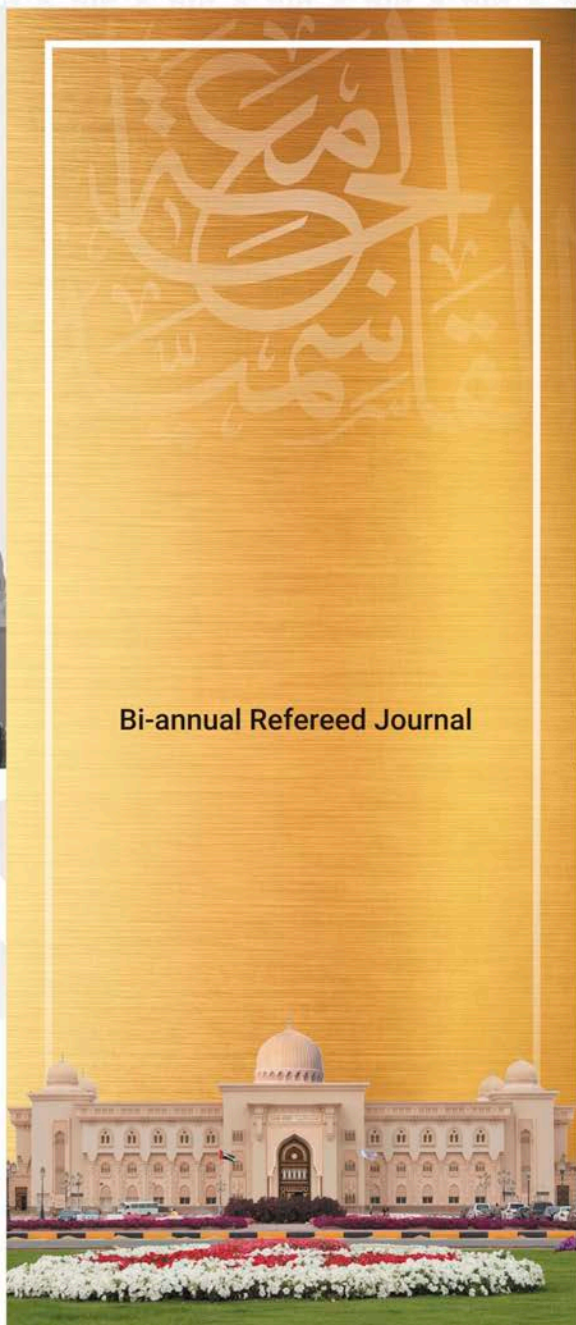


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تنشيط دور التمويل الاجتماعي الإسلامي في تحقيق أهداف التنمية
المستدامة: مراجعة شاملة

REVITALIZING THE ROLE OF ISLAMIC SOCIAL
FINANCE IN ACHIEVING THE SDGS: A
COMPREHENSIVE REVIEW¹

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الملخص

الهدف الأساسي للتمويل الاجتماعي الإسلامي هو القضاء على الفقر وتعزيز رفاهية الإنسان، بما يتماشى تماما مع أهداف التنمية المستدامة. يكشف الفحص الدقيق لأهداف التنمية المستدامة عن ارتباط قوي بالتمويل الاجتماعي الإسلامي، مع التركيز على الروابط الوثيقة والقابلية للمقارنة. لذلك، تهدف هذه الدراسة إلى استكشاف كيف يمكن لمصادر التمويل الاجتماعي الإسلامي أن تقدم حولا قابلة للتطبيق لمكافحة عدم اليقين، وإنشاء مجتمع أكثر توازنا وعدلا من الناحية الاقتصادية - وهو هدف مشترك مع أهداف التنمية المستدامة. ولتحقيق هذا الهدف، تجري الدراسة مراجعة شاملة للدراسات القائمة وذات الصلة حول التمويل الاجتماعي والتمويل الاجتماعي الإسلامي. تقيم هذه المراجعة السياق الحالي، ومساهماتها في أهداف التنمية المستدامة، وتحدد القيود والثغرات في كل من النظرية والتطبيق. تشير نتائج البحث إلى أنه على الرغم من أن النظام المالي الاجتماعي القائم على الشريعة الإسلامية حديث العهد نسبيا، إلا أنه اكتسب شعبية من خلال تقديم الخدمات المالية لأولئك الذين لا يقبلون النظام المالي التقليدي القائم على الفائدة. وبالتالي، هناك طلب كبير على الخدمات المالية القائمة على الشريعة الإسلامية وبدون فوائد. تلعب مؤسسات قوى الأمن الداخلي دورا حاسما في القضاء على الفقر، خاصة عند مقارنتها بالمؤسسات المالية القائمة على الديون التي تفرض أسعار فائدة عالية على الاستثمارات. الآثار الضارة للديون وارتفاع أسعار الفائدة واضحة، مما يؤدي إلى مشاكل مالية واجتماعية ونفسية وأخلاقية مختلفة. في هذا السياق، تبرز قوى الأمن الداخلي القائمة على الشريعة كمصدر بديل واعد للدعم المالي للسكان الفقراء في العديد من البلدان ذات الأغلبية المسلمة في جميع أنحاء العالم. تؤكد الخصائص الفريدة والقيم الأخلاقية القوية المتأصلة في التمويل الاجتماعي الإسلامي على قدرته على المساهمة بشكل كبير في التخفيف من حدة الفقر، والتنمية المالية، وتعزيز الشمول المالي، وكلها تتماشى مع الأهداف الشاملة لأهداف التنمية المستدامة. هذه الصفات تضع قوى الأمن الداخلي كمحرك رئيسي لتسريع التقدم

نحو أهداف التنمية المستدامة. ومع ذلك، على الرغم من قدرتها على إحداث آثار اجتماعية إيجابية، تواجه قوى الأمن الداخلي العديد من التحديات التي يجب التغلب عليها لتسهيل الشمول المالي الشامل بدون فوائد من خلال الآليات المالية الإسلامية. تقدم هذه الدراسة بعض التوصيات السياسية لمواجهة هذه التحديات وزيادة تعزيز فعالية التمويل الاجتماعي الإسلامي في دعم تحقيق أهداف التنمية المستدامة.

Abstract

The primary objective of Islamic social finance is to eliminate poverty and promote human welfare, aligning perfectly with the goals of the SDGs. A close examination of the SDGs reveals a strong correlation with Islamic social finance, emphasizing their close bond and comparability. Therefore, this study aims to investigate how Islamic social finance (ISF) sources can offer viable solutions to combat uncertainty, establishing a more economically balanced and just society - a shared aim with the SDGs. To achieve this objective, the study conducts an extensive literature review of existing and pertinent studies on social finance and Islamic social finance. This review assesses the current context, their contributions to the SDGs, and identifies limitations and gaps in both theory and practice. The research findings indicate that although the *Shari'ah*-based social financial system is relatively young, it has been gaining popularity by providing financial services to those who do not accept the interest-based conventional financial system. Consequently, there is significant demand for *Shari'ah*-based and interest-free financial services. ISF institutions play a crucial role in eradicating poverty, especially when compared to debt-based financial institutions that impose high interest rates on investments. The detrimental effects of debt and high interest rates are evident, leading to various financial, social, psychological, and moral problems. In this context, *Shari'ah*-based ISF emerges as a promising alternative source of financial support for impoverished populations in many Muslim-majority countries worldwide. The unique characteristics and strong moral values inherent in Islamic social finance underscore its potential to significantly contribute to poverty alleviation, financial development, and enhanced financial

inclusion, all of which align with the overarching goals of the SDGs. These qualities position ISF as a key driver for expediting progress toward SDGs. However, despite its potential to yield positive social impacts, ISF faces numerous challenges that must be overcome to facilitate extensive interest-free financial inclusion through Islamic financial mechanisms. This study provides some policy recommendations to address these challenges and further enhance the effectiveness of Islamic social finance in supporting the attainment of SDGs.

الكلمات الدالة: التمويل الاجتماعي الإسلامي، أهداف التنمية المستدامة، التخفيف من حدة الفقر، الشمول المالي.

Keywords: Islamic Social Finance, SDGs, Poverty Alleviation, Financial Inclusion.

1.0 Introduction

Islamic social finance represents a holistic philosophy intertwined with human life, aligning seamlessly with the objectives of the Sustainable Development Goals (SDGs). It derives its foundations from Islam, a religion that espouses complete guidance for humanity through the teachings of Prophet Muhammad (s.a.w.s.) and the sacred book, *Al-Qur'an*. Within the Islamic framework, there exists a well-defined structure for a successful and welfare-oriented state, with financial stability and development being pivotal components.

Following the global financial crisis (GFC), the resurgence and undeniable significance of Islamic finance and its institutions garnered considerable attention from scholars. Islamic finance, known for its resilience in times of crisis, demonstrated the capability to recover losses and ensure stability (Ahmed et al., 2015; Banna et al., 2020; Mirakhor, 2008). Notably, Islamic social finance emerged as a prominent sector within Islamic finance, reflecting ethical principles and a commitment to social well-being.

Islamic social finance encompasses diverse financial instruments, including *zakat* (charity/almsgiving), *awqaf* (plural of

waqf endowments), *sadaqah* (charity), and *qard al-hasan* (interest-free loans). It also encompasses Islamic microfinance and Islamic microcredit, both aimed at advancing the welfare of Muslim communities. Collectively, these facets of Islamic social finance share a common mission to foster happiness, social and financial security, poverty eradication, hunger alleviation, and improved living standards.

The primary objective of Islamic social finance aligns with the SDGs, emphasizing the elimination of poverty and the promotion of universal welfare. An examination of the SDG agenda reveals a profound connection, with both Islamic social finance and the SDGs sharing the vision of establishing a balanced, equitable society (Abduh, 2019; Ali & Kassim, 2020; Jouti, 2019). Both strive for social welfare, dedicating unwavering efforts to achieve this noble goal (Saniff et al., 2020). Given this intrinsic relationship, this paper aims to explore how the revitalization and effective implementation of Islamic social finance can facilitate the achievement of the SDGs. The urgency of this study is underscored by the global impact of the Covid-19 pandemic, causing widespread economic hardship (Jackson et al., 2020; Fernandes, 2020; Bagchi et al., 2020).

While various conventional financial institutions have responded to alleviate economic hardships, their activities often exacerbate misery by offering loans with high or moderate interest rates, incompatible with Islamic finance principles. This study seeks to evaluate existing research on the potential of Islamic social finance sources to alleviate people's hardships during the global pandemic. Building upon prior evidence from the GFC, where Islamic finance outperformed conventional finance in economic recovery (Ahmed et al., 2015; Banna et al., 2020), this study anticipates that the revival of Islamic social finance will benefit those affected by Covid-19 and contribute to SDG attainment. Islamic finance's zero tolerance for interest or harmful practices underpins this expectation.

Therefore, the primary objective of this study is to investigate how Islamic social finance sources can provide practical solutions to address uncertainty and establish a more equitable and just society—a shared goal with the SDGs. The study draws theoretical support from Ahmed et al. (2015), which showcases Islamic finance's contribution

to economic recovery after the GFC. Additionally, Kassim (2016) provides empirical evidence of Islamic finance's significant role in a country's economic growth, aligning with SDG objectives. The paper aims to explore the compatibility between Islamic social finance and the SDGs, scrutinizing the existing body of literature. By doing so, it aims to contribute valuable insights for future researchers investigating the role of Islamic social finance during crisis periods and its potential to achieve SDG goals, reshaping public perception and fostering economic sustainability. The remainder of this paper is structured as follows: Section two provides an overview of the current landscape of Islamic social finance sources, while section three outlines the study's methodology. Sections four and five respectively establish the connections between Islamic social finance and the SDGs and identify constraints in implementing Islamic social finance. Finally, section six offers concluding remarks.

2.0 Current Scenario of the Sources of Islamic Social Finance

Islamic social finance encompasses a range of instruments, including *zakat* (charity/almsgiving), *awqaf* (plural of *waqf*/endowments), *sadaqah* (charity), and *qard al-hasan* (interest-free loans). Among these, *zakat* stands as one of Islam's fundamental pillars and a primary source of Islamic economics. Its core objective is the establishment of an equitable society where poverty is eradicated, ensuring equal status and dignity for all individuals, irrespective of wealth. *Zakat*, therefore, aligns seamlessly with the SDGs, which aim to achieve 17 goals by 2030 for a harmonious world free from depression or frustration (Yahaya & Ahmad, 2018). Specifically, SDGs 1 (no poverty), 2 (no hunger), 3 (good health), 10 (reducing inequality), and 11 (sustainable cities and communities) closely mirror the goals of *zakat* (Saniff et al., 2020), emphasizing social welfare and development. These shared objectives reinforce the strong connection between *zakat* and the SDGs (Nurzaman & Kurniaeny, 2019; Rehman & Pickup, 2018).

To expand the impact of *zakat*, numerous Islamic countries have integrated additional social financial aspects, such as *waqf*, Islamic microfinance/microcredit, and *sukuk*, into the *zakat* system (Pickup et al., 2018). *Zakat* plays a vital role in establishing a just society by eliminating poverty and hunger, ensuring quality education, good

health, equality, and overall economic growth (Ismail & Shaikh, 2017). Aligning with Islam's goal of enhancing the socio-economic well-being of mankind, the effective implementation of *zakat* contributes to achieving the SDGs, ultimately creating a better world. *Zakat*, when properly collected and distributed, guarantees social security and equality (Nurzaman & Kurniaeny, 2019; Yahaya & Ahmad, 2018; Rehman & Pickup, 2018). Several countries recognize *zakat* as a potent tool for poverty eradication. For example, Malaysia and Indonesia view *zakat* as an effective mechanism to foster equality and harmony, further strengthened by the inclusion of other social financial instruments like *sadaqat* and *waqf* for economic growth (Demirgüç-Kunt et al., 2015; Farah Aida et al., 2012). The core objectives of *zakat*/Islamic social finance align with those of the SDGs, emphasizing the need for the proper application of *zakat* based on Islamic principles.

Another integral source of Islamic social finance is *waqf* (endowment), a versatile instrument used for various religious and socio-economic purposes, including education, healthcare, and infrastructure development within Muslim communities. In a broader context, *waqf* addresses poverty and hunger, aligning with SDG objectives (Ainul-Basirah & Siti-Nabiha, 2020). *Waqf* is a voluntary system characterized as Islamic philanthropy, dedicated to the economic development of Muslim communities through universal charity and good deeds (IRTI Social Finance Report, 2017). Globally, *waqf* has experienced significant revival in recent years as it contributes to social development (Cajee, 2007). Many countries have enshrined *waqf* in their federal constitutions, with Malaysia exemplifying this approach by maintaining *waqf* administration through specific legislation (Ainul-Basirah & Siti-Nabiha, 2020). The primary objective of *waqf* is to promote economic security, social harmony, and an improved quality of life, all of which are central to the SDGs (Abdullah, 2018; Kahf, 2007). Thus, *waqf* plays a pivotal role in achieving the SDGs, particularly during the Covid-19 pandemic, highlighting its potential for socio-economic development (Nazari, 2020).

Another source of Islamic social finance is *sadaqah*, which represents arbitrary donations to the needy or the downtrodden solely

for the sake of Allah (s.w.t.), without expecting material gain. It embodies love, compassion, generosity, and faith, sharing similarities with *zakat*, although *zakat* is an obligatory Islamic pillar. Alongside *sadaqah*, a *qard al-hasan* is an Islamic social finance source, referring to interest-free loans provided by the affluent to the less privileged, with flexible repayment terms determined by the borrower's financial capacity (Zauro et al., 2020). These elements, including other facets of Islamic social finance, contribute significantly to integrating a large population into formal financial services, thereby enhancing financial inclusion (Hassan, 2015; Atia, 2010; Naceur et al., 2015). Increased financial inclusion leads to improved economic well-being and poverty reduction, which are core goals of the SDGs. Moreover, these components of Islamic social finance promote socio-economic justice, stimulate economic development, generate wealth, and reduce poverty (Iqbal & Mirakhor, 2013), all in alignment with the SDGs' objectives. However, the practice and implementation of these noble aspects of Islamic social finance are on the decline. Considering the current global context, revitalizing these sources of Islamic social finance is essential to establish a just and balanced society, ultimately contributing to the achievement of the SDGs.

3.0 Methodology

This study employs a comprehensive literature review strategy to explore the connection between social finance and Islamic social finance within the framework of the Sustainable Development Goals (SDGs). It is essential to note that this research falls under the category of a review study, and it does not involve bibliometric analysis. Instead, the study meticulously selects and consolidates relevant research from reputable databases like Emerald, Web of Science, and Google Scholar to illuminate critical aspects, including the current state of Islamic social finance, its contributions to the SDGs, and existing gaps and limitations in theory and practice.

The process of selecting pertinent papers followed a systematic and thorough approach. Initially, a wide array of existing studies was identified and gathered from the aforementioned databases. These studies underwent careful scrutiny, with a focus on issues closely aligned with the research objectives. Subsequently, these concepts

were refined and synthesized to align with the primary goals of the study. It is worth noting that the study does not provide specific quantitative statistics regarding the number of papers included or excluded. Instead, the primary aim is to extract valuable insights from the selected literature.

This study centres its attention on gaining a comprehensive understanding of the broader landscape of Islamic finance and its relationship with the attainment of SDGs. It acknowledges the constraints and challenges that Islamic social finance encounters while projecting potential future implications. Rather than emphasizing quantitative assessments, the study prioritizes the synthesis of qualitative information to construct a holistic perspective of the subject matter.

4.0 Islamic social finance (ISF) and the SDGs

In recent years, the Islamic finance industry has witnessed substantial growth in both Muslim-majority and non-Muslim countries worldwide. Notably, the annual growth rate of Islamic finance assets stands at approximately 12.7%, amounting to a total asset value of 1.273 billion USD (Karake-Shalhoub, 2008). Furthermore, Islamic finance has experienced remarkable expansion in Western countries such as the U.K. Switzerland, and the U.S..A (Biancone & Salem, 2018). The widespread appeal of Islamic social finance (ISF) in these Western nations can be attributed to its ethical underpinnings and commitment to social responsibility.

While Islamic finance has made significant contributions to economic progress and development, ISF serves as a potent financial instrument for effecting positive social and environmental change within communities. ISF's purpose extends beyond fostering social entrepreneurship, emphasizing instead the well-being of community members and the dedicated allocation of surplus funds to community development. While a comprehensive discussion of ISF has been provided in the preceding section, this paper seeks to scientifically evaluate ISF's significant role in advancing the Sustainable Development Goals (SDGs), a task that requires a thorough and comprehensive approach given the limited timeframe.

Introduced by the United Nations (UN) in 2015, the SDGs aim to accelerate global development across all countries. Comprising 17 distinct goals to be achieved by all UN member states by 2030, these global goals underscore the logical connection between ISF and the SDGs, as ISF targets the well-being of communities and individuals by providing financial support. In recent years, the SDGs have significantly influenced global capital markets by emphasizing the link between investments and the achievement of these goals. Consequently, many investors, donors, apex bodies, and international organizations have incorporated the SDGs into their investment policies. Meeting the financial requirements to achieve the SDGs is a formidable task for many countries, as not all possess robust economic conditions, and governments often struggle to provide full financial support. In this context, private investors, donors, NGOs, and international organizations are instrumental in filling the funding gap (Schmidt-Traub & Shah, 2015). These funders have introduced various development mechanisms, including microfinance, social finance, and health and education programs, to advance the previous Millennium Development Goals (MDGs) and the current SDGs. ISF, alongside these development mechanisms, has emerged as a potent tool for creating a positive impact within communities, particularly during crisis moments when international donors and foreign aid organizations may reduce funding.

Numerous Muslim-majority countries, including Indonesia, Malaysia, Pakistan, Sudan, Nigeria, South Africa, and India, can harness the potential of ISF by utilizing their *zakat* collections to significantly reduce poverty. Additionally, *waqf* has the potential to generate substantial resources, as witnessed in India where waqf assets in prime locations yield returns far surpassing their book value, creating a surplus of assets to address various social issues. The utilization of *zakat* and *waqf* through ISF not only reduces poverty but also alleviates funding shortages, making ISF a valuable mechanism during times of crisis. However, ISF is still in its infancy and requires advanced policies, research, and development initiatives to become a more effective contributor to social welfare.

Nevertheless, several countries have successfully utilized various ISF products to advance specific SDGs. For example, the

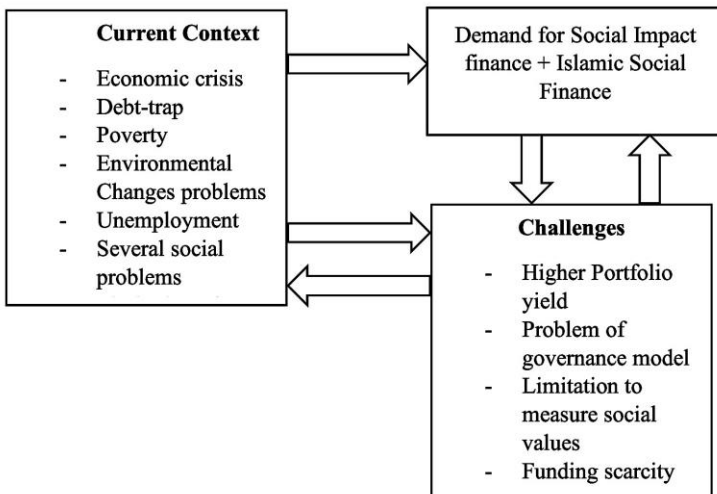
U.A.E. has employed *zakat* to reduce poverty (SDG 1) and ensure social welfare. *Zakat* collections fund financial support, food distribution, and vital services for low-income individuals and families, leading to poverty reduction and improved social well-being. In Turkey, *waqf* has been instrumental in enhancing the quality of education (SDG 4) and healthcare systems (SDG 3), with numerous *waqf* foundations financing schools, hospitals, and healthcare centres to provide citizens with access to quality education and healthcare services. Developing countries have also employed ISF products to achieve SDGs. In Bangladesh, Islamic microfinance plays a crucial role in promoting decent work and economic growth (SDG 8). Islamic microfinance encourages entrepreneurship, financial inclusion, and job creation, contributing significantly to economic growth and poverty alleviation. Indonesia utilizes the *zakat* system to promote community development (SDG 11), directing funds toward infrastructure projects such as sanitation facilities, clean water systems, and housing for marginalized communities. These initiatives improve living conditions, reduce inequities, and drive long-term urban growth.

ISF receives funding from three primary sources: *infaq* or charity, *waqf*, and *zakat*. These sources can be either compulsory or voluntary for well-off Muslims. ISF collects these funds from wealthy individuals and institutions and distributes them among the poor and destitute to maintain social peace and reduce social disparities. Unlike conventional microfinance, which often relies on debt-based financing and secondary sources of funding from formal financial institutions, ISF is a *Shari'ah*-compliant social financing system that derives its funding from compulsory and non-compulsory sources, including *zakat*, *waqf*, and charity. This distinction allows ISF to create a more significant impact on society and the environment, being more cost-effective and directly improving community well-being. ISF aligns with the UN's global goals of 2015, and its potential to contribute to the UN's overall global goals is significant.

5.0 Constraints of the implementation of Islamic social finance and some recommendations

The prevailing financial market is predominantly dominated by the conventional financial system. However, this conventional system is plagued by numerous issues that impede its beneficiaries in achieving overall well-being. Moreover, the social objectives set forth by conventional financial institutions often go unmet. In recent times, financial institutions, whether operating within the conventional or Islamic framework and whether based on equity or debt, have encountered significant challenges. This sector has been severely impacted by a range of issues, including economic crises, over-indebtedness, poverty, economic slowdowns, political instability, environmental challenges, higher portfolio yields, and constraints on public spending (Biancone & Salem, 2018). The diagram below illustrates the current landscape and the factors contributing to the demand for the Islamic social finance (ISF) system. Nevertheless, it is important to note that the entire Islamic finance industry has not been immune to these challenges.

Figure 1: The backdrop of ISF and its challenges.



Source: Authors

The figure presented above, Figure 1, illustrates the existing economic, social, environmental, and political context, highlighting the demand for a social impact finance system capable of promoting the well-being of individuals in society. However, it is essential to recognize that the current financial landscape is fraught with numerous challenges that must be taken into account to ensure the effectiveness of ISF. In addition to the challenges depicted in the figure, several other limitations and potential barriers to the implementation of an effective ISF warrant discussion. These are briefly outlined below:

Higher Interest Rates

Conventional financial systems heavily rely on interest earnings as a primary source of profitability and business growth. These institutions often impose high-interest rates to cover their operational expenses and portfolio yields (Mia and Rana, 2018). However, from the perspective of beneficiaries, the imposition of high-interest rates poses significant difficulties in repaying instalments promptly. According to Helms and Reille (2004), nominal interest rates in microfinance institutions can range from 20% to 80%, and in some countries, rates for diversified loan products are even higher. Conventional institutions, including those in the microfinance sector, set interest rates between 22% and 110% (Faruqee and Khalily, 2011). Given that interest is strictly prohibited in Islam, ISF emerges as a potential alternative source of financial support in contrast to interest-based conventional financial systems.

Restoring Social Trust

Social trust, a combination of ‘society’ and ‘trust’, underpins the overall sustainability of a community. Social trust emerges when individuals residing within a society believe in each other, fostering faith in their fellow citizens. Pew Research Centre (2007) defines social trust as a “belief in the honesty, integrity, and reliability of others, equating to faith in people.” Social scientists, however, grapple with understanding why people trust or do not trust one another, with various cognitive, demographic, and economic factors influencing the establishment of social trust within a particular society. The level of social trust manifests through the financial transactional attitudes of the population, and it can vary across different societies. With the ever-

changing social context, technological advancements, and evolving societal dynamics, bonds of faith, belief, and honesty among individuals undergo continuous transformation. People are increasingly becoming self-centred, disengaging from complex financial matters. ISF has the potential to foster social trust by providing financial assistance to the poor and the underprivileged.

Ensuring Equal Distribution of Wealth and Assets

A significant portion of social wealth is concentrated in the hands of the affluent, while a large proportion of the population experiences impoverished living conditions. Currently, there are few proper *Shari'ah*-compliant systems in place to ensure equitable distribution of this wealth among all members of society. Wealth accumulation is often driven by the rich, who spend lavishly on various comforts without adequately benefiting the poor. Consequently, the impoverished turn to informal financial lenders, including loan sharks, and are burdened by exorbitant interest rates (Yunus, 2007). ISF has the potential to address this issue by promoting equitable distribution of wealth and assets in society.

Restoring Social Coherence

Social coherence is characterized by stable emotional relationships among individuals within a community, whether it is a team, family, or social organization. It relies on harmonious relationships, effective communication, cooperation, and efficiency. Greater social coherence leads to increased peace within a society. According to Keyes (1998), social coherence has been defined as “the perception of quality, organization, and operation of the social world, and it includes a concern for knowing about the world.” As a result, social coherence deteriorates. However, it is expected that ISF has the potential to serve as an alternative source of *Shariah*-compliant financing that can restore social coherence.

Stabilizing Social Disorder, Unrest, and Crime

When the wealthy fail to provide financial support to the poor, social disorder, unrest, and crime often ensue. The disenfranchised population may resort to forceful means to claim their rights, engaging in criminal activities such as theft, robbery, and even terrorism. Conversely, the affluent may seek to accumulate wealth through unfair

means or corruption, leading to societal deterioration. ISF, by receiving compulsory and non-compulsory charity from the wealthy and distributing it among the poor, can prevent various forms of disorder, unrest, and criminal activities.

Governance Framework Challenge

The implementation of ISF programs necessitates a *Shari'ah* governance framework. Hence, it is imperative that the *Shari'ah* governance framework is clearly defined and agreed upon in advance. A *Shari'ah* supervisory board ensures that the financial operations and mechanisms of Microfinance Institutions (MFIs) adhere to *Shari'ah* principles. The development of new financial products designed to ensure profitability and maximum outreach among the poor requires guidance in accordance with *Shari'ah* principles. *Shari'ah* scholars must be selected based on stringent criteria. Moreover, the *Shari'ah* Supervisory Board must operate independently, with members demonstrating academic honesty and integrity - essential prerequisites for *Shari'ah* supervisory governance policies. These policies must encompass reporting structures, codes of conduct, ethics, roles, responsibilities, the scope of duties, risk reporting, oversight functions, and various other policies and procedures, all documented under the Islamic financial *Shari'ah* governance framework.

Risk Management Framework

Risk management is crucial in the financial system, particularly because risks stemming from uncertain future events can significantly impact financial institutions' objectives. Risk management is complicated by the inherent uncertainty of future events, which financial institutions may fail to predict accurately. These uncertainties can relate to debtors' inability to meet financial obligations due to insolvency, the institution's poor profitability, fraud, fluctuations in exchange rates, or noncompliance with *Shari'ah* principles. *Shari'ah*-compliant business contracts entitle involved parties to profit for assuming certain risk aspects, referred to as essential risk or the risk of return in *Shari'ah*-compliant business activities or contracts. Islamic finance is exposed to both generic and unique risks, with the latter arising from the nature of Islamic finance (e.g., credit risk, market risk, operational risk, liquidity risk, equity investment risk, rate of return

risk, displaced commercial risk, *Shari'ah* non-compliance risk, inventory risk). All financial institutions, including ISF, must adopt a risk management framework to ensure sustainable operations.

6.0 Suggestions

Based on the comprehensive analysis of the various constraints associated with Islamic Social Finance (ISF), the following recommendations are put forth:

Combatting Excessive Interest Rates

In response to the issue of excessive interest rates, it is imperative that Islamic social finance institutions persist in providing interest-free financial products. Simultaneously, governments and regulatory bodies should employ incentives to encourage conventional financial institutions to offer equitable and accessible financing options to underserved groups.

Promoting Transparency and Ethical Fund Administration

ISF should launch proactive initiatives to promote transparency and ethical fund management. Public awareness campaigns and community engagement programs should be emphasized to rebuild social trust.

Advancing Equitable Wealth Distribution

To address wealth disparities, ISF should advocate for equitable wealth distribution through established mechanisms such as *zakat* and *awqaf*. Concurrently, governments should implement policies aimed at minimizing economic disparities and fostering a more just and inclusive society.

Supporting Community Development and Collaboration

ISF should actively engage in supporting community development projects and fostering collaboration among diverse community stakeholders. Ethical principles and community involvement are vital elements for reestablishing robust social relationships and cohesion.

Providing Financial Assistance to Marginalized Communities

ISF should extend financial support to marginalized individuals and communities, thereby contributing to the reduction of social

disturbance and criminal activities. Governments should create a stable environment conducive to both social and economic well-being.

Strengthening Shariah Governance Structures

To promote transparency and ethical conduct, it is essential for governments to establish robust *Shari'ah* governance structures. These structures should provide clear instructions, delineate duties and responsibilities, and set stringent standards for *Shari'ah* supervisory bodies.

Implementing Comprehensive Risk Management

The establishment of comprehensive risk management frameworks is crucial. These frameworks should address both generic and specific risks associated with Islamic financing. Regular risk assessments and the formulation of effective contingency plans are paramount for ensuring financial stability. By systematically addressing these issues and implementing the recommended strategies, ISF can navigate the challenges it faces and fulfil its potential as a key driver of social and economic well-being.

7.0 Conclusion

The emerging *Shari'ah*-based social financial system, while relatively young, has garnered increasing popularity and provides a viable alternative to those who are averse to the interest-based conventional financial system. Consequently, a substantial demand for *Shari'ah*-based, interest-free financial services persist, particularly in many Muslim-majority countries. This demand is driven by the recognition that debt and high interest rates can engender numerous financial, social, psychological, and moral issues. Islamic Social Finance (ISF) serves as a potential source of financial support for the impoverished, thereby contributing significantly to poverty alleviation, financial development, and financial inclusion. ISF's unique characteristics and high moral principles position it as a key accelerator of the Sustainable Development Goals (SDGs).

While the aim of this study was to assess the contribution of Islamic finance to the SDGs, it uncovered a significant disparity between theory and practice within the sector. Furthermore, ISF has yet to mature as an industry, particularly in terms of practical

implementation. The Islamic social financing model requires refinement to enhance its consumer-friendliness and compliance with Islamic and *Shari'ah* principles. Despite its potential to effect social change, ISF faces several challenges that must be surmounted to enable widespread interest-free financial inclusion through an effective Islamic social financial mechanism. This study not only highlights the limitations but also provides insights for potential improvements in the future. It contributes to the existing body of literature, offering guidance for scholars engaging in empirical and exploratory research in this field. Additionally, the study recommends specific policies to enhance ISF's effectiveness as a *Shari'ah*-compliant tool for substantial contributions to the achievement of the SDGs by 2030.

One crucial recommendation involves establishing a formal authority responsible for aggregating *zakat* and *waqf* assets and subsequently channelling these resources into ISF institutions for equitable distribution among disadvantaged community members. Strict adherence to *Shari'ah* compliance by national or local *Shari'ah* boards is essential to ensure the seamless receipt and distribution of funds to those in need. Furthermore, the implementation of robust rules, regulations, and legal obligations is necessary to uphold good governance in ISF operations. ISF institutions must also place a strong emphasis on risk evaluation and the development of consumer-friendly products and services to maximize their social impact. By harnessing the potential of financial inclusion through ISF, the attainment of global goals becomes a more achievable reality.

Looking ahead, ISF institutions should prioritize the development of *Shari'ah*-compliant financial products that cater to the needs of consumers. Simultaneously, they should explore the establishment of a formal body to oversee *zakat* and *waqf* assets for efficient distribution. Ensuring strict adherence to *Shari'ah* compliance by regulatory authorities, the implementation of stringent rules, and an increased focus on risk management and product design are essential components for ISF banks. In the foreseeable future, ISF is poised to expand its role in the financial industry, attracting a larger client base seeking interest-free solutions aligned with the SDGs and ethical principles. To fulfil its potential and make a substantial

contribution to global development objectives, ISF must surmount challenges and continually refine its financing strategies.

In conclusion, this study, limited to a review of existing literature without access to primary or secondary data sources, exposes a significant constraint in exploring the dynamics and establishing conclusive evidence of relationships. Nonetheless, it paves the way for numerous investigations, particularly regarding the performance of Islamic social finance in achieving global targets in the years to come.

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