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The Paradox of Prosperity: Interest-Based Finance, Inequality, and Islamic Risk-Sharing as a Framework for Sustainable Development

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Abstract

This paper develops a conceptual analytical framework to explain the coexistence of economic growth with rising inequality, financial fragility, and social exclusion in contemporary interest-based financial systems, a phenomenon described as the Paradox of Prosperity. Drawing on development economics, financial instability theory, and Islamic economic principles, the study examines how debt-driven financial deepening can promote aggregate growth while undermining distributive justice and systemic stability. The paper advances Islamic risk-sharing finance as an institutional alternative capable of addressing these structural contradictions. Rather than presenting Islamic finance solely as a normative critique, the study positions risk-sharing arrangements as a macro-financial framework with implications for stability, inclusion, and sustainable development. By linking Islamic finance principles to broader debates on financialization, inequality, and institutional quality, the paper extends Islamic finance analysis beyond micro-level instruments to system-level financial design. The study contributes to the literature by introducing the Paradox of Prosperity as a unifying conceptual lens, advancing Islamic finance theory through an emphasis on institutional design and risk-sharing, and offering policy-relevant insights aligned with the objectives of Shariah (maqasid al-Shariah) and the Sustainable Development Goals, particularly in Muslim and developing economies.

Keywords: Islamic finance; interest-based finance; *riba*; inequality; sustainable development; risk-sharing
JEL Classifications: E44; G01; O16; O17; Q01

1. Introduction

The global financial system is historically entrenched in an interest-based framework, underpinned by neoclassical economic theory that legitimises interest as a means for equilibrating savings and investment, rewarding deferred consumption, and fostering capital accumulation (Conard, 2023; Fisher, 1930; Qasim et al., 2025). Yet such orthodoxy obscures a significant paradox: while interest

(riba, in Islamic discourse) is frequently portrayed as a catalyst for prosperity, it has instead been implicated in economic instability, heightened inequality, and unsustainable sovereign debt (Bohoslavsky, 2016; Magwedere & Marozva, 2023; Rachel & Summers, 2019). Nowhere is this more apparent than in developing economies, where escalating interest payments compete with vital expenditure on health, education, and infrastructure, thereby constraining inclusive growth and perpetuating cycles of indebtedness (IMF, 2023; Reinhart & Rogoff, 2010; Said & Sani, 2020).

From the Islamic economic perspective, such adverse outcomes are anticipated, as the Qur'an unequivocally forbids riba, deeming it exploitative and antithetical to justice (Al-Baqarah, 2:275–279). This ethical paradigm prioritises distributive justice, social welfare, and shared prosperity (Chapra, 2011; Sani & Mustapha, 2023; Yuliani & Rohman, 2021). By tethering profits to real economic activity and risk-sharing, Islamic economics offers a critical alternative to conventional finance, challenging systems that privilege capital accumulation over collective wellbeing. In this

context, the present study interrogates the neoclassical rationale for interest, scrutinises the role of riba-based finance in exacerbating debt and inequality, and explores Islamic finance as a framework aligned with the UN Sustainable Development Goals (SDGs).

This study advances the literature by conceptualising the "Paradox of Prosperity," elucidating how financial deepening through interest can coexist with worsening inequality and systemic fragility. It reframes risk-sharing Islamic finance not merely as a moral alternative, but as a robust institutional remedy for macroeconomic instability and distributive injustice. Furthermore, the analysis connects Islamic finance principles to contemporary policy debates and the SDGs, advocating their relevance for macro-financial system design. Ultimately, the study contends that addressing the vulnerabilities of interest-based systems necessitates a paradigm shift grounded in justice and sustainability, thus providing a basis for reimagining financial architecture in pursuit of stability and equitable development.

2. Literature Review

2.1 Conventional Perspectives on Interest

Interest occupies a pivotal role in modern finance, traditionally justified by the Loanable Funds Theory and the Time Preference Theory (Bertocco & Kalajzić, 2019; Conard, 2023; Hansen, 1951). The former views interest as the price equilibrating savings and investment, while the latter interprets it as compensation for deferred consumption, reflecting individuals' preference for present utility (Fisher, 1930; Trostel & Taylor, 2001; Wang et al., 2025). Together, these frameworks underpin the economic rationale for interest, portraying it as both rational and essential for capital formation and economic growth.

However, these conventional perspectives largely overlook distributional outcomes, social inequalities, and systemic financial fragility (Farooq et al., 2019; Kilinc & Kilinc, 2023, 2025a; Yuliani & Rohman, 2021). Real-world evidence reveals that rising interest obligations often redirect scarce resources towards debt servicing, thereby constraining inclusive growth and entrenching fiscal vulnerability, especially in developing economies. Thus, the ensuing discussion critically assesses these theoretical justifications and explores alternative frameworks, particularly Islamic finance, that emphasise justice, risk-sharing, and sustainable development.

2.2 Critical Perspectives on Interest-Based Systems

Despite conventional theories framing interest as a neutral facilitator of capital allocation and growth, empirical studies reveal significant drawbacks. High interest burdens have often contributed to financial instability, entrenched inequality, and unsustainable debt, particularly in developing economies (Reinhart et al., 2010; Said & Sani, 2020). Historical analyses show that escalating interest obligations can trap nations in cycles of borrowing and repayment, undermining fiscal capacity and crowding out essential social investment (Álvarez-Gálvez & Jaime-Castillo, 2018; Fosu, 2007; Lora & Olivera, 2007). This "paradox of prosperity" underscores how long-term reliance on interest-bearing debt may ultimately destabilise economies.

Moreover, interest-based systems perpetuate structural inequality and financial fragility. Returns on capital typically outpace economic growth, widening wealth divides (Piketty, 2014; Kilinc & Kilinc, 2025; Magwedere & Marozva, 2023). Over-leveraging and speculative borrowing further amplify economic cycles, increasing vulnerability to crisis (Minsky, 1992; Reinhart et al., 2012; Stiglitz, 2015). Consequently, conventional theories often overlook distributional impacts and systemic risks, highlighting the need for alternative models, such as Islamic finance, that prioritise equity, risk-sharing, and sustainability (Hakim, 2025; Muthoharul Janan et al., 2025).

2.3 Islamic Economics: Principles and Mechanisms

In contrast to conventional interest-based systems, Islamic economics offers a framework that explicitly integrates ethical, distributive, and social considerations into financial practice (Dzulkepli & Barom, 2021; Kato, 2022; Yuliani & Rohman, 2021). Central to this approach is the prohibition of riba, which the Qur'an condemns as exploitative and unjust (Quran, 2:275–279). This ethical injunction underpins a financial system designed not merely for efficiency or capital accumulation, but for equitable and sustainable development.

2.3.1 Ethical Foundations

The principles of Islamic finance are grounded in justice, equity, and social welfare (Chapra, 2011). Unlike conventional systems that often prioritize individual profit maximization, Islamic economics emphasizes shared prosperity and collective responsibility. Financial transactions are expected to reflect real economic activity and avoid abstract claims on capital that generate wealth without contributing to production or societal well-being. By embedding ethical considerations into economic decision-making, Islamic finance seeks to mitigate structural inequalities and the instability often observed in interest-based systems.

2.3.2 Mechanisms: Risk-Sharing and Asset-Backed Financing

These principles are operationalized through mechanisms that link financial returns directly to real economic outcomes. Profit-and-Loss Sharing (PLS) contracts, such as Mudarabah and Musharakah, exemplify this approach (Saleem et al., 2024; Sari, 2024). In Mudarabah, one partner provides capital while the other contributes expertise, with profits shared according to a pre-agreed ratio and losses borne by the capital provider. Musharakah, by contrast, involves all partners contributing capital and sharing profits and losses proportionally. Another key mechanism is asset-backed financing, which mandates that transactions be linked to tangible assets or productive activity (Abdul-Rahman, 2010). This ensures that financing supports real economic development rather than speculative gain. By distributing both risk and reward, these mechanisms promote equitable growth, social welfare, and sustainable economic development, offering a clear departure from conventional interest-based lending where returns are guaranteed regardless of performance. These operational principles form the theoretical foundation for understanding the developmental implications of Islamic finance.

2.3.3 Theoretical Implications for this Study

Islamic finance provides a practical alternative to conventional systems, directly addressing their limitations. By embedding risk-sharing, equity, and asset-backed financing into its design, it offers a framework for mitigating debt cycles, reducing inequality, and promoting sustainable development. This theoretical foundation underpins the study's argument that riba-free financial systems can more effectively support the Sustainable Development Goals (SDGs) while maintaining macroeconomic stability.

2.4 Identified Gap and Conceptual Framework

The preceding discussion highlights a fundamental tension in global financial systems. Conventional theories, such as the Loanable Funds and Time Preference frameworks, justify interest as a neutral mechanism for growth and capital allocation. Critical perspectives, however, reveal that these systems often produce long-term instability, rising inequality, and recurring debt crises (Minsky, 1992; Piketty, 2014; Reinhart & Rogoff, 2010). Islamic economics, by contrast, offers a normative and operational framework that prioritizes equity, risk-sharing, and asset-backed financing, aligning financial activity with social welfare and sustainable development (Chapra, 2011; Iqbal & Mirakhor, 2019).

Despite extensive critiques of interest-based systems, few studies systematically examine the "Prosperity Paradox" within a unified Islamic economic framework. Existing literature does not explicitly connect riba-driven fiscal fragility with inequality and SDG constraints, nor does it contrast this with the stabilizing potential of Islamic risk-sharing mechanisms. Building on these principles, this study identifies a critical gap in the literature and develops a conceptual framework to examine how riba-free, risk-sharing financial systems can mitigate the Prosperity Paradox and contribute to inclusive, stable, and sustainable development.

2.4.1 Conceptual Framework

Building on established theoretical and empirical insights, this study develops a conceptual framework that places the **"Paradox of Prosperity"** at the core of the analysis. Consistent with the literature on debt-based financial systems and financial instability (Minsky, 1992; Stiglitz, 2015), the framework contrasts the developmental paths associated with interest-based and Islamic financial systems. In interest-based systems, periods of short-term economic expansion are frequently accompanied by rising leverage and debt accumulation, which, over time, translate into fiscal stress, heightened financial fragility, and widening income and wealth inequality, thereby undermining the sustainability of growth (Piketty, 2014; UNCTAD, 2019).

In contrast, Islamic finance systems, anchored in principles of risk-sharing and asset-backed financing, allocate risk more symmetrically between financiers and entrepreneurs, reduce systemic dependence on debt, and strengthen the linkage between financial flows and real economic activity. These features promote more equitable returns, mitigate debt vulnerability, and enhance macro-financial stability, thereby fostering a development process that is both inclusive and resilient (Chapra, 2011; Mirakhor & Iqbal, 2011). Moreover, the institutional orientation of Islamic finance aligns closely with the objectives of the United Nations Sustainable Development Goals (SDGs), particularly those related to inequality reduction, financial inclusion, and economic resilience, reinforcing its relevance as a viable framework for sustainable development.

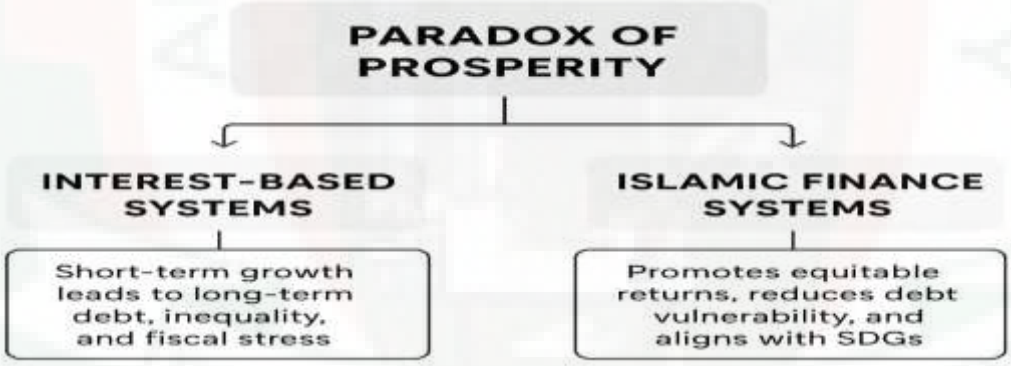


Figure 1: Conceptual Framework of the Paradox of Prosperity in Interest-Based and Islamic Financial Systems.

Figure 1 illustrates the conceptual framework, highlighting the central role of the "Paradox of Prosperity" and the contrasting pathways of the two financial systems. The diagram shows how the interest-based system can lead to fiscal stress and inequality, while the Islamic finance system promotes equitable growth and alignment with SDGs, with arrows indicating causal relationships between system characteristics, intermediate outcomes, and sustainable development results. This visual representation bridges theory and practice, provides a lens for policy evaluation, and guides

subsequent analysis by linking debt cycles, inequality, and SDG outcomes to the systemic properties of each financial paradigm.

2.5 Empirical Literature

The empirical literature demonstrates that debt accumulation, inequality, and macroeconomic instability are not isolated phenomena but deeply intertwined outcomes of interest-based financial architectures. Collectively, these dynamics reveal the "paradox of prosperity"—a condition in which mechanisms designed to promote economic growth ultimately erode fiscal resilience, intensify inequality, and undermine sustainable development. This section synthesizes major empirical findings that explain how interest-based finance generates cyclical vulnerabilities while contrasting these patterns with Islamic finance principles emphasizing equity, stability, and social welfare.

2.5.1 Sovereign Debt and Fiscal Fragility

Cross-country analyses and historical data consistently identify sovereign indebtedness as a key determinant of fiscal stress and macroeconomic instability. Reinhart and Rogoff (2010), in their landmark study of 44 countries spanning two centuries, found that public debt-to-GDP ratios exceeding approximately 90 percent correlate with a marked slowdown in economic growth, largely because debt servicing crowds out productive public investment. Panizza and Presbitero (2014) caution, however, that this relationship is context-dependent and mediated by institutional quality, governance, and political economy dynamics. Similarly, Manasse and Roubini (2009) demonstrate that debt crises rarely stem from a single factor; rather, they emerge from interacting vulnerabilities such as excessive short-term borrowing, low reserves, and weak fiscal institutions. This is consistent with Alesina and Tabellini (1990), who argue that political instability and short-term fiscal incentives drive governments toward unsustainable debt accumulation, generating self-reinforcing debt traps.

Recent evidence from the International Monetary Fund (IMF, 2023) reveals that these structural weaknesses remain embedded in contemporary financial systems. In Sub-Saharan Africa, public debt levels have more than doubled over the past decade, with interest payments consuming an increasing share of government revenues. Ghana's case is illustrative: by 2022, interest payments accounted for over 25 percent of domestic revenue, sharply constraining public investment in health, education, and infrastructure. Similarly, Sri Lanka's 2022 sovereign debt crisis showed how rising debt-servicing obligations can trigger macroeconomic collapse despite prior periods of GDP expansion. These cases exemplify the "paradox of prosperity," wherein debt-financed growth delivers short-term stimulus but erodes fiscal space, increases external vulnerability, and heightens systemic fragility.

3.5.2 Debt, Inequality, and Wealth Concentration

Parallel to fiscal distress, the empirical literature reveals a strong association between interest-based finance and the persistence of structural inequality. Dwyer (2018) observes that the expansion of credit and normalization of indebtedness have transformed debt from a financial instrument into a social institution that structures inclusion, exclusion, and life chances. Her relational approach moves beyond individual borrowing behavior to examine how financial institutions and policy regimes sustain economies increasingly dependent on debt, thereby reproducing structural disparities. Piketty's (2014) reinforces this structural insight, showing that when the return on capital (r) persistently exceeds the rate of economic growth (g), wealth accumulation becomes disproportionately concentrated among capital holders. This $r > g$ dynamic institutionalizes upward transfers of income through interest, dividends, and capital gains—processes that Islamic

economics conceptualizes as zulm (injustice in economic relations), antithetical to the Maqasid al-Shariah, which prioritize distributive adl (justice).

Complementary studies support this interpretation. Keen (2011, 2017) and Stockhammer (2013) document how financialization—the growing dominance of financial over productive sectors—redirects income flows from wages to profits, deepening inequality. Rajan and Myers (2010) show that pre-crisis credit booms inflated asset prices, enriching existing owners while burdening lower-income households with unserviceable debt. In many emerging markets, limited access to affordable credit perpetuates dependence on high-interest borrowing, entrenching social hierarchies. Moreover, government debt servicing frequently diverts fiscal resources away from social investment, reinforcing intergenerational inequity (Huberman and Laskaridis 2023; Stiglitz, 2015). Thus, while interest-based finance is often justified as growth-enhancing, empirical evidence reveals its structural tendency to concentrate wealth and marginalize vulnerable populations.

2.5.3 Financialization and Systemic Instability

Beyond fiscal and distributive impacts, interest-based financial systems exhibit inherent tendencies toward macroeconomic instability. Minsky's (1992) Financial Instability Hypothesis provides a theoretical foundation for understanding how speculative borrowing, driven by optimism and leverage, transforms stability into fragility. Jordà et al. (2011), in a historical dataset spanning 140 years, identify rapid credit growth as the most reliable predictor of financial crises—episodes that produce deeper and more protracted recessions than normal downturns. Historical evidence, including Latin America's 1980s "Lost Decade," illustrates this pattern: periods of debt-fueled expansion followed by systemic collapse once interest burdens become unsustainable. Similar mechanisms underpinned the 1997 Asian Financial Crisis and more recent emerging-market volatility triggered by global interest rate hikes, where sudden capital flight and currency depreciation transmitted instability across borders.

Micro-level studies reveal the same dynamics at the household and firm level. Mian and Sufi, (2022) identify household leverage as the primary transmission channel through which housing market corrections precipitated the 2008 global recession. Bernanke et al. (1999) further explain how deteriorating balance sheets amplify shocks through the "financial accelerator" mechanism. At the external level, Catão and Milesi-Ferretti (2014) show that reliance on interest-bearing public debt strongly predicts crisis recurrence, whereas equity-based financing—analogous to Islamic profit-and-loss sharing—demonstrates stabilizing effects. Empirical assessments by Hasan and Dridi, (2010) confirm that Islamic banks exhibited greater resilience and lower default risk during financial crises, reflecting the stabilizing role of risk-sharing and asset-backing. These findings collectively validate a central principle of Islamic economics: financial stability depends on the alignment of finance with real economic activity and shared risk.

2.5.4 Synthesis: The Paradox of Prosperity and Islamic Finance Alternatives

Across fiscal, distributional, and systemic dimensions, the evidence demonstrates a self-reinforcing cycle: inequality fuels credit expansion, debt accumulation constrains fiscal capacity, and financialization magnifies fragility. Dabla-Norris et al. (2015) show that financial deepening initially supports growth but beyond a threshold exacerbates inequality through speculative instruments and political capture. Atkinson and Morelli (2011) confirm that rising inequality not only precedes financial crises but also amplifies post-crisis asymmetries, worsening long-term recovery. This cyclical process produces what this study conceptualizes as the Paradox of Prosperity, a structural condition in which interest-based finance generates apparent growth that simultaneously undermines fiscal sustainability, distributive justice, and macroeconomic stability.

In contrast, empirical and conceptual evidence converge on the potential of Islamic finance as a stabilizing alternative. By replacing debt with risk-sharing contracts such as mudarabah and musharakah, and by linking finance to tangible assets, Islamic finance aligns monetary flows with productive activity while promoting equitable distribution of returns. This system curtails speculative excesses and mitigates fiscal vulnerability, reinforcing the Maqasid al-Shariah objectives of justice, welfare, and stability. The contrasting trajectories are summarized in Figure 1 and Table 1, which should be placed immediately following this paragraph. Figure 1 illustrates the causal pathways from financial system characteristics to fiscal, distributional, and macroeconomic outcomes, while Table 1 compares the key mechanisms and impacts of interest-based and Islamic finance systems.

Islamic Finance Pathway: risk-sharing and asset-backing → equitable returns → fiscal prudence → stability → SDG alignment.

Empirical literature thus substantiates the rationale for re-evaluating global finance through an Islamic lens—offering an institutional architecture capable of reconciling efficiency with equity and fostering a more stable, just, and sustainable economic order.

Table 1: Comparative Pathways of Interest-Based and Islamic Finance Systems

Dimension	Interest-Based Financial System	Islamic Finance System (Riba-Free)
Core Mechanism	Credit expansion through debt contracts with fixed interest obligations	Profit-and-loss sharing, asset-backed financing, and risk-sharing mechanisms (mudarabah, musharakah)
Growth Pattern	Short-term stimulus driven by borrowing and leverage	Sustainable growth linked to productive investment and asset creation
Fiscal Outcome	Rising debt service burdens → constrained fiscal space → reduced public investment	Fiscal prudence through equity-based finance → greater resilience against debt shocks
Distributional Effect	Wealth concentration due to r > g dynamic and unequal access to capital	Equitable wealth distribution through partnership-based returns and real-sector linkage
Macroeconomic Stability	High vulnerability to financial crises, capital flight, and speculative bubbles	Stability through alignment of finance with real assets and prohibition of speculation (gharar)
Social Implications	Structural inequality, economic insecurity, and cyclical instability	Social welfare, inclusion, and justice consistent with Maqasid al-Shariah
Sustainability Alignment	SDG setbacks due to fiscal fragility and inequality	SDG alignment through ethical, inclusive, and risk-sharing finance

Source: *Author's synthesis based on Reinhart & Rogoff (2010); Piketty (2014); Dwyer (2018); IMF (2023); Minsky (1992); Hasan & Dridi (2010); Abedifar et al. (2015).*

The figure illustrates how interest-based finance produces debt accumulation, fiscal stress, inequality, and instability, whereas Islamic finance promotes risk-sharing, equitable returns, fiscal prudence, and macroeconomic stability, aligning with the SDGs.

3. Methods and Materials

This study employs a conceptual and analytical research design, underpinned by a systematic synthesis of contemporary empirical literature. Such approaches are prevalent in economics and finance for investigating structural relationships and integrating evidence where primary data estimation is not central (Jaakkola, 2020; Tranfield et al., 2003). The methodology proceeds in three stages: first, a review of conventional and critical theories clarifies how interest-based systems shape resource allocation, wealth distribution, and macroeconomic stability (North, 1990; Stiglitz, 2015); second, recent empirical findings from both advanced and developing economies are analysed to uncover patterns linking debt, financialisation, and inequality (Webster & Watson, 2002); third, Islamic finance principles—especially risk-sharing and ethical constraints—are evaluated as alternatives to interest-based mechanisms (Chapra, 2011; Minsky, 1992). This

integrative approach enables robust analytical inference and the generation of policy-relevant insights for sustainable and inclusive economic development.

4. Discussion of Findings and Interpretation

The analysis reveals that conventional interest-based financial systems, although designed to promote growth, often generate unintended and adverse consequences. Empirical evidence consistently highlights that interest-based mechanisms contribute to macro-financial instability, structural inequality, and fiscal vulnerability, a phenomenon we describe as the *Paradox of Prosperity*. Short-term credit expansion may stimulate investment, but interest obligations accumulate into long-term debt stress, crowding out productive public spending and reinforcing inequality (Dwyer, 2018; Kilinc & Kilinc, 2025; Magwedere & Marozva, 2023; Piketty, 2014). Historical and cross-country evidence supports this interpretation: Reinhart et al., (2009) demonstrate that high public debt impedes growth, while Huberman and Laskaridis, (2023) show that debt servicing often diverts resources from social investment, perpetuating intergenerational inequities. In emerging economies, limited access to affordable credit compounds reliance on high-interest borrowing, further entrenching social hierarchies (Stiglitz, 2015).

Interest-based finance amplifies wealth concentration and speculative behaviour, destabilizing the real economy (Hadiana & Davoudia, 2016; Suhaib et al., 2025). In South Africa and other developing countries, rising household debt correlates with increasing income inequality and financial instability (Magwedere & Marozva, 2023). Similarly, simulations comparing Islamic and capitalist models indicate that riba-based loan systems accelerate wealth concentration, while profit–loss sharing and redistributive mechanisms restrain inequality (Kato, 2022). Empirical studies within IsDB countries further confirm that conventional financing schemes often fail to reduce inequality, whereas equity, leasing, and installment-based Islamic financing effectively support low- and middle-income households (Yuliani & Rohman, 2021).

Islamic finance offers a resilient and distributive framework that addresses the structural and ethical limitations of interest-based systems. Its mechanisms link financial outcomes to real economic activity, risk-sharing, and justice, thereby mitigating systemic vulnerabilities (Ali, 2024; Jamiu et al., 2024). Risk-sharing instruments such as mudaraba and musharakah align profits and losses with productive activity, reducing unsustainable debt accumulation (Suhaib et al., 2025). First, asset-backed financing discourages speculation and promotes financial discipline, contributing to macroeconomic stability (Chapra, 2000; Iqbal & Mirakhor, 2019); second, redistributive mechanisms including zakat, waqf, and Qard Hasan operationalize Maqasid al-Shariah by advancing social justice, poverty alleviation, and inclusive growth (Dzulkepli & Barom, 2021; Setiadi & Herlinawati, 2022); third, sovereign experiences and case studies demonstrate that Islamic finance enhances institutional credibility and promotes ethical investment. In conflict-affected regions like Gaza, profit-sharing mechanisms and interest-free financing correlate with greater stability and infrastructure development (Azizah & Hasanah, 2024). Similarly, sukuk financing in Nigeria's road sector illustrates the efficiency of project-linked, ethical financial instruments in addressing infrastructural deficits while attracting ethical investors (Jamilu Baita & Bashir, 2024).

The principles of Islamic finance have direct relevance for achieving the SDGs: First, poverty reduction (SDG 1): Risk-sharing, microfinance, and zakat redistribute wealth to low-income households (Jamiu et al., 2024; Raimi et al., 2024); second, decent work and economic growth (SDG 8): Asset-backed investments stimulate productive activity and entrepreneurship while curbing speculation (Gundogdu, 2018; Kato, 2022); third, reduced inequalities (SDG 10):

Redistributive instruments and equitable financial access promote social cohesion and reduce structural disparities (Dzulkepli & Barom, 2021; Yuliani & Rohman, 2021); fourth, peace, justice, and strong institutions (SDG 16): Ethical finance strengthens institutional credibility, mitigates fiscal stress, and reinforces governance mechanisms (Muhmad et al., 2021; Raimi et al., 2024).

5. Conclusion, and Recommendations

5.1 Conclusion

The central conclusion of this study is that financial stability and sustainable development depend less on the scale of financial deepening than on the institutional design of financial systems. Conventional interest-based finance, rooted in debt contracts and fixed returns, underestimates the long-term systemic and distributive consequences of riba-driven growth. While short-term credit expansion may stimulate investment, accumulated interest obligations ultimately constrain public spending, weaken fiscal resilience, and widen inequality. Islamic finance offers both a normative and operational alternative capable of addressing these limitations. Its emphasis on risk-sharing, asset-backing, and ethical redistribution directly mitigates debt-induced fragility while aligning financial incentives with productive economic activity and social welfare. As such, Islamic finance provides a coherent theoretical framework for reconciling growth with stability, equity, and sustainability, and offers a credible response to the paradox of prosperity inherent in interest-based financial systems.

5.3 Recommendations

Based on the findings of this theoretical analysis, the following recommendations are advanced:

1. Policymakers, particularly in debt-prone developing economies, should prioritize structural reform of financial systems rather than excessive reliance on debt-financed growth strategies.
2. Risk-sharing, asset-backed financing, and redistributive instruments such as zakat and waqf should be progressively integrated into national financial architectures to enhance resilience, equity, and fiscal sustainability.
3. Ethical and distributive objectives should be treated as functional components of financial policy, not merely normative ideals, given their role in achieving inclusive growth and institutional stability.
4. Further work is needed to quantitatively model riba-free financial systems, conduct comparative country-level studies, and explore pathways for embedding Islamic finance principles within the global financial order.

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