economy. They found that it had a big impact on economic growth, as shown by GDP growth numbers from 1998 to 2017. The study found that Malaysia's GDP grows by 0.62% for every 1% rise in Islamic bank accounts.

At the same time, there are a number of differences between Islamic banks and other banks that make them different. According to Islamic law, bank savings accounts can't have fixed interest rates. In this context, Zucchelli (2022) argued that Islamic philosophy says that earning interest makes people less motivated to give to charity, so they don't. create wealth and, as a result, have less drive to build societies that work well for everyone. Interest-based finance is also thought

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to cause a lot of mistakes. Economies are more likely to become unstable when they have a lot of debt and trade on risky financial markets. On the other hand, when people share risks and benefits, they can lower their own risks and get benefits together. Also, Islamic law doesn't allow banks to do any kind of financial work that is based on the profit and loss sharing (PLS) concept. In this situation, Hassan and Aliyu (2018) suggested that the first Islamic banking experts came up with a PLS system instead of loans with fixed interest rates.

On the other hand, social banks encourage loans with cheaper interest rates for projects that they think are good for society, ethics, or the environment. Mitić et al. (2017) found that many social banks, like Charity Bank and GLS Bank, offer special savings accounts that are used to fund social safety programmes. If clients agree to a lower interest rate, the difference between the lower rate and the normal rate is put towards these projects.

People became more interested in social banking during the 2008 financial crisis, mostly because of how well it handled problems with money. Sadiq and Mushtaq (2015) looked at how committed Islamic financial institutions are to social and environmental goals that are similar to the main goals of Islamic finance (Maqasid). The study also pointed out that the "Takaful" idea in Islamic banking encourages investors to put their money into projects that help the poor become more resilient. Still, the study showed that more research needed to be done on how Islamic banks can help with sustainable development projects.

Efficacy of Islamic and Social Banking in Mitigating Income Inequality

The rate of inflation around the world is going up, which affects both poor and rich countries. As of August 2022, inflation had reached or was close to double-digit levels in the Euro area (9.1%), the European Union (10.1%), and some

Baltic and Eastern European Member States (20% or more). Food and energy prices are mostly to blame for the current inflation. Households in less wealthy EU countries or with low incomes are more likely to be affected by it because they spend more on these essential goods.

For consumers, higher interest rates will mean higher loan costs, which will make it harder for them to spend money on other things. Since interest rates on loans for countries are about to go up, government programs that helped lower-income families buy things and lessened the effects of inflation on consumers will likely be looked at more closely.

Poor people tend to save less than wealthy people, especially when inflation is high. Moreover, they need easier access to the bank's money-related tools. On the other hand, wealthy people are easier to borrow money from and have better access to financial tools that help them protect against currency devaluation. When the value of the currency goes down, it is sometimes seen as a form of taxes that moves money from poor people to rich people. Poor people are usually the ones who suffer the most during times of inflation. So, the traditional banking business plan may make the gap between rich and poor even bigger in a country, helping the rich get richer while making the poor worse off.

A big difference in income makes it hard for poor people to get loans because the credit system is broken. When both the lender and the borrower don't know much about each other, this is called asymmetric information, and it makes it harder to make smart choices. This limits the ability to borrow money and the returns on investments. Also, bad laws make it harder for creditors to get back money that was owed them on defaulted loans because they can't take back the collateral assets that were used as security. These kinds of rules make it harder to

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collect debts, which is why potential creditors have to deal with strict terms and conditions. This makes credit unavailable to some people, especially those who are poor. Investment depends on a person's salary and assets. This means that poor people who don't have many assets are at a disadvantage.

The wealth gap grows or shrinks depending on how easy it is to get money or loans. Credit shocks in some industries can mess up the division of capital, the rate of economic growth, and the search for production resources, especially labor, which can make poverty and income inequality worse. The current conventional banking system encourages unfair distribution by putting all the risks on the borrowers, making it hard for entrepreneurs to get access to financial tools that help create jobs, boost output, and improve the well-being of the poor.

Setiawan (2016) says that poverty is a big problem that comes with society being successful. There are different ways to look at the reasons for poverty. Micro-poverty happens when different people own different resources, which leads to unequal income sharing. Individuals who are poor need more means. Inequalities in the quality of human resources lead to poverty. Poor quality human resources lead to low output, which has a negative effect on pay rates. Not getting enough schooling leads to lower-quality workers, prejudice, the plight of the disadvantaged, or inheritance. Inequalities in access to cash lead to poverty.

It is said by Dourtmes and Andrikopoulos (2021) that social banks have two main goals: (1) to make a positive difference in communities, the environment, and long-term economic growth; and (2) to make a steady profit. There are also lower interest rates on loans, especially for projects that will be sustainable in terms of the earth or society. With stable interest rates, clients can choose to give some of the interest they earn on their savings to environmental

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projects.

The next three charts (Figures 1-2-3) show how the business cycle works in Islamic, traditional, and social banks. How they make money is one of the main differences between regular banks and social or Islamic banks. Social and Islamic banks are both based on economic models that encourage people to do business while putting a focus on charity and community development. Normal banks, on the other hand, focus on high interest rates and economic value, no matter what kind of business it is. The difference between rich and poor people in the same society is affected by the economic or value creation methods used by each bank.

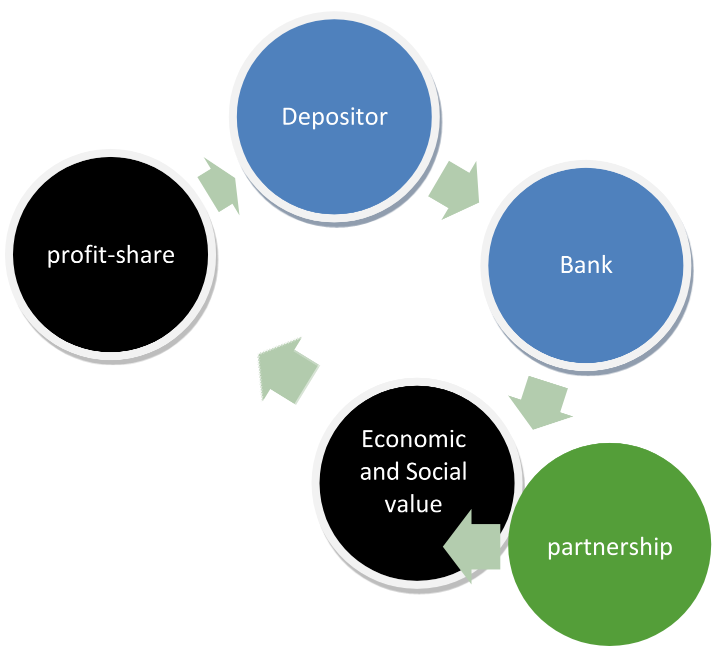

Figure 1
Islamic Banks' Economic Cycle

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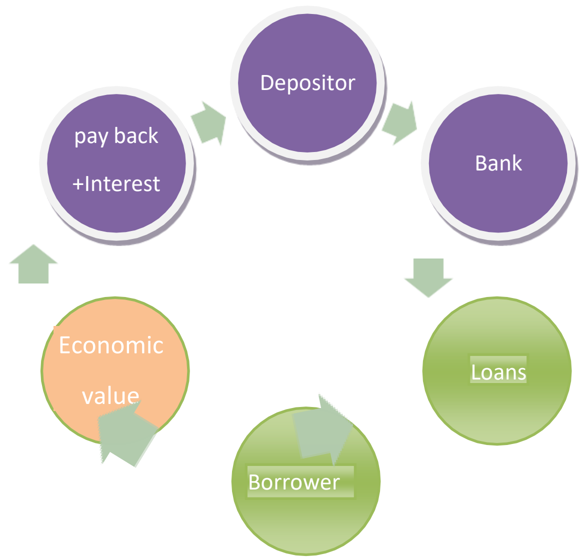

Figure 2
Commercial Banks' Economic Cycle

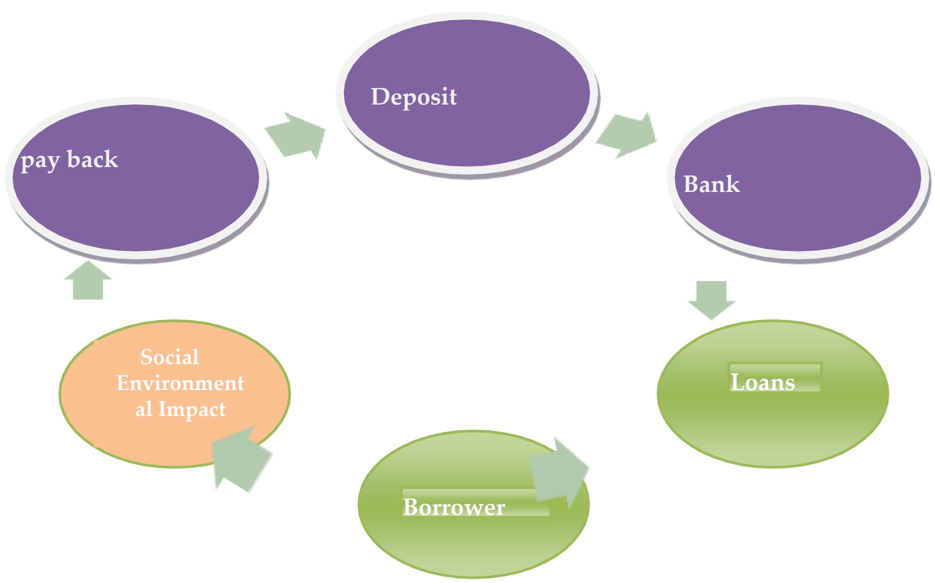

Figure 3
Social Banks' Economic Cycle

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The Role of Islamic and Social Banks in Sustainable Economic Development

The 2030 Agenda for Sustainable Development was approved by all UN Member States at 2015. It is a plan for achieving peace and prosperity for all people and the world, now and in the future. The Sustainable Development Goals (SDGs) replace the Millennium Development Goals (MDGs), which were set in 2000. The SDGs have 17 numeric and qualitative goals. To promote peace and prosperity for all people and the world by building a strong global network of projects that involve people from different countries working together. The eight Millennium Development Goals (MDGs) included 21 targets that were meant to reduce poverty (MDG 1), improve education, health, and gender equality (MDGs 2–6), and promote long-term growth (MDG 7). All of these goals were based on working together as global community.

Islamic finance can help with development, especially in terms of the Sustainable Development Goals (SDGs), by boosting stronger growth, promoting positive social results, expanding access to financial services, and making the financial sector more resilient.

Muslims are told to help out in their own neighbourhoods and put the needs of the weak first. The 2020 OECD study on Islamic finance says that the goal of Islamic finance is to make wealth distribution fairer by sharing assets among groups. In this situation, Islamic social finance mechanisms like zakat and awqaf help Muslims meet this duty by continuously giving to others. They are one of their religious duties and the only one that has a financial element. To reach SDG1, we need Islamic social finance's parts of redistribution and social equality. The word zakat means "to increase" and also means "that which cleans wealth." The most important idea in Islam is that everyone should clean their annual gains.

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When figuring out zakat, all extra money must be taken into account, including cash on hand, bank deposits, jewelry made of valuable metals, crops grown, livestock income, stocks, and investment gains. Zakat is an important part of Islam that has a big impact on how wealth is distributed and how poor people are helped. Muslims who have more than a certain amount of money (nisab) are required to give a certain amount of their wealth and income to certain groups every year. This is seen as an important part of prayer. The zakat rate is different for different types of assets. It is 2.5% for cash, gold, and silver, 5% for crops that are watered with irrigation, and 10% for crops that get their water from rivers, streams, or rain. Through the study of early Islamic history, we can see that zakat was an effective way to help the poorest people in Muslim societies. In this way, Zakat and CSR work together because companies use money they get from Zakat for their CSR programmes. According to this policy, state organisations like sharia banking should do two things: give zakat to the people and manage social funds from the public, such as zakat, grants, infaq, and sodaqoh.

According to Kamdzhalov (2022), both traditional and Islamic finance are important for business social responsibility (CSR). Corporate social responsibility in the West is different from its Islamic counterpart because of the role of giving. Sharia law urges people to be generous and kind by telling people and organisations what they need to do to meet their duties.

On the other hand, Islamic waqf is an investment that is meant to help both Muslims and non-Muslims in the long run. In this situation, waqf was created to help the poor and needy by giving them money and also to make things easier for them, like providing public utilities, schooling, healthcare, research, service animals, and protecting the environment.

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A lot of waqf assets in many Muslim countries are sitting idle and not being used to improve society or the economy. Indonesia owns waqf land that covers 1,400 square kilometres and is worth $60 billion. If these investments earn a 5% annual return, $3 billion in US dollars could be set aside for different social and economic projects. It's possible that waqf could be used in effective social development programmes, but this hasn't been looked into in detail yet. Carè (2018) said that social banks are naturally long-lasting, but the opposite isn't always true. Sustainable banks are "profit-oriented institutions" that always work to reach their sustainability goals. Sustainable banks are trying to be sustainable, as shown by their new environmentally friendly products, risk management plans, and openness policies. They also care about their general success, brand image, and market share.

Businesses have to give a different sustainability report because of the Global Reporting Initiative GRI Guidelines. Businesses need the integrated report to make long-term choices and for investors and other stakeholders to judge how well a business is doing. In addition, it builds a more complete picture of the company while still meeting the materiality requirements. Novokmet and Rogošić (2016) looked at the sustainability reports of commercial banks listed on the stock exchanges of ten European countries from 2001 to 2013. The countries they looked at were Denmark, Finland, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden, and the UK. The results showed that the banking sector needs to keep working to be more environmentally friendly. To improve quality, visibility, and trust in the investing community, financial institutions, national governments, and foreign organizations must work together to commit to sustainability.

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CONCLUSION

Sharia law says that Islamic banks shouldn't lend money to businesses that aren't sure what they're doing and shouldn't take on too many risks. Shariah law also says that Islamic banks can't give money to actions that are morally wrong or illegal, like gambling, drinking, or speculation. This is a big difference between Islamic banks and regular banks.

Social banks are linked to impact investing, SRI (socially responsible investing), CSR (business social responsibility), and ethical banking. Social banks put providing banking services first while focusing on the "triple bottom line" of fairness for everyone, making money, and protecting the environment. While making money is important, it's not the only or main goal. In their mission statements, social banks talk about the good things they do and how they help people and the world in a way that is sustainable and open to everyone. You can think of Islamic banks as organisations that work for fairness and responsibility in society. In Islamic law, social duties are based on the idea of family, which is called "*ukhuwah*." As a result, Islamic banks play an important part in society and can be thought of as banks with a social responsibility. Similar rules apply to both social and Islamic banks. For example, they don't allow financial market speculation, they put social, moral, or environmental concerns first when they decide how to finance projects, and they encourage depositors and debtors to work together. Islamic banks are different from social banks because they do different things, especially with *murabahah* and *mudarabah.*

The 2030 Sustainable Development Goals (SDGs), which were agreed upon by all UN Member States in 2015, include protecting the environment, boosting the economy, ensuring social justice, and all-around development on all levels (human, social, economic, and environmental). These goals are closely linked to the main goals of Islamic and social banks.

The study's results show that the two banks may make big steps towards achieving the Sustainable Development Goals (SDGs). These include SDG 1: "No Poverty," SDG 2: "Zero Hunger," SDG 3: "Good Health and Well-Being," SDG 4: "Quality Education," SDG 6: "Clean Water and Sanitation," SDG 8: "Decent Work and Economic Growth," and SDG 10: "Reduced Inequalities."

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