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Institutional Quality and Islamic Economy Performance: Evidence From Leading Islamic Economies

Kholilatul Khusni^{1*} M. Bastomi Fahri Zusak²

Universitas Diponegoro.

Corresponding Author: Kholilatul Khusni kholilatulkhusni@gmail.com

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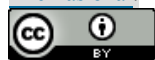
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ABSTRACT

This study examines the relationship between institutional quality and Islamic economy performance across 13 leading Islamic economies. Using a balanced panel dataset comprising 130 country-year observations over a ten-year period, the study investigates six dimensions of the Worldwide Governance Indicators (WGI): Voice and Accountability, Political Stability, Government Effectiveness, Regulatory Quality, Control of Corruption, and Rule of Law. Islamic economy performance is measured using the Global Islamic Economy Indicator (GIEI). Panel data regression is employed, with the Fixed Effects Model selected based on the Hausman specification test at the 10% significance level. The empirical findings reveal that Rule of Law is positively and significantly associated with Islamic economy performance, highlighting the importance of legal certainty and effective institutional enforcement. Conversely, Voice and Accountability and Government Effectiveness exhibit negative and statistically significant relationships, suggesting that improvements in general governance do not necessarily translate into stronger Islamic economic outcomes. Political Stability and Regulatory Quality show statistically insignificant relationships, while the findings for Control of Corruption vary across model specifications. These results demonstrate the multidimensional and context-dependent nature of institutional quality in shaping Islamic economy performance. The study contributes to the literature by extending institutional analysis beyond Islamic finance to the broader Islamic economic ecosystem. The findings emphasize the importance of integrating legal certainty, sector-specific regulatory frameworks, and effective Shariah governance into Islamic economic development strategies

INTRODUCTION

Institutional quality defined as the effectiveness of formal and informal rules, governance structures, and regulatory frameworks plays a pivotal role in shaping the performance of the Islamic economy, which encompasses Shariah-compliant finance, halal industries, and related sectors. The global Islamic economy has emerged as a dynamic and rapidly expanding segment, driven by demographic shifts, rising consumer demand for ethical and faith-based products, and technological innovation. Understanding how institutional quality, particularly as measured by the six Worldwide Governance

Indicators (WGI), influences Islamic economy performance is critical for policymakers, investors, and scholars seeking to foster sustainable, inclusive growth and resilience in both Muslim-majority and minority contexts (Chianeh et al., 2019; Handoyo, 2023; Singh & Pradhan, 2022).

The global Islamic economy has experienced substantial growth in recent decades, driven by a combination of demographic, socioeconomic, technological, and institutional factors. The continued expansion of the global Muslim population, particularly the emergence of a younger and increasingly affluent Muslim middle class, has

strengthened demand for products and services that comply with Shariah principles and reflect Islamic ethical values (Chianeh et al., 2019; Randeree, 2020).

This demographic transformation has supported the development of a diverse Islamic economy ecosystem extending beyond Islamic finance to include halal food, Muslim-friendly tourism, modest fashion, pharmaceuticals, cosmetics, and other halal-related industries. Among these sectors, Islamic finance has demonstrated particularly strong expansion, with total assets having tripled since 2007 and projections indicating continued growth, while the halal industry and Islamic tourism have similarly expanded across major markets, particularly in Southeast Asia and the Middle East (Harrison & Ibrahim, 2016; Rehman & Aisha, 2023; Salam et al., 2019).

At the same time, Islamic social finance instruments, including zakat, waqf, and Islamic microfinance, have gained increasing attention for their potential contribution to poverty alleviation, financial inclusion, and social equity, although challenges related to governance, institutional effectiveness, and impact assessment remain (Abdullah Alserhan & Khoshtaria, 2026; Ahmid, 2026). The growing economic relevance of these sectors has also been accompanied by increasing academic and policy interest, with substantial research activity concentrated in countries such as Malaysia, Indonesia, and Turkey and a growing tendency toward interdisciplinary and cross-border collaboration (Anam et al., 2025; Laila et al., 2021a; Rahman et al., 2025).

Overall, the expansion of the global Islamic economy reflects the interaction between endogenous drivers, including demographic change, religious values, and evolving consumer preferences, and exogenous factors such as technological innovation, regulatory development, and

institutional support, with several countries emerging as important regional and global centers of Islamic finance, halal industries, and Muslim-friendly tourism (Chianeh et al., 2019; Randeree, 2020).

METHODS

This study employs a quantitative approach using balanced panel data from 13 leading Islamic economies observed over ten years, resulting in 130 country-year observations. Panel data are appropriate because they combine cross-sectional and time-series variation while allowing the model to control for unobserved country-specific heterogeneity (Baltagi, 2021; Wooldridge, 2010).

Islamic economy performance is measured using the Global Islamic Economy Indicator (GIEI) reported in the State of the Global Islamic Economy Report. Institutional quality is measured using six dimensions of the Worldwide Governance Indicators (WGI): Voice and Accountability (VA), Political Stability and Absence of Violence/Terrorism (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Control of Corruption (CC), and Rule of Law (RL). These indicators provide internationally comparable measures of governance across countries and over time (Kaufmann et al., 2009).

The empirical model is specified as follows:

$$GIEI_{it} = \alpha + \beta VA_{it} + \beta PS_{it} + \beta GE_{it} + \beta RQ_{it} + \beta CC_{it} + \beta RL_{it} + \mu_i + \varepsilon_{it}$$

where i and t denote country and year, respectively; μ_i captures country-specific effects; and ε_{it} is the error term. $GIEI_{it}$ denotes the global Islamic economic index in region i at time t . VA_{it} represents the level of Voice and Accountability. PS_{it} represents Political Stability and Absence of Violence/Terrorism, GE_{it} indicates the Government Effectiveness, RQ_{it} indicates the Regulatory Quality, CC_{it} indicates the Control of Corruption, and RL_{it} indicates the Rule of Law.

RESULTS AND DISCUSSION

Descriptive Statistics and Model Selection

Table 1. Descriptive Statistics and Model Selection

Variables	Obs	Mean	Std.Dev.	Min	Max
Islamic Economy Performance (SGIE)	130	69.874	44.637	27	290
Voice and Accountability	130	43.755	9.07	28.445	62.889
Political Stability	130	62.528	15.676	24.387	89.569
Government Effectiveness	130	60.388	14.241	36.947	95.666
Regulatory Quality	130	60.617	12.88	31.027	90.038
Control of Corruption	130	50.995	16.297	24.149	90.914
Rule of Law	130	57.239	11.082	35.713	83.596

The study employs a balanced panel dataset consisting of 130 observations from 13 leading Islamic economies over a ten-year period. Islamic economy performance (SGIE) has a mean value of 69.87 and a standard deviation of 44.64, with values ranging from 27 to 290. The relatively wide dispersion indicates substantial heterogeneity in Islamic economy performance across countries and over time. Institutional quality indicators also exhibit considerable variation. Voice and Accountability (VA), Political Stability (PS), Government Effectiveness (GE), Regulatory Quality (RQ), Control of Corruption (CC), and Rule of Law (RL) record mean values of 43.76, 62.53, 60.39, 60.62, 51.00, and 57.24, respectively. These variations provide sufficient cross-country and temporal heterogeneity to investigate the institutional determinants of Islamic economy performance.

The appropriate panel estimator was determined by comparing the Fixed Effects Model (FEM) and Random Effects Model (REM). The test for country-specific fixed effects yields an F-statistic of 22.83 with a probability value of 0.0000, indicating significant unobserved heterogeneity across countries. Furthermore, the Hausman specification test produces a chi-square statistic of 12.44 with a probability value of 0.0529. Since this study adopts a 10% significance level, the null hypothesis of systematic equality between FEM and REM coefficients is rejected. Accordingly, the Fixed Effects Model is selected as the preferred specification. This result implies that unobserved country-specific characteristics are correlated with the explanatory variables and therefore need to be controlled for in the estimation.

Table 2. Estimation Results.

Variables	Model 1	Model 2
Voice and Accountability	−2.907** (0.029)	−1.958* (0.072)
Political Stability	1.024 (0.206)	0.678 (0.353)
Government Effectiveness	−3.275** *	−2.668* *
Regulatory Quality	−1.955 (0.251)	−1.248 (0.425)
Control of Corruption	−0.310 (0.827)	−0.040* (0.012)
Rule of Law	9.251*** (0.001)	6.019** (0.012)

Notes: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$.

The coefficient for Voice and Accountability is negative in both models, amounting to -2.907 in Model 1 and -1.958 in Model 2. Based on the reported p-values, the relationship is statistically significant at the 5% level in Model 1 ($p = 0.029$), while in Model 2 it is significant only at the 10% level ($p = 0.072$). VA has negative impact on globalization (Asongu et al., 2018). The negative coefficient may instead reflect the distinctive institutional structures of leading Islamic economies. Several countries with highly developed Islamic economy ecosystems are characterized by strong state-led development strategies, particularly in Islamic finance, halal certification, halal tourism, and national halal industry development. Moreover, VA measures general political and societal governance rather than institutions specifically designed to support Islamic economic sectors. Consequently, improvements in broader political accountability do not necessarily translate directly into stronger halal industries, Islamic financial markets, or other components captured by the SGIE indicator. The result therefore highlights the importance of distinguishing general institutional indicators from sector-specific institutional arrangements.

Government Effectiveness demonstrates a negative and statistically significant relationship with halal industry performance in both models. The coefficient is -3.275 in Model 1 ($p = 0.008$) and -2.668 in Model 2 ($p = 0.023$). The consistency of the negative coefficients across the two specifications indicates that the observed relationship is relatively robust to the model changes represented in the table. This result appears counterintuitive from the perspective of conventional institutional theory, which generally expects effective governments to improve economic performance through better public services, stronger policy implementation, and greater policy credibility. Nevertheless, the finding may reflect the particular characteristics of Islamic economy development. Islamic economy performance is not necessarily determined by overall government effectiveness alone. Countries may possess relatively

efficient public institutions while placing limited strategic emphasis on Islamic finance, halal industries, Muslim-friendly tourism, modest fashion, or other sectors incorporated into the Islamic economy indicator.

Rule of Law exhibits a positive and statistically significant relationship with halal industry performance in both models. The coefficient is 9.251 in Model 1 ($p = 0.001$) and 6.019 in Model 2 ($p = 0.012$). The findings are supported by the literature (Zusak et al., 2025). These results indicate that the positive association remains statistically significant across both specifications. This finding supports the proposition that legal certainty constitutes a fundamental institutional foundation for the development of the Islamic economy. The effectiveness of a country's regulatory institutions plays a significant role in shaping market performance (Zusak et al., 2025). These conditions are particularly relevant to an Islamic economic ecosystem involving financial institutions, halal producers, certification agencies, investors, consumers, regulators, and international supply chains. The result is also consistent with fundamental principles of Islamic economics. Legal certainty and effective enforcement are closely related to 'adl (justice), the fulfillment of contracts, protection of property rights, accountability, and the prevention of opportunistic behavior. Thus, Rule of Law represents not only a conventional institutional requirement but also an institutional condition compatible with the normative foundations of Islamic economic transactions.

Regulatory Quality exhibits negative coefficients in both models, with values of -1.955 in Model 1 and -1.248 in Model 2. However, the corresponding p-values of 0.251 and 0.425 indicate that neither coefficient is statistically significant at conventional levels. The development of Islamic economic sectors may depend more strongly on specialized regulatory arrangements, including halal certification, Shariah governance, Islamic financial regulations, halal supply-chain standards, and Muslim-friendly tourism frameworks. Therefore,

general improvements in regulatory quality may not necessarily generate measurable changes in SGIE performance.

Control of Corruption also shows no statistically significant effect ($\beta = -0.310$; $p = 0.827$). Political Stability exhibits positive coefficients in both models, amounting to 1.024 in Model 1 and 0.678 in Model 2. However, the corresponding p-values of 0.206 and 0.353 indicate that these relationships are not statistically significant at conventional significance levels. This finding does not imply that corruption control is irrelevant to Islamic economic development. Rather, its effect may operate indirectly through investment, institutional credibility, government effectiveness, or broader economic development (Zusak et al., 2025). Moreover, Islamic economy performance may respond more immediately to sector-specific institutional arrangements than to short-term changes in general corruption-control indicators. Corruption is associated with higher economic growth in politically unstable countries, whereas it tends to hinder economic growth in countries characterized by greater political stability (Shabbir et al., 2016). Political stability may function primarily as an enabling condition that requires complementary policies, investment, market development, and sector-specific institutions before translating into stronger Islamic economy performance.

The empirical findings reveal that institutional quality matters for Islamic economy performance, but its effects are heterogeneous across institutional dimensions. The joint significance of the model demonstrates that institutional conditions collectively contribute to explaining variations in Islamic economy performance. However, not all dimensions of governance exert statistically significant independent effects. In contrast, the negative coefficients of Voice and Accountability and Government Effectiveness indicate that the relationship between general institutional quality and Islamic economy performance is more complex than a simple assumption that “better governance always produces a stronger Islamic economy.” Islamic economy development may be shaped by the

interaction between general institutions and sector-specific policies, state capacity, market structure, financial infrastructure, and national Islamic economy development strategies.

Overall, the findings support the argument that institutional quality should be examined as a multidimensional concept rather than treated as a homogeneous determinant of Islamic economy performance. Strengthening the Islamic economy therefore requires not only improvements in general governance but also legal certainty, enforceable regulations, credible Shariah and halal standards, and sector-specific institutional arrangements capable of translating institutional capacity into competitive Islamic economic outcomes.

CONCLUSION

This study demonstrates that institutional quality is associated with Islamic economy performance in distinct and context-dependent ways across 13 leading Islamic economies. Using panel data analysis, the findings reveal that Rule of Law has a positive and statistically significant relationship with Islamic economy performance, emphasizing the importance of legal certainty and effective institutional enforcement. Conversely, Voice and Accountability and Government Effectiveness exhibit significant negative relationships, while Political Stability and Regulatory Quality show no statistically significant associations. The findings for Control of Corruption vary across model specifications. These results highlight that improvements in general governance do not necessarily translate into stronger Islamic economic performance, underscoring the importance of sector-specific institutional arrangements. Accordingly, policymakers should prioritize legal certainty, effective Shariah governance, regulatory coordination, and institutional frameworks tailored to Islamic economic sectors. This study contributes to the literature by providing multidimensional empirical evidence on the relationship between institutional quality and the broader Islamic economic ecosystem. Nevertheless, its limited country coverage and reliance on aggregate

governance indicators suggest the need for future research incorporating sector-specific measures and alternative econometric approaches.

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