International Journal of Economics, Management and Accounting 33, no. 1 (2025): 77-97

ISLĀMIC FINANCE AND POVERTY REDUCTION IN AFRICAN COUNTRIES: AN EMPIRICAL ANALYSIS

Adamu Ahmed Wudil[a,b*], Norma MD Saad[a,c], Jasmin Omercic[a,d], Lacheheb Zakaria[a,e], Rislanudeen Muhammad[f]

[a]*Department of Economics, Kulliyyah of Economics and Management Sciences, International Islamic University Malaysia. (Email:* [b]*adamwudil@gmail.com,* [c]*norma@iium.edu.my,* [d]*ojasmin@iium.edu.my,* [e]*lachehebzak@iium.edu.my)*

[f]*Research and Strategy Division, Bank of Industry, Lagos, Nigeria. (Email: mrislanudeen@boi.ng)*

ABSTRACT

This paper examined the effect of *Islāmic* finance on poverty reduction in 53 African countries over the period 2013 to 2022. *Islāmic* finance, based on *Islāmic* principles and values, emphasizes ethical conduct, social responsibility, and promotion of social welfare. Poverty remains a pressing issue in many African countries, and traditional financial systems have for long struggled to effectively address this challenge. *Islāmic* finance offers unique features and mechanisms that can contribute to poverty reduction efforts. This study employs a panel System Generalized Method of Moments (SGMM) estimation technique and explores the empirical evidence on the relationship between *Islāmic* finance development and poverty reduction, while controlling for other variables such as foreign aid, government budgets, and government effectiveness. The findings indicate that *Islāmic* finance development, foreign aid, and government budgets have significant positive effects on poverty reduction, while government effectiveness has a negative effect. Thus, the findings highlight the potential of *Islāmic* finance in poverty reduction in African countries and provide valuable insights for policymakers, practitioners, and researchers in harnessing the benefits of *Islāmic* finance for inclusive and sustainable development.

JEL Classification: O16, G21, I32, C23

Keywords: *Islāmic* finance, Poverty reduction, African countries, *Maqāṣid* (higher objectives) of *Sharī'ah* (*Islāmic* law), System Generalized Method of Moments (SGMM)

*Corresponding author: adamwudil@gmail.com

Submitted: 05/07/2023 Accepted: 29/03/2024 Published: 28/06/2025

1. INTRODUCTION

Islāmic finance, which is based on the *Sharī'ah* principles, presents a major alternative financial system that values moral and social responsibility and promotes social welfare (Khan et al., 2022). From the poverty standpoint, *Islāmic* finance has distinct dimensions concerning needs of the poor and vulnerable groups by developing products that target underserved and the third sector (Wudil and Muhammad 2023; Wulandari, 2019). For example, *Islāmic* finance creates inclusive growth by allocating resources equitably and using risk-sharing instruments such as profit and loss sharing (i.e., *muḍārabah* and *mushārakah*). This boosts entrepreneurship and private property development by creating favorable business environments, hence increasing the wealth of the previously excluded (Sheikh, 2021; Shabbir et al., 2018). *Islāmic* finance indeed promotes financial inclusion by bringing financial services closer to the underserved. Through *Islāmic* microfinance, the poor can access interest-free credit and save to start or expand their businesses (Ali, Shirazi, and Nabi, 2013). Also, *Islāmic* finance promotes social welfare and protection against destitution through the *Zakāt*, *Wāqf*, and *Sadaqat*, which has the potential to cushion the poor and supports initiatives that enhance community welfare (Pericoli, 2020; Daly and Frikha, 2015).

Islāmic finance provides a viable solution to Africa's poverty alleviation, as the continent's traditional finance fails to offer an inclusive solution. Although *Islāmic* finance has spanned matured markets in regions such as the Gulf Cooperation Council (GCC) countries, Malaysia and others, it remains mostly under-developed in North Africa and many Muslim-majority countries (Bougatef, 2015). According to Kedir et al., (2017), to effectively combat poverty in Africa, substantial growth rates and investment levels are needed, with estimates suggesting a double-digit growth rate of 16.6% annually to end extreme poverty by 2030. *Islāmic* social finance, including *wāqf* and *zakāt* as distinct institutions in Islam, and other instruments such as *sadaqat*, have potential to make a significant contribution to poverty alleviation. This used to be the case during crises such as the COVID-19 pandemic (Umar et al., 2022; Ascarya, 2021). Integrating corporate social responsibility with the various forms of the *Islāmic* third sector finance such as *wāqf* and the *zakāt* system is a faith-based

intervention mechanism in a predominantly Muslim country (Raimi, Ashok, and Ismail, 2014). For example, *zakāt* has reduced poverty through several distributions to the poor, which has enabled them to live with dignity, good health, adequate nutrition, and access to education (Islam et al., 2023). Moreover, properly administered *Islāmic* microfinance can also complement poverty alleviation, as revealed in Nigeria and Indonesia case studies (Amsami et al., 2021; Prasetyo, Effendi, and Nursyamsiah, 2018). *Islāmic* cooperative societies and microfinance institutions also show the potential to deliver to socio-economic development, as evidenced in Nigeria (Olayinka et al., 2021).

While *Islāmic* finance potential contributions to poverty reduction in Africa seems promising, empirical evidence on the role of *Islāmic* finance in African countries is limited. Therefore, more research is needed to determine how *Islāmic* finance can effectively help reduce poverty in African countries. Thus, this paper aims at informing policymakers, practitioners, and researchers about the potential of *Islāmic* finance for poverty reduction in African countries. Following our introduction, section two presents our empirical literature review. Section three articulates the methodology while section four presents the results and discussion of the findings. Finally, section five presents the conclusions and policy implications of the study.

2. LITERATURE REVIEW

Literature on *Islāmic* finance reveals much on its potential in poverty reduction and economic growth, and sustainable development. Guled (2022), Saba, Khan, and Jawed (2021), Rahman and Asyifaa (2021) and Shabbir et al. (2018) emphasized on the positive impact of *Islāmic* finance on social development, aligning with principles of social justice and equality, which can aid in poverty reduction and social justice. Khavarinezhad, Biancone, and Jafari-Sadeghi (2021) and Kassim (2016) focused on how *Islāmic* finance can contribute to economic growth, with Sukuk playing a significant role in the real economic growth of *Islāmic* countries as well as macroeconomic indicators.

Moreover, *Islāmic* finance is shown to be well-aligned with sustainable development goals (SDGs), promoting sustainable economic growth, poverty eradication, gender equality, and sustainable infrastructure (Danlami, Abduh, and Razak, 2023; Nizami

2020; Rusydiana, 2020; Jan et al., 2021). Hamoudi, Hadi, and Abdul Rahman (2018) and Ahmed et al. (2015) explored how *Islāmic* finance supports education for sustainable development, providing funding to educational institutions and promoting overall development. *Islāmic* social finance instruments such as *zakāt, wāqf,* and *sadaqat* are highlighted for their role in supporting social enterprises, promoting social impact, and addressing the charitable sector, driving social innovation based on ethical principles (Walaa, 2021; Iannaci and Mekonnen, 2020; Pericoli, 2020; Azman and Ali, 2019).

The literature also delves into the potential of *Islāmic* finance in supporting economic sustainability, as seen in studies by Sarker, Khatun and Alam (2019), which reveal the testing of *Islāmic* finance in China for economic sustainability. Furthermore, the ethicality of *Islāmic* banks' business models and their impact on financial stability are discussed, emphasizing the importance of ethical principles in *Islāmic* finance (Jatmiko, Iqbal, and Ebrahim, 2023). The literature also explores the convergence of principles of *Islāmic* finance and corporate social responsibility (CSR), with CSR being a key factor in this relationship (Franzoni and Allali, 2018). This convergence is influenced by both formal and informal institutions, with *Islāmic* banks showing a stronger commitment to CSR, particularly in emerging countries (Aracil, 2019). Further integration of CSR activities with *Islāmic* and conventional elements is however needed in line with *Sharī'ah* principles (Sofian, 2016). The concept of CSR in *Islāmic* culture is also discussed, with a focus on the *Islāmic* reporting initiative and the integration of *Islāmic* values and beliefs in CSR practices (Litardi, Fiorani, and Harb, 2019).

Overall, most of the reviewed literature implied that *Islāmic* finance has the potential to contribute to poverty reduction, economic development, and sustainable growth under the identified mechanisms of ethical orientation, financial inclusion, social enterprise development, and targeted approach to sustainable development problems. The literature, however, has yet to demonstrate and make hopefully similar greater impact on African poverty reduction efforts. Despite the growing popularity of *Islāmic* finance in certain African countries, especially in countries with significant Muslim population, limited studies cover how *Islāmic* finance impacts poverty reduction across different African countries. Considering diverse socioeconomic and developmental problems among African countries, it is crucial to understand whether *Islāmic* finance can reduce poverty and promote sustainable development in the continent.

3. METHODOLOGY

3.1 THEORETICAL MODEL

From a theoretical perspective, this study uses the *maqāṣid* (higher objectives) of *Sharī'ah* theoretical model to evaluate and assess how *Islāmic* finance development impacts on poverty reduction. *Maqāṣid* of *Sharī'ah* rooted in *Islāmic* jurisprudence (*fiqh*), focuses on the higher purposes or aspirations of *Islāmic* law such as justice, fairness, responsibility, integrity, due diligence, and social welfare to name a few. By applying the *maqāṣid* of *Sharī'ah* framework, the study aims at analyzing how *Islāmic* finance aligns with these principles and its effectiveness in addressing poverty. The framework provides a comprehensive lens for examining the social impact of *Islāmic* finance development and its contribution to individual and societal well-being (Abu Bakar and Abdul Rahim, 2021; Siddiqi, 2010; Auda, 2008).

3.2 MODEL SPECIFICATION

The model is grounded in *maqāṣid* of *Sharī'ah* theory and the empirical works of Guled (2022) and Shabbir et al. (2018). As a result, the empirical model is as follows:

$$(1) \quad PR_{it} = f\ (IFD_{it}, AID_{it}, GB_{it}, GE_{it})$$

Where $PR_{it}$is the Poverty Reduction variable of country i at time t, IFD_{it} is the *Islāmic* finance development of country i at time t, AID_{it} is the foreign aid of country i at time t, GB_{it} is the Government budget of country i at time t, and GE_{it} is the government effectiveness as a measure of quality of governance of country i at time t.

On this basis, the econometric model can be specified as follows:

$$(2) \quad PR_{it} = \beta_0 + \beta_1 IFD_{it} + \beta_2 AID_{it} + \beta_3 GB_{it} + \beta_4 GE_{it} + \mu_{it}$$

β_0, β_1, β_2, β_3, and β_4 respectively, are the coefficients of *Islāmic* finance development, foreign aid, government budget, and government effectiveness. while μ_{it} is the error term which captured unobservable factors affecting poverty reduction variable not captured in the model. The error term is assumed to be normally distributed with zero mean and constant variance.

3.3 ESTIMATION TECHNIQUE

The Generalized Method of Moments (GMM) estimation technique, more precisely the System Generalized Method of Moments (SGMM) estimator, is employed. GMM is selected because of its advantages in mitigating endogeneity, omitted variable biases, unobserved panel heterogeneity, and consistency of estimation even when measurement error exists. The SGMM estimator is chosen for greater estimation efficiency as suggested by Blundell and Bond (1998). In comparison, the Difference Generalized Method of Moments (DGMM) lacks in that regard given its potential finite sample biases. Hence, by utilizing the SGMM estimator, this study obtains reliable and robust estimates of analysis concerning dynamic effects of *Islāmic* finance on poverty reduction. Therefore, equation (2) can be re-specified using SGMM developed by Blundell and Bond (1998) as follows:

$$InPR_{it} = \beta_0 + \beta_1 InPR_{it-1} + \beta_2 InIFD_{it} + \beta_3 InAID_{it} + \beta_4 InGB_{it} + \beta_5 GE_{it} + (\eta_i + \varepsilon_{it}) \quad (3)$$

$$\Delta InPR_{it} = \beta_0 + \beta_1(\Delta InPR_{it-1}) + \beta_2(\Delta InIFD_{it}) + \beta_3(\Delta InAID_{it}) + \beta_4(\Delta InGB_{it}) + \beta_5(\Delta GE_{it}) + \Delta\mu_{it} \quad (4)$$

Where $InPR_{it}$ is the natural log of the dependent variable poverty reduction, $InPR_{it-1}$ is the dependent variable's lag value, δi is country unobserved specific effect, $\Delta\mu_{it}$ is the error term and subscripts i and t represent country and time series respectively. In the system GMM estimation, lagged levels of the endogenous variables, i.e., $InPR_{it-1}$ are used as instruments in the level equation (3) and lagged differences of potential endogenous variables, i.e., $(\Delta InPR_{it-1})$ are used as instruments in the difference equation (4).

TABLE 1
Variables and their Operationalisation

Variables	Proxies	Notation	Type	A priori expectation	Source
Poverty Reduction	Consumption Expenditure	PR	Independent		World Development Indicators (WDI)
Islāmic Finance	*Islāmic* Finance Development	IFD	Dependent	Positive	Rifinitiv Database
Foreign Aid	Official Development Assistance (ODA)	AID	Control	Positive	World Development Indicators (WDI)
Government Budgets	Government Expenditure	GB	Control	Positive	World Development Indicators (WDI)
Government Effectiveness	GE Estimate	GE	Control	Positive or Negative	World Governance Indicators (WGI)

Source: Authors' Illustrations.

3.4 JUSTIFICATION FOR USING SYSTEM GMM (SGMM)

The procedure for deciding between difference and system GMM (DGMM and SGMM) estimators explained by Bond (2002) justifies our choice in this paper as follows:

a. Estimate pooled OLS estimator and get the lagged regression dependent variable coefficient value which establishes the upper bound.
b. Estimate the fixed effect model and get the lagged regression dependent on variable coefficient value which establishes the lower bound.
c. Estimate the DGMM model for the respective estimate and compare it to the fixed effect estimate. If the DGMM estimate is lower than or closest to the fixed effect estimate, the DGMM estimator is downward biased due to violations of instrument orthogonality conditions. Therefore, it concludes that the DGMM estimator lacks instrument strength (downward biased) and points to the SGMM estimator as the right choice.

3.5 DIAGNOSTIC TESTS

3.5.1 ARELLANO-BOND TEST

The Arellano-Bond test is used to identify serial correlation in the GMM estimation. The test checked for first- and second-order autocorrelations in the model. Assuming there should be no serial correlation, the null hypothesis is rejected when serial correlation is present. The first-order serial correlation, however, does not always necessarily lead to model misspecification. Hence, the second-order serial autocorrelation and validity of the instruments are mandatory to establish GMM estimator's consistency (Arellano and Bond, 1991; Maddala and Lahiri, 2009).

3.5.2 SARGAN-HANSEN TEST

The Sargan-Hansen test, also called the over-identification test, is a commonly used tool in Generalized Method of Moments (GMM) estimations to determine instrument validity. More specifically, it refers to examining whether the instruments are uncorrelated with the error term, which means that they support the assumption of instrument exogeneity. It is a comparison between the number of

instruments known as over-identifying restrictions and the number of estimated parameters in the model. The calculated test statistic is usually a chi-square statistic indicating whether the instruments are jointly significant with respect to the endogenous variables. An insignificant chi-square test statistic confirms that the instruments are valid. Thus, the model is correctly specified. Otherwise, it suggests the model has misspecification issues or inadequate instruments causing bias in the estimation (Roodman, 2009).

4. RESULTS AND DISCUSSIONS

4.1 DESCRIPTIVE STATISTICS AND CORRELATION MATRIX

As implicit from Table 2 on descriptive statistics and correlation matrix, maximum and minimum values for each variable and respective skewness and kurtosis identify the nature of distribution. We analyze each in due course.

Namely, Poverty Reduction (PR) has a mean score of 81.66. The minimum value is 44.26 while the maximum value is 116.44. The data reveals slightly negative skewness, -0.29, indicating a slight left-tail distribution since kurtosis value of 3.45 suggests moderately peaked distribution.

TABLE 2
Descriptive Statistics and Correlation Matrix

	PR	IFD	AID	GB	GE
Mean	81.65851	90.79176	56.46591	14.42230	-0.25498
Median	82.93416	9.00000	50.23036	13.71335	-0.68228
Maximum	116.43800	812.00000	304.83940	38.44804	14.63538
Minimum	44.25666	1.00000	0.32528	-1.02557	-1.79129
Std. Dev.	13.01229	144.04650	38.20287	7.18897	2.44551
Skewness	-0.28626	2.12087	2.25624	0.62647	5.15476
Kurtosis	3.44999	7.45417	11.97006	3.68173	29.04743
PR	1	0.841	0.318	0.080	-0.197
IFD	0.841	1	-0.005	-0.105	-0.107
AID	0.318	-0.005	1	0.015	0.146
GB	0.080	-0.105	0.015	1	-0.284
GE	-0.197	-0.107	0.146	-0.284	1

Source: Authors' Computations.

Islāmic Finance Development (IFD) has a mean score of 90.79 with a minimum value of 1 and a maximum value of 812. *Islāmic* finance data shows positive skewness of 2.12, indicating a right-tail distribution while the kurtosis value of 7.45 suggests a relatively peaked distribution.

Foreign Aid (AID) has a mean value of 56.47, with a minimum value of 0.33 and a maximum value of 304.84. Foreign aid data also shows positive skewness of 2.26, indicating right-tail distribution while kurtosis value of 11.97 implies a highly peaked distribution again.

Government Budgets (GB) have a mean of 14.42, with a minimum value of -1.03 and a maximum value of 38.45. The data reflects slightly positive skewness of 0.63, indicating slightly right-tail distribution. Kurtosis value of 3.68 suggests moderately peaked distribution.

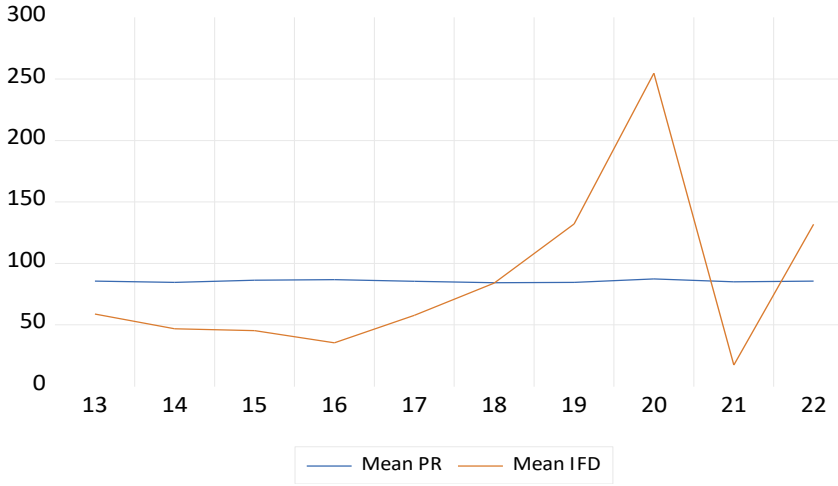
Lastly, Government Effectiveness (GE) has a mean of -0.25, with a minimum value of -1.79 and a maximum value of 14.64. The data have positive skewness of 5.15 indicating highly right-tail distribution, and the kurtosis is 29.05 suggesting a highly peaked distribution.

Analysis of correlation matrix among variables indicates that the correlation between Poverty Reduction (PR) and *Islāmic* Finance Development (IFD) is 0.084. This implies a weak positive relationship between the two variables. The correlation between PR and Foreign Aid (AID) is 0.318 and suggests a moderate positive correlation, indicating that higher levels of foreign aid are moderately associated with higher levels of poverty reduction. Insight into the correlation between PR and Government Budgets (GB) of 0.080 defines a weak positive correlation, suggesting, however, that higher government budgets are associated with slightly higher levels of poverty reduction. Lastly, the correlation between PR and Government Effectiveness (GE) is -0.197. This is a weak negative correlation, suggesting that higher government effectiveness is associated with slightly lower levels of poverty reduction.

Figure 1 illustrates the trend of Poverty Reduction (PR) and *Islāmic* Finance Development (IFD) across African countries. The denotations on the horizontal axes display values of variables while the vertical axes show years. The variable PR remained relatively stable over the years with slight fluctuation around the average value. There is no clear upward or downward trend observed in the data. On the other hand, IFD values show a relatively upward trend from 2016

to 2020. The observed decline in IFD in 2021 was attributable to the COVID-19 pandemic impact. The pandemic led to serial lockdowns and movement control orders (MCOs) across the globe, completely suspending much economic activity and impacting IFD growth and development. With the end of the pandemic measures and restoration of most operations 'back to normal', however, it is evident how IFD value restored its earlier growth and development path, with a likelihood and expectation of maintaining the momentum or increasing further.

FIGURE 1
Trend of *Islāmic* Finance Development (IFD) and Poverty Reduction (PR)



Source: Authors' Computations.

4.2 JUSTIFICATION FOR USING SYSTEM GMM (SGMM)

The coefficient of the lagged value of dependent variables through the three estimators was 0.846924 for Pool OLS in Table 3, 0.168259 for fixed effects (FE) in Table 4, and 0.124572 for DGMM in Table 5. Since the value of the lagged dependent variable is lower in the DGMM estimate compared to the value in the FE estimate, it indicates that the DGMM is biased downward. This is caused by the weak instrumentation problem. Therefore, the SGMM estimator was used to overcome the problem.

TABLE 3
Pooled OLS Estimate

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PR(-1)	0.846924	0.027854	30.40564	0.0000
IFD	0.006096	0.002405	2.534879	0.0117
AID	0.023480	0.009989	2.350523	0.0194
GB	0.131132	0.042267	3.102461	0.0021
GE	-0.024744	0.155937	-0.158682	0.8740
C	8.671102	2.292039	3.783139	0.0002
Root MSE	6.005197	R-squared		0.797492
Mean dependent var	82.28503	Adjusted R-squared		0.794215
S.D. dependent var	13.36586	S.E. of regression		6.063220
Akaike info criterion	6.461223	Sum squared resid		11359.65
Schwarz criterion	6.532700	Log likelihood		-1011.643
Hannan-Quinn criter.	6.489781	F-statistic		243.3735
Durbin-Watson stat	2.692888	Prob(F-statistic)		0.000000

Source: Authors' Computations.

TABLE 4
Fixed Effect Estimate

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PR(-1)	0.168259	0.049377	3.407640	0.0008
IFD	0.003200	0.002395	1.336298	0.1826
AID	0.030829	0.015820	1.948699	0.0523
GB	0.930887	0.098256	9.474074	0.0000
GE	0.557540	1.524656	0.365682	0.7149
C	52.50297	4.545132	11.55147	0.0000
Effects Specification				
Cross-section fixed (dummy variables)				
Root MSE	4.056710	R-squared		0.907587
Mean dependent var	82.28503	Adjusted R-squared		0.894481
S.D. dependent var	13.36586	S.E. of regression		4.341730
Akaike info criterion	5.892590	Sum squared resid		5183.922
Schwarz criterion	6.369107	Log likelihood		-888.0829
Hannan-Quinn criter.	6.082976	F-statistic		69.25022
Durbin-Watson stat	1.954334	Prob(F-statistic)		0.000000

Source: Authors' Computations.

TABLE 5
Difference GMM Estimate

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PR(-1)	0.124572	0.004202	29.64775	0.0000
IFD	0.002490	0.000427	5.834153	0.0000
AID	-0.036676	0.003644	-10.06387	0.0000
GB	1.654692	0.010722	154.3261	0.0000
GE	-12.13733	1.120987	-10.82737	0.0000
Effects Specification				
Cross-section fixed (first differences)				
Root MSE	6.114812	Mean dependent var		-0.064209
S.D. dependent var	6.548349	S.E. of regression		6.170151
Sum squared resid	10469.46	J-statistic		30.11095
Instrument rank	35	Prob(J-statistic)		0.459982

Source: Authors' Computations.

Table 6 presents the results of the panel SGMM estimation for the relationship between the dependent variable Poverty Reduction (PR) and the independent variables. The results show that the PR(-1) coefficient is 0.4801 with a standard error of 0.015628. The t-statistics are 30.72244, indicating that the lagged value of PR has a highly significant positive effect on the current level of Poverty Reduction.

TABLE 6
System GMM Estimate (Dep. Var: logPR)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
logPR(-1)	0.4801***	0.015628	30.72244	0.0000
logIFD	0.0027***	0.001038	2.626862	0.0131
logAID	0.0494***	0.006944	7.113145	0.0000
logGB	0.2410***	0.069949	3.444716	0.0016
GE	-6.7006***	1.572883	-4.260088	0.0002
No. of Obs.				264
R (2)				0.1526
J-statistic				28.1313
Group/Instrument rank				33/33
Sargan-Hansen				0.4575

Notes: ***, **, * are statistical significance at 1%, 5% and 10% level respectively.
Source: Authors' Computations.

Islāmic Finance Development (IFD) coefficient is 0.0027 with a standard error of 0.001038. The t-statistic is 2.626862, and indicates that IFD has a significant positive effect on PR. A percentage change in IFD is associated with a 0.27% increase in PR in the short run, at 1% level of significance on average - ceteris paribus. Hence, IFD and PR exhibit an inelastic relationship. This finding is consonant with the findings of Guled (2022) and Shabbir et al. (2018).

Foreign Aid (AID) coefficient is 0.0494 with a standard error of 0.006944. The t-statistic is 7.113145, indicating that AID has a highly significant positive effect on PR. A percentage change in AID leads to a 4.94% increase in PR in the short run, at 1% level of significance on average - ceteris paribus. Hence, AID and PR exhibit an elastic relationship. A range of studies have found a significant positive effect of foreign aid on poverty reduction. For instance, Alvi and Senbeta (2012) and Mahembe and Odhiambo (2019) reported that foreign aid is associated with a decline in poverty, with multilateral aid and grants being particularly effective.

Government Budgets (GB) coefficient is 0.2410 with a standard error of 0.069949. The t-statistics are 3.444716, indicating that GB have a significant positive effect on PR. A percentage reduction in GB results to a 24.1% increase in PR in the short run, at 1% level of significance on average - ceteris paribus. Hence, Government Budgets and poverty reduction exhibit an elastic relationship. Existing studies have found a positive relationship between government spending and poverty reduction. For example, Nigerian government expenditure on health, education, and building and construction was found to have a significant and positive impact on per capita income, which is closely linked with poverty reduction (Oriavwote and Ukawe, 2018). Moreover, Iranian constructive government expenditures were found to have a positive effect on poverty reduction (Dahmardeh and Tabar, 2013). Similarly, Pakistan's government spending on education and law and order was found to significantly contribute to poverty reduction (Asghar, Shirazi, and Nabi, 2012).

Government Effectiveness (GE) coefficient is -6.7006 with a standard error of 1.572883. The t-statistic is -4.260088, indicating that GE has a highly significant negative effect on PR. A percentage increase in GE results in a 670.6% decrease in PR in the short run, at 1% level of significance on average - ceteris paribus. Hence, GE and PR exhibit an elastic relationship. This finding aligns with the data, which show predominantly negative estimates of government

effectiveness across the studied African countries. The prevalence of embezzlement cases, coupled with high rates of money laundering, contributes to a lack of trust in institutions and governance frameworks in Nigeria (Abere and Akinbobola, 2019). This further highlights the challenges and impact of poor governance on social development outcomes in Nigeria and so also in many other African countries. Corroborating this finding, Nyamboga et al. (2014) and Musiba (2013) identified challenges in effectiveness of government policies and expenditure in poverty reduction, including weak mapping and coordination of the lead institutions, duplication of efforts, inadequate coverage by region and even gender, competition among and between players, and lack of clear policy direction. Furthermore, Tebaldi and Mohan (2010) highlighted the importance of a robust system to control corruption and ensure effective government in promoting economic growth and reducing poverty.

The Arellano-Bond Serial Correlation Test statistic value of 0.1526 suggests no significant evidence of serial correlation in the model's residuals, indicating that the model is free from second order serial correlation. In addition, the Sargan-Hansen Test statistic value of 0.457503 suggests that the instruments used in the model are valid. This establishes the reliability of instrumental variable estimation and indicates that the instruments are suitable for addressing endogeneity and obtaining consistent parameter estimates in our study.

Considering this in light of the *maqāṣid* (higher objectives) of *Sharī'ah,* we can convey that greater allocation of *Islāmic* financial funds, foreign aid and government funding and effectiveness in management and application has the potential to establish greater justice, consistency, fairness, inclusivity and integrity in African socio-economic growth and development. The theory of *Islāmic* finance, as advocated by scholars such as Saleem et al. (2023), and Siddiqi (2006) underscores a strong social commitment by emphasizing socio-economic objectives such as social justice, equity, cooperation, poverty alleviation, and human well-being, all of which are rooted in the *maqāṣid* (higher objectives) of *Sharī'ah*. Furthermore, Alhammadi (2022) highlights how *Islāmic* banking and finance can contribute to reconstructing the economy based on *maqāṣid* (higher objectives) of *Sharī'ah* to enhance social, economic, and environmental welfare, especially in challenging times such as the COVID-19 era.

5. CONCLUSION AND POLICY IMPLICATIONS

This study examined the effect of *Islāmic* finance on poverty reduction in 53 African countries over the period 2013 to 2022. The findings reveal that *Islāmic* finance development, foreign aid, government budgets, and government effectiveness have significant effects on poverty reduction. *Islāmic* finance development, foreign aid and government budgets exhibit a positive effect on poverty reduction. Government effectiveness, however, has a negative effect on poverty reduction. These results suggest that *Islāmic* finance can contribute to poverty reduction efforts in African countries by promoting inclusive economic growth and providing accessible financial services to the poor. This ensures the possibility of attaining the *maqāṣid* (higher objectives) of *Sharī'ah,* such as justice, fairness and greater socio-economic welfare.

The findings of this study have important implications for policymakers, practitioners, and researchers. First, policymakers can consider leveraging the potential of *Islāmic* finance when developing poverty reduction strategies. By promoting *Islāmic* finance principles and practices, governments can foster inclusive economic growth, improve financial inclusion, and support social welfare programs. Second, *Islāmic* finance industry practitioners can design and offer innovative financial products and services that specifically target the the poor and marginalized communities. This can include microfinance solutions, *Islāmic* social finance mechanisms, and ethical investment options. Lastly, researchers can build upon these findings to further explore *Islāmic* finance impact on poverty reduction, specifically in the African context. Future research can delve into specific mechanisms and channels through which *Islāmic* finance can effectively contribute to poverty reduction, besides investigating potential challenges and barriers in implementing *Islāmic* finance initiatives in African contexts.

REFERENCES

Abere, S.S., and T.O. Akinbobola. "An Empirical Investigation of the Institutions' Hypotheses in Nigeria." *Journal of Economics and Development Studies* 4, no. 7 (2019): 110-19.

Abu Bakar, M., and A.K. Abdul Rahim. "Maqasid Al-Shari'ah Theory: A Comparative Analysis Between the Thoughts of Al-Shatibi and 'Izz Al-Din Ibn 'Abd Al-Salam." *International Journal of Academic Research in Business and Social Sciences* 11, no. 8

(2021): 1038-051.

Ahmed, H., M. Mohieldin, J. Verbeek, and F.W. Aboulmagd. "On the Sustainable Development Goals and the Role of Islamic Finance." *Working Paper, World Bank Group* (2015). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2606839

Alhammadi, S. "Analyzing the Role of Islamic Finance in Kuwait regarding Sustainable Economic Development in Covid-19 Era." *Sustainability* 14, no. 2 (2022): 701.

Ali, S., N. Shirazi, and M. Nabi. "The Role of Islamic Finance in the Development of the IDB Member Countries: A Case Study of the Kyrgyz Republic and Tajikistan." *Islamic Economic Studies* 21, no. 2 (2013): 121-30.

Alvi, E., and A. Senbeta. "Does Foreign Aid Reduce Poverty." *Journal of International Development* 24 (2012): 955-76.

Aracil, E. "Corporate Social Responsibility of Islamic and Conventional Banks." *International Journal of Emerging Markets* 14, no. 4 (2019): 582-600.

Arellano, M., and S. Bond. "Some Tests of Specification for Panel Data: Monte Carlo Evidence and an Application to Employment Equations." *Review of Economic Studies* 58, no. 2 (1991): 277–97.

Asearya, A. "The Role of Islamic Social Finance During Covid-10 Pandemic in Indonesia's Economic Recovery." *International Journal of Islamic and Middle Eastern Finance and Management* 15, no. 2 (2023): 386-405.

Asghar, N., Z. Hussain, and H. Rehman. "The Impact of Government Spending on Poverty Reduction: Evidence from Pakistan 1972 to 2008." *African Journal of Business Management* 6 (2012): 845-53.

Auda, J. "Maqasid Al-Shariah as Philosophy of Islamic Law: A Systems Approach." *Islamic Studies* 47*,* no. 3 (2008): 371-96.

Azman, S.M.M.S., and E.R.A.E. Ali. "Islamic Social Finance and the Imperative for Social Impact Measurement." *Al-Shajarah: Journal of the International Institute of Islamic Thought and Civilization (ISTAC)*, (2019). https://journals.iium.edu.my/shajarah/index.php/shaj/article/view/896/387

Bond, S.R. "Dynamic Panel Data Models: A Guide to Microdata Methods and Practice." *CEMMAP Working Paper, No. CWP09/02*, Centre for Microdata Methods and Practice (CEMMAP), (2002). https://doi.org/10.1920/wp.cem.2002.0902

Bougatef, K. "The Impact of Corruption on the Soundness of Islamic Banks." *Borsa Istanbul Review* 15, no. 4 (2015): 283-95.

Dahmardeh, N., and M.H. Tabar. "Government Expenditures and its Impact on Poverty Reduction: Empirical from Sistan and Baluchestan Province of Iran." *International Journal of Academic Research in Economics and Management Sciences* 2, no. 1 (2013): 251.

Daly, S., and M. Frikha. "Islamic Finance in Favor to Development and Economic Growth: An Illustration of the Principle of "Zakat"." *Arabian Journal of Business and Management Review* 5, no. 5 (2015): 2-10.

Danlami, M., M. Abduh, and L. Razak. "Social Finance, Institutional Quality and Stability of Islamic Banks: Evidence from four Countries." *International Journal of Social Economics* 50, no. 8 (2023): 1186-216.

Franzoni, S., and A.A. Allali. "Principles of Islamic Finance and Principles of Corporate Social Responsibility: What Convergence?" *Sustainability* 10, no. 3 (2018): 1-11.

Guled, A.A. "The Effects of Islamic Finance Practices on Social Development in Mogadishu, Somalia." *EPRA International Journal of Economics, Business and Management Studies* 9, no. 4 (2022): 15-24.

Hamoudi, H., Z. Hadi, and S. Abdul Rahman. "The Impact of Islamic Finance in Promoting Education for Sustainable Development." *Iraqi Administrative Sciences Journal* 2, no. 4 (2018): 20-45.

Iannaci, D., and Gideon, M.J. "Islamic Finance and Social Finance, an Opportunity for Social Enterprises." *European Journal of Islamic Finance,* 1 (2020): 1-12.

Islam, Md. K., S.T. Mitu, R. Munshi, and R. Khanam. Perceptions about the Common Malpractice of Zakat Paying in Bangladesh during Covid-19 Pandemic: Evidence from the Supply Side. *Journal of Islamic Accounting and Business Research* 14, no. 3 (2023): 361-78.

Jan, A., M.N. Mata, P.A. Albinsson, J.M. Martins, R. Hassan, and P.N. Mata. "Alignment of Islamic Banking Sustainability Indicators with Sustainable Development Goals: Policy Recommendations for Addressing the Covid-19 Pandemic." *Sustainability* 13, no. 5 (2021): 2607.

Jatmiko, W., A. Iqbal, and M. Ebrahim. "On the Ethicality of Islamic Banks' Business Model." *British Journal of Management* 35 no. 1 (2023): 115-36.

Kassim, S. "Islamic Finance and Economic Growth: The Malaysian

Experience." *Global Finance Journal* 30 (2016): 66-76.

Kedir, A., A. Elhiraika, Z. Chinzara, and D. Sandjong. "Growth and Development Finance Required for Achieving Sustainable Development Goals (SDGS) in Africa." *African Development Review* 29, S. 1 (2017):15-26.

Khan, Q., A. Zafar, S. Shabbir, and R. Kouser. "Islamic Finance: A Catalyst for Sustainable Development of Developed and Developing Countries." *Sustainable Business and Society in Emerging Economies* 4, no. 1 (2022): 205-18.

Khavarinezhad, S., P. Biancone, and V. Jafari-Sadeghi. "Financing in the Islamic System and Sustainable Economic Development of Selected Islamic Countries." *European Journal of Islamic Finance, no.* 19 (2021): 18-23.

Litardi, I., G. Fiorani, and D. Harb. "Corporate Social Responsibility in Islamic Culture. Comparison between Western CSR and Islamic CSR: Focus on Islamic Reporting Initiative and Islamic Financial Institution." *European Journal of Islamic Finance,* (2019): 1-8.

Maddala, Gangadharrao S., and Kajal Lahiri. *Introduction to Econometrics* (4th Edition). Hoboken, NJ: Wiley, 2009.

Mahembe, E., and N.M. Odhiambo. "Foreign Aid and Poverty Reduction: A Review of International Literature." *Cogent Social Sciences* 5 (2019): 1-15.

Musiba, C. "The Impact of Government Expenditure on Pro Poor Sectors in Reducing Poverty: The Case of Kibaha District." *A Thesis for Master of Science in Economics, Mzumbe University,* (2013).

Nyamboga, T.O., B.O. Nyamweya, A. Sisia, and G.E. George. "The effectiveness of Poverty Reduction Efforts in Kenya: An Evaluation of Kenyan Government's Policy Initiatives on Poverty Alleviation." *International Affairs and Global Strategy* 23 (2014): 30-40.

Oriavwote, V.E. and A. Ukawe. "Government Expenditure and Poverty Reduction in Nigeria." *Journal of Economics and Public Finance* 4, no. 2 (2018).

Pericoli, A. "Islamic Finance and Charity in the Muslim World: The Role of the Islamic Development Bank in Financing Aid." *Eurasian Business & Economics Journal* 5, no. 2 (2020): 113-33.

Prasetyo, A., J. Effendi,and T. Nursyamsiah, "The Effectiveness of Islamic Microfinance Distribution on Microbusiness Owner's Poverty Alleviation (Case Study: BMT Bina Masyarakat

Purworejo)." *Afkaruna* 14, no. 1, (2018): 1-26.

Rahman, A., and S.N. Asyifaa. "The Role of Islamic Social Finance on Community Welfare in Indonesia." *Proceedings of the International Conference on Research and Education Development* (ICRED) (2021): 476-84.

Raimi, L., P. Ashok, and A. Ismail. "Corporate Social Responsibility, Waqf System and Zakat System as Faith-Based Model for Poverty Reduction." *World Journal of Entrepreneurship, Management and Sustainable Development* 3, no. 10 (2014): 228-42.

Roodman, D. "How to do xtabond2: An Introduction to Difference and System GMM in Stata." *Stata Journal* 9, no. 1 (2009): 86-136.

Rusydiana, A.S. "Islamic Finance and Sustainable Development Goals (SDG): A Bibliometric Review." *Journal of Islamic Economics Literatures* 1, no. 1 (2020): 1-10.

Saba, I., A. Khan, and H. Jawed. "Islamic Finance and SDGs: Connecting Dots." *In Islamic Finance and Sustainable Development* (2021): 47-67.

Saleem, A., D. Ahmad, R.M.A. Zahid, and J. Sági. "Financial Intermediation Through Risk Sharing Vs Non-Risk Sharing Contracts, Role of Credit Risk, and Sustainable Production: Evidence from Leading Countries in Islamic Finance." *Environment Development and Sustainability* 26, no. 5 (2024): 11311-1341.

Sarker, Md. N.I., M.N. Khatun and G.M. Alam. "Islamic Banking and Finance: Potential Approach for Economic Sustainability in China." *Journal of Islamic Marketing* 11, no. 6 (2019):1725-741.

Shabbir, M., N. Kassim, M. Faisal, M. Abbas, and Y.M. Sabti. "Poverty Reduction through Islamic Modes of Finance: The Way Forward." *Journal of Social Sciences Research* 11 (2018): 58-65.

Sheikh, I. "Prospects for Interest-Free Micro Finance in India: An Empirical Study." *Journal of Islamic Economic and Business Research* 1, no. 1 (2021): 15-39.

Siddiqi, M.N. "Islamic Banking and Finance in Theory and Practice: A Survey of State of the Art." *Islamic Economic Studies* 13, No. 2 (2006): 1-48.

Siddiqui, M.N. "Maqasid-e-Shariat (Objectives of the Shari'ah)." *Markazi Maktabah-e-Islami: New Dehli* (2009).

Silva, J., and U. Nizami. "How Islamic Finance Contributes to Achieving the Sustainable Development Goals." *OECD*

Development Policy Papers no. 30 (2020): 1-44.

Sofian, F.N.R.M., and R. Muhamad. "Corporate social responsibility (CSR) and Islamic Banks: A Synthesis of Literature Review." Int*ernational Conference on Accounting Studies (ICAS)* (2016): 143-49.

Tebaldi, E. and R. Mohan. "Institutions and Poverty." *The Journal of Development Studies* 46, no. 6 (2010): 1047-066.

Umar, U.H., A.J. Baita, M.H.B. Haron, and S.H. Kabiru. "The Potential of Islamic Social Finance to Alleviate Poverty in the Era of COVID-19: The Moderating Effect of Ethical Orientation." *International Journal of Islamic and Middle Eastern Finance and Management* 15*,* no. 2 (2022): 255-70.

Walaa, J.A. "Using Blockchain in Waqf, Wills and Inheritance Solutions in the Islamic System." *International Journal of Economics and Business Administration* 9, S. 2 (2021): 101-16.

Wudil, A.A. and R. Muhammad. "Al-Mubadarat Al-Riyfia: An Islamic Finance Product for The Underserved Segment and the Third Sector of the Economy." *Journal of Emerging Economies and Islamic Research* 11, no. 3 (2023): 65-79.

Wulandari, P. "Enhancing the Role of Baitul Maal in Giving Qardhul Hassan Financing to the Poor at the Bottom of the Economic Pyramid." *Journal of Islamic Accounting and Business Research* 10, no. 3 (2019): 382-91.