



# The History of Islamic Finance Between Two Business Models: The 1960s Vs. the 1970s (Lessons for the Future in the AI Era)

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**Abstract:** Using deductive, inductive, and analytical methodologies, this paper aims to explore the early inception of Islamic financial institutions (IFIs) in Muslim countries throughout the modern era. The literature on Islamic banking and finance clearly shows that IFIs emerged in two stages: in the 1960s and 1970s. The 1960s saw the creation of two organizations in two countries, based on different objectives and aspirations. However, they share a common characteristic, namely their "community-oriented" nature. These were the local savings bank or local development bank and/or the people's bank in Mit-Ghamr, in the Nile Delta province of Egypt, and the Tabung Haji (Hajj Fund) in Malaysia. The main business of these initiatives was based on a community-driven approach, in a way that resembles, to some extent, the widespread ecosystem of the Local Exchange Trading System (LETS). In contrast, the 1970s experiment began with the creation of the Islamic Bank of Dubai in 1975, based on the universal business model of a traditional commercial bank that has been operating for centuries in the West. Rather than focusing on a historical narrative of the development of IFIs over time in different jurisdictions, this paper has adopted a heterodox approach that has two objectives: (1) to make a quick comparison between the core business models of the two experiments, and (2) to draw lessons for the future directions of the sector's development in the age of AI and digitalization. In doing so, it is hoped that this research will lead to future studies focused on the relevance or irrelevance of a traditional financial business model in meeting the needs and aspirations of societies in the territories where IFIs operate. The initial results of the study indicate that the community-based approach is more appropriate and flexible for achieving people's aspirations by genuinely and realistically implementing the principle of asset-based financing in Islamic finance (IF), which links finance to real activities in an authentic and substantive manner. In addition, it encompasses social aspects that foster cooperation in a "win-win" scenario, thereby improving the effectiveness, resilience, and efficiency of financial resource allocation. Furthermore, AI and other digital developments seem to enable community-based initiatives that respond more effectively to the needs and aspirations of people within a well-defined "virtual" or "geographical" location. However, a balance must be sought between the benefits of such developments and the risks associated with their execution.

**Keywords:** Islamic banks, local savings banks, Tabung Haji, Mit-Ghamr, commercial banks, AI, MS Copilot AI.

**JEL Classification:** R11, P40, Z1, Z12

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## INTRODUCTION

The evolution and development of Islamic finance and its institutional outlets have attracted considerable interest from various quarters over the past few decades, with different aspects of this evolution being explored. Efficiency, profitability, economic and social contributions, stability, and resilience, compared with their conventional counterparts, are just a few examples of topics that have been explored. More than six decades have passed since the first institutional implementation of this dream, with the establishment of a financial organization based on the fundamental principles of Shari'ah in the modern era.

Taking advantage of this opportunity, some prominent stakeholders called for an in-depth assessment of the experiment from multiple angles. Al-Barakah Symposium, held in Medina, Saudi Arabia, on April 14 and 15, 2025, devoted its 45th session to the sector's largest player, namely Islamic commercial banks, under the theme "Islamic Banking: Fifty Years of Achievements and Future Aspirations." For its part, the renowned International Association for Islamic Economics (IAIE) organized the 16<sup>th</sup> International Conference on Islamic Economics and Finance in collaboration with the Faculty of Economics at the University of Setif 1 in Algeria on May 13 and 15, 2025, on the theme "The Islamic Financial Industry After Fifty Years of Practice."

As part of this review, key questions were raised and/or addressed in order to assess the socio-economic impact of the IFIs on the lives of societies and the economic progress of countries where these institutions play a significant role in their respective financial systems, including:

1. To what extent have IFIs, particularly Islamic banks, contributed to wealth creation in countries where they operate?
2. To what extent and degree have they contributed positively to the well-being of the people? Have they contributed effectively and efficiently to the resolution of certain pressing issues, such as poverty alleviation, reduction of income and wealth disparities, and enhancement of financial inclusion?
3. Have they contributed to economic growth in an adequate and appropriate manner, drawing on the various modes of financing they have used and/or have at their disposal within the framework of the fundamental principles of Shari'ah?
4. To what extent have they contributed to the resilience and stability of the economic and financial systems of their respective countries?

These questions transcend beyond the scope of this study, whose main objective is to examine the relevance or otherwise of the business models established in the 1960s and 1970s in order to draw lessons for the future direction of the sector in a highly complex and dynamic environment, overwhelmed by AI and other digital transformation tools and applications.

Accordingly, this paper responds to the call to revisit the development of IFIs by highlighting under-researched aspects that have not been addressed appropriately, in order to achieve a twofold objective: (1) to emphasize the fact that the history of the creation of modern financial institutions goes far beyond the fifty years mentioned in the main themes of the two events held in Medina and Setif, respectively; (2) to analyze the significance and importance of parallels and/or contrasts between the two business models of the industry,

namely those of the 1960s and 1970s, deriving lessons to ensure the industry remains fit-for-purpose in the AI and digital eras.

### **RESEARCH MOTIVATIONS**

It must be acknowledged from the outset that considerable time has elapsed since the call for a thorough and comprehensive review of the results achieved or otherwise since the inception of IFIs, particularly during the second phase of the 1970s. For example, in 2014, the late Muhammad Najatullah Siddiqi (1931-2022), a prominent Muslim economist and pioneer, wrote a seminal essay in which he revisited his earlier ideas and reflections on possible arrangements for IFIs as a viable alternative to long-established conventional finance: "this is a personal review of the development of the Islamic economics paradigm as it stands today ... revisiting my vision of the sixties," (Siddiqi, 2014, p. 61). This review allowed Professor Siddiqi to ascertain that "many ingredients of a vigorous recipe were missing [in the envisioned and/or aspired model of an ideal IFI that he and other visionaries/pioneers have advocated] when compared to the reality on the ground ..." These disparities between the theoretical vision and the reality on the ground led Professor Siddiqi to conclude that "the end result was unrealistic utopias rather than achievable agendas" (Siddiqi, 2014, p. 62). Hence, the call for review and evaluation is not new (Wilson, 2014), but the approaches, methodologies, emphasis, and comprehensiveness differ. This synthesis adopts a somewhat different approach from the prevailing trend by exploring the relevance or irrelevance of a specific business model during the early stages of Islamic banking's development in the modern era. Therefore, the motivations for this research revolve around the following factors:

1. Stalemate of the current discourse on the socio-economic contribution of Islamic commercial banks (ICBs) in the abundant literature on Islamic economics and finance.
2. The bulk of the research by the younger generation repeats certain unfounded "claims," such as "the deviation of IBs from the 'ideal' theoretical model of the profit and loss sharing (PLS) paradigm or two-tier *Mudarabah* as an alternative to the interest-based financial intermediation model." Such a claim has led to a strong assertion of a "unanimous agreement" regarding this model among Islamic economists (Alonso, 2013, p. 4).
3. Overemphasize of some Muslim economists' devotees on equity financing modes as the only viable alternative to the dominant interest-based financial intermediation model in the commercial banking sector, even asserting that the "risk-sharing" paradigm as the "Islamic alternative" to conventional interest-based financing (Askari *et al.*, 2011).
4. Shade light on the core issues surrounding the discussion on the current shape of industry: has theory been so wrong about the appropriateness of the proposed PLS modes of financing for the inherent nature of the business model of commercial banks? What about the effect and impact of the dominant globalized capitalist model of economic and financial systems, its laws and regulations, on the shape and direction taken by the Islamic finance industry since the transition from community-

driven initiatives in the 1960s to universal-centered commercial banking in the 1970s?

## RESEARCH OBJECTIVES AND METHODOLOGY

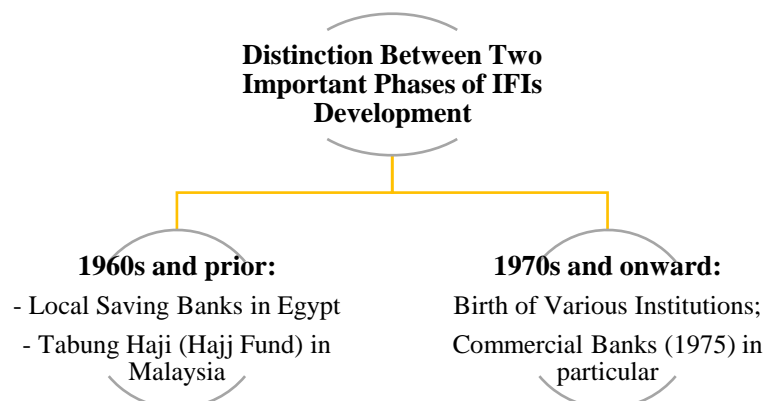
Considering the above discussion, the research aims to achieve the following objectives:

1. Contribute to the current debate on the deadlock in which the industry finds itself, particular attention has been paid to the dominant players (i.e., ICBs) to determine whether they are able to respond to the socio-economic and welfare issues of the societies in which they operate.
2. Provide a brief account of the development of Islamic banks over the past six decades.
3. Explore in a comparative manner the key characteristic factors of the two business models of the 1960s and 1970s, respectively.
4. Draw some lessons for the future development of the industry in the age of AI and digitalization.

To achieve these objectives, this research adopted deductive, inductive, and analytical methodologies. The remainder of this paper is structured as follows: Section (1) presents a brief overview of the evolution and development of the Islamic finance industry from the 1960s to the present day. Section (2) provides an overview of the history of the origin of the two business models of the 1960s and 1970s, as they appeared in their nascent societies in the West as well as the route they have been taken under the ‘Islamization’ process. Section (3) is devoted to the future direction and development of the industry in light of a proposed comprehensive theoretical framework grounded in the fundamental sources of Shari’ah with some key interpretations by prominent Muslim jurists. Section (4) concludes with the main findings and recommendations.

## EMERGENCE OF IFIS AND THEIR EVOLUTION OVER THE PAST SIX DECADES

It is well documented in the literature on Islamic economics and finance that the evolution of IFIs in the modern era has undergone two phases of development, as shown in Figure (1).



**Figure (1): History of Institutional Arrangement of IFIs in Modern Era**

Source: Author's Own

The experiment of local savings banks (LSBs) in *Mit-Ghamr*, Egypt, was inspired by the German LSB movement, which was based on an attitude of social transformation at the grassroots level, i.e., “instilling the saving behavior and letting it transform the attitude into a habit that people at the local level will benefit from the small resources they have,” (El-Naggar, 1993, p. 32). The guiding theme of El-Naggar’s initiative, as noted by Schöenbach (1982., p. 32), was to bring “social and economic change for the most disadvantaged segments of Egyptian society.” El-Naggar’s choice of region and people was not random; it was based on the belief that economic change must come from within society itself through a bottom-up approach, making cooperation and trust in participants’ abilities the cornerstones of the business model. More importantly, the resources collected were used to serve economic and social projects and to meet the needs of the local community. People, therefore, began to observe and reap the fruits of the modest resources they had collectively contributed.

Another important dimension is the fact that the *Mit-Ghamr* business model was built on communal trust. The project’s founder believed that the use of collateral and guarantees in the banking sector undermines the role of trust in financial relationships (Alonso, 2010, p. 7). Furthermore, taking into account the “unique” sociocultural characteristics of Arab communities is an inherent feature that has greatly contributed to the initiative’s growth and adherence among local farmers in the Dakahlia governorate.

On the other hand, the experiment considered the social aspect as intrinsic rather than a “plugged in” element, as in the private sector (Belouafi, 2020). Social responsibility in this regard was demonstrated by this experience, which enabled social transformation and the dissemination of financial education, as highlighted in the foundation’s 1967 report. According to the report’s findings, nearly 90% of the 150 people surveyed reported having savings with Mit-Ghamar LSB, 61% reported having no savings before the bank was established, and 51% regretted not having developed a habit of saving before the bank was established (Ready, 1967). El-Naggar is deeply convinced that economic change must come from within society itself, using a bottom-up approach. Furthermore, as El-Naggar and other Muslim economists point out, “any program aimed at improving the living conditions of traditional Muslim societies must take Islamic beliefs into account” (Schöenbach, 1982, p. 32). Failure to take this dimension into account leads to failure, as the long history of contemporary Muslim societies shows. The same is true of the Malaysian experience in its early days, where the business model was based on the effect of cooperation resulting from the law of large numbers, which transforms small contributions from participants into a vast pool of financial resources\*. In addition, the aim was to instill and spread a culture of saving from the moment a child is born into a Malaysian Muslim family. The results, as predicted by the then-head of Al-Azhar, Sheikh Mahmoud Shaltout (PMFB, 1995, p. 11), were remarkable and positively affected potential stakeholders, namely Muslim pilgrims, the financial system, and the economy, through financial inclusion and planning.

The outcomes observed since its launch to date provide compelling evidence of its effectiveness. For example, Tabung Haji in Malaysia has devised an innovative way to encourage Muslims to save money to finance their pilgrimage expenses. It has effectively managed the resources mobilized from small savers and invested them in industry, trade,

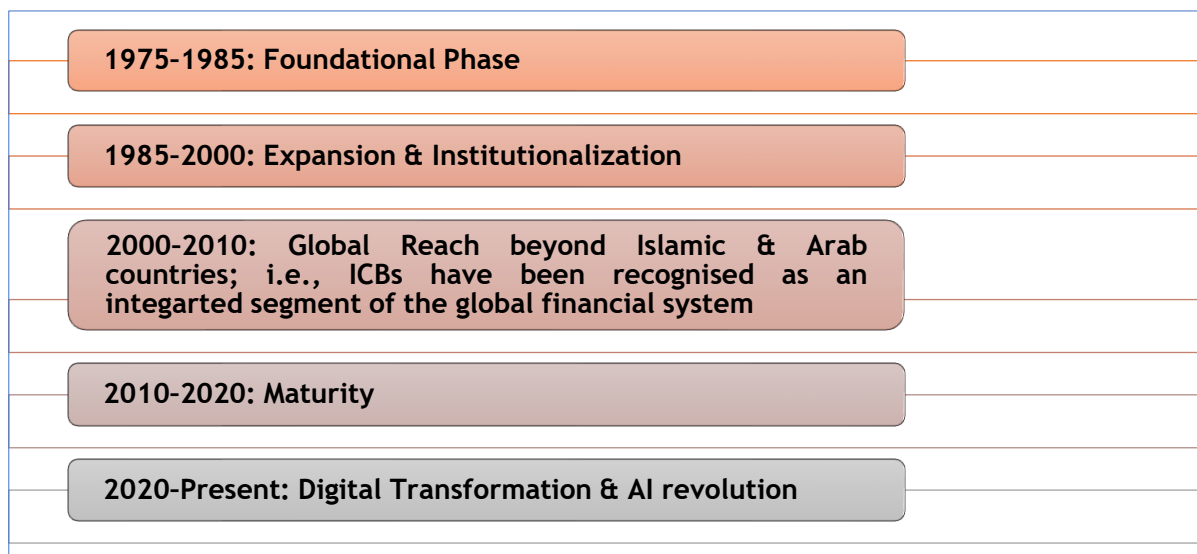
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\* The minimum amount required to open an account with the fund was only Malaysian ringgit 10 (PMFB, 1995, p. 14).

agriculture, and real estate, in accordance with Islamic principles" (PMFB, 1995, p. 7). In fact, the fund did not play a role in pooling financial resources; rather, it served as an investment vehicle to support real economic activity, playing a similar or more significant role. As such, it provided a typical example of how a crucial ritual of the Islamic faith was utilized to create a savings and investment entity. More importantly, it played a central role in shaping the behavior and attitudes of Malaysian pilgrims through various courses and training sessions covering the rules for performing the Hajj and the rules and regulations of the home and host countries. These aspects consolidate the unique integration of cultural, social, and economic dimensions and reflect, to a certain extent, the holistic and comprehensive essence of Ibadah (worship) in its broadest sense, as taught and practiced by the Prophet (PBUH), his companions, and those who followed their footsteps in later generations.

In recognition of its achievements, the fund was awarded the prestigious IDB Award in 1410 AH (1990), which justified this award, among other reasons, by "the significant contribution to the mobilization of individual savings and the successful management of an investment fund according to Islamic principles in order to fulfill the lifelong desire of many people: performing the *Hajj* pilgrimage to Mecca" (PMFB, 1995, p. 7).

On the other hand, the 1970s saw the birth of fully-fledged Islamic commercial banks, whose evolution can be summarized in six stages, as shown in Figure (2). According to some estimates, the industry has grown from a niche market to a mass market, worth around \$4 trillion (GIBSC, 2025).

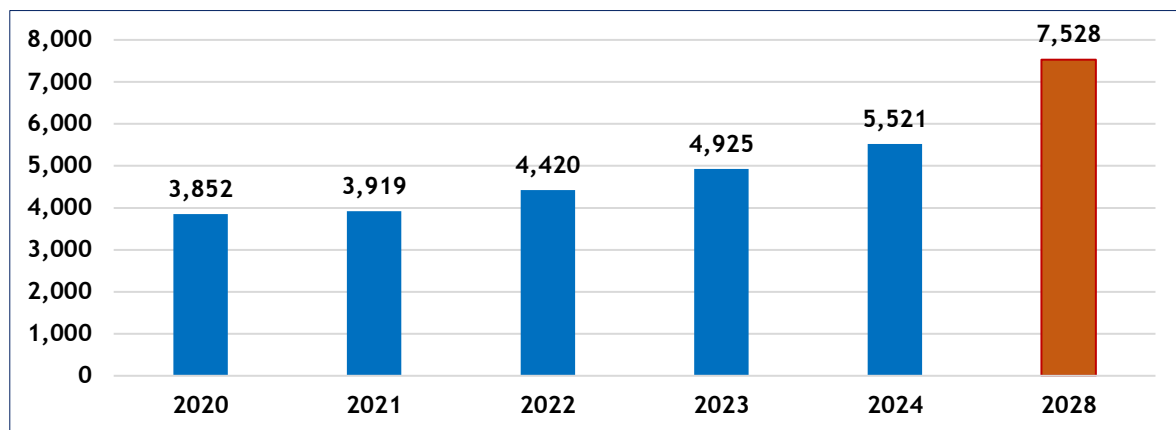


**Figure (2): Evolution of Islamic Banking from 1975 to the Present.**

Source: Author's Compilation from Various Sources

These phases of rapid and spectacular expansion in the sector have been reflected in the growth of total assets over recent decades. A report recently published by the Group of Islamic Banking Standard Chartered (GIBSC) traces the history of the sector, stating that "in the early years of Islamic finance, its adoption was limited to a handful of markets. Today, a network of more than 1,980 IFIs offers Islamic finance products and solutions in

more than 90 markets around the world" (GIBSC, 2025, p. 6)<sup>†</sup>. The report projects that total Islamic finance assets will reach US\$7.5 trillion by 2028, up from US\$5.5 trillion in 2024, reflecting the growing importance of Shari'ah-compliant finance globally (GIBSC, 2025, pp. 7-9; Neo & Ben Khadra, 2025). The sector is therefore expected to grow by 36% over four years and double the value of its assets in eight years, as shown in Figure (3). Commercial banks are the dominant players in the industry, controlling just over 70% of these assets, which are expected to reach \$4 trillion in 2024 and \$5.2 trillion by 2028 (IFSB, 2025, p. 8; GIBSC, 2025, p. 9; Neo & Ben Khadra, 2025).



**Figure (3): Growth of Islamic Finance Assets (2020-2024, USD Billions)**

Source: GIBSC, 2025, p. 7

Despite these significant developments, questions have been raised, as indicated in the introduction to this paper, about the positive contribution of these banks to the socio-economic well-being of the populations and economies of the countries where they have a considerable presence, i.e., countries where Islamic finance is systemically important, with total assets exceeding the threshold of 15% of total domestic banking assets (SESRIC, 2012).

While it is important to raise such questions in order to assess the contribution of Islamic banks, the approach adopted in this research emphasizes the need to exercise caution in these assessments. The following section will highlight important factors to consider in order to arrive at an objective outcome that situates Islamic banks within a broader context, beyond the desire to overcome some of the acute socio-economic problems afflicting many Muslim economies.

### **BUSINESS MODELS OF ISLAMIC FINANCE IN THE 1960S AND 1970S: A COMPARATIVE OVERVIEW**

In order to assess the suitability of the two business models studied in relation to the socio-economic conditions and aspirations of contemporary Muslim societies, this study presents a concise comparative assessment. The comparison is based on both their historical evolution and practical application, as well as on how these models are presented in the literature of the geographical areas where they first emerged.

<sup>†</sup> The ICD-LSEG report identified 2,225 IFIs operating globally in 2025 and projected that total assets would reach US\$9.72 trillion by 2029 (ICD-LSEG, 2025, p. 8).

It is essential to understand the early development of IFIs, as each model emerged in a distinct socio-economic and institutional environment. These origins have embedded certain structural and operational characteristics that continue to influence how each model is adopted, adapted, or resisted in different Muslim contexts. By tracing this evolution, the study seeks to identify elements of each model that may constitute obstacles rather than solutions, particularly when these characteristics risk compromising fundamental Shari'ah principles, whether through indirect stratagems, superficial asset-linking, or other forms of legalistic compliance.

It should also be noted that the comparative analysis focuses primarily on the Egyptian experiment, rather than the Malaysian Hajj Fund (Tabung Haji), which represents a different historical trajectory and institutional framework.

Table (1) presents a brief comparison between the business model of local savings banks (LSBs) and that of universal commercial banks (UCBs) based on carefully determined factors that have profound consequences and implications at the operational level. These factors have been drawn from the literature and documents that trace the origins of these institutions in the countries where they began operations.

**Table (1): Comparative of the Inherent Characteristics of Local Savings Banks (LSBs) vs. Universal Commercial Banks (UCBs)**

Dimension	Local Savings Banks (LSBs) - 1960s Business Model adopted to offer Shari'ah-compliant products & services.	Universal Commercial Banks (UCBs) - 1970s Business Model adopted to offer Shari'ah-compliant products & services.
Foundational Orientation and Inception Context	Created primarily by religious figures, social reformers, and community-focused promoters. Despite conducting interest-based transactions, the founding philosophy emphasized mutuality, cooperation, and collective welfare. Over time, governments institutionalized and supported this model as part of public services.	Founded by profit-oriented financiers with a clear commercial focus. The business model was primarily structured to maximize shareholder wealth and expand into competitive markets.
Core Value Orientation	Stakeholder value is the central objective (Belouafi, 2020). Institutional priorities extend to depositors, local communities, and regional development.	Shareholder value is the cornerstone of the business model. The primary goal of strategic decisions is to maximize returns for equity holders.
Economic Function and Financing Structure	Strongly rooted in local economic activities. Financing is closely linked to real transactions and community needs. Profit maximization is secondary to the prudent mobilization of savings and low-risk investments. In the German case, savings banks operate under a public service mandate that emphasizes regional development rather than purely financial performance metrics.	Financing is predominantly debt-based. This model often contributes to rising household indebtedness and consumerism. Financial transactions may exhibit only a formal or superficial link to real economic activity (e.g., structured debt instruments such as organized Tawarruq or buy-back sales).
Social Justice and Inequality Dimension	Social responsibility is intrinsic to the institutional framework. LSBs historically supported redistribution mechanisms (e.g., Zakat and charitable accounts) and aimed to reduce the exploitation of small farmers and artisans (Orhan & Kavakci, 2024). German	Social engagement is typically incorporated through external governance frameworks (e.g., CSR, ESG, SDGs). Lending practices based on creditworthiness and collateral may disproportionately favor wealthier

	savings banks explicitly assume responsibility for regional socio-economic development.	borrowers, potentially reinforcing structural inequality.
Behavior During Financial Crises	Relationship-based banking model characterized by long-term commitment to customers. Institutions tend to support their customers during periods of distress, thereby contributing to local shock absorption and resilience.	Contract-based orientation emphasizing recovery through guarantees and collateral enforcement. Crisis responses may intensify financial distress and amplify systemic vulnerabilities.
Financial Inclusion and Target Clientele	Focused on residents of designated territories, particularly the low- and middle-income classes. The principle of inclusion promotes broad access to financial services. SMEs constitute a core segment of the financing market; for example, German Sparkassen dominate SME financing in Germany.	It operates at the national and global levels. Access to financing is heavily influenced by creditworthiness, risk assessment, and profitability considerations. Financial inclusion is secondary to risk-adjusted returns.
Role in the Payment System and Money Creation	Limited systemic role in money creation and the payment system.	Central and pivotal role in the payment system and endogenous money creation. Commercial banks generate most of the broad money supply (+ 90%) in modern financial systems.
Resilience and Stability Paradigm	In general, they operate conservatively, with stronger capitalization and lower risk profiles. They have historically demonstrated relative resilience during major crises, notably the Great Depression. Emphasis on community interdependence enhances stability.	More crisis prone. Empirical evidence shows numerous systemic banking crises across jurisdictions (Laeven & Valencia, 2012), reflecting the structural fragility of profit-driven financial systems. More importantly, the cost of such crises is immense and "has lasting negative effects on output" (Cecchetti <i>et al.</i> , 2009, p. 1).

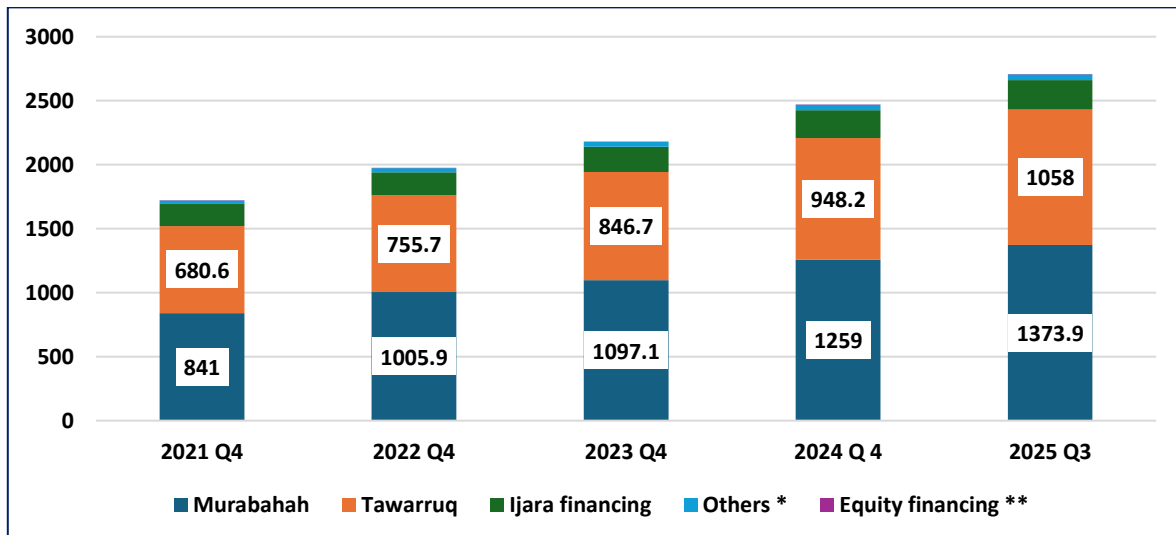
**Note.** LSBs = Local Savings Banks; UCBs = Universal Commercial Banks; CSR = Corporate Social Responsibility; ESG = Environmental, Social, and Governance; SDGs = Sustainable Development Goals. Belouafi (2020) emphasizes that stakeholder value is central to the LSB model (p. 125). Orhan and Kavakcı (2024) discuss the early reformist goals of protecting small producers from exploitation (p. 130). Laeven and Valencia (2012) identify 147 systemic banking crises between 1970 and 2011 (p. 3). **Source:** Author's Compilation from Various Sources.

It follows from the above that the LSB business model has certain characteristics and attributes that integrate socio-economic dimensions rather than adding them as a residual of CSR and other initiatives. This model is therefore more appropriate for achieving the "ideal" principles of Islamic finance (IF), i.e., PLS and asset-linking/backing to economic activities in an authentic and non-superficial manner. Furthermore, close ties with local customers strengthen socio-economic inclusiveness, which may place its core business in a better position to serve the mutuality and communal aspects that some Islamic finance advocates tend to criticize in the current form of the industry. The shape that is dominated by commercial banking activities, as shown in the previous paragraph.

In a nutshell, this brief comparison provides compelling evidence that the time has come for the advocates of the Islamic finance industry to break out of the vicious circle that places almost all socio-economic aspirations in the commercial banking sector. This goal has not been achieved and will not be achieved, given the inherited nature of commercial banks' business model, which deals with a highly sensitive source of financing characterized by strict and limited constraints, namely, very short maturities and a significant contribution to the money supply in contemporary economies. These specific characteristics make these

institutions subject to increased supervision and regulation by central banks regarding the use of the financial resources they have collected through deposits. This over-supervision significantly affects the character and quality of the assets they acquire with their funds.

Furthermore, this character may explain the inherent characteristic of heavy dependence or concentration on short- and medium-term financing modes on the asset side of Islamic banks, as illustrated in Figure 4, using the Kingdom of Saudi Arabia as an example over the last five years (2021-2025).



**Figure (4): Composition of Shari'ah-Compliant Assets Over the Last Five Years (2021-2025)**

**Note.** Murabaha (cost-plus financing), tawarruq (organized/banking, not the traditional form known in early Islamic societies), and Ijara (leasing) are debt modes of financing. \*Others include Shari'ah-compliant credit cards. \*\* Equity financing includes Mudaraba and Musharakah. Debt modes of financing account for nearly 100% of total financing over the five-year period, leaving a negligible share for equity financing. The two methods, Murabaha and Tawarruq, account for approximately 90% of total assets, and sometimes more, and Ijara accounts for approximately 09%, indicating a high concentration of Shari'ah-compliant financing methods in the Saudi market across three main methods. Source: Argaam (January 11, 2026), based on statistics from the Saudi Central Bank (SAMA); <https://www.argaam.com/ar/article/articledetail/id/1871733>

It is very apparent from the data presented in the graph that the use of funds in Islamic commercial banks is mainly through debt modes of financing, which are directly targeted at individuals/households in the short to medium-term. These types of institutions target individuals who use financing almost exclusively for consumption purposes. As a result, their contribution to socio-economic welfare and entrepreneurial initiatives is almost nil. This model corresponds to the core business of commercial banks.

The same or a close pattern can be observed in Saudi jurisdiction (Belouafi & Alamoudi, 2025). These findings once again indicate that the very nature of commercial banks' core business is to manage debt financing on both sides of the balance sheet. Thus, the call by some 'zealots' of Islamic finance for Islamic commercial banks (ICBs) to turn to equity financing seems far from reflecting the reality on the ground, supported by inherited and biased regulations that favor debt financing over that of equity through tax deductions and other legislation, not to mention the predominance of the consumerist model, which

can strongly influence the behavior of economic agents in almost all countries, including Arab and Muslim countries (Al-Suwailem, 2025). Unless there is a profound shift in policies and behaviors in the face of this stalemate, the call for increased equity financing in ICBs will find itself in a vicious circle: on the one hand, vocal voices in academic circles and symposia, and the deeply rooted reality on the ground, on the other.

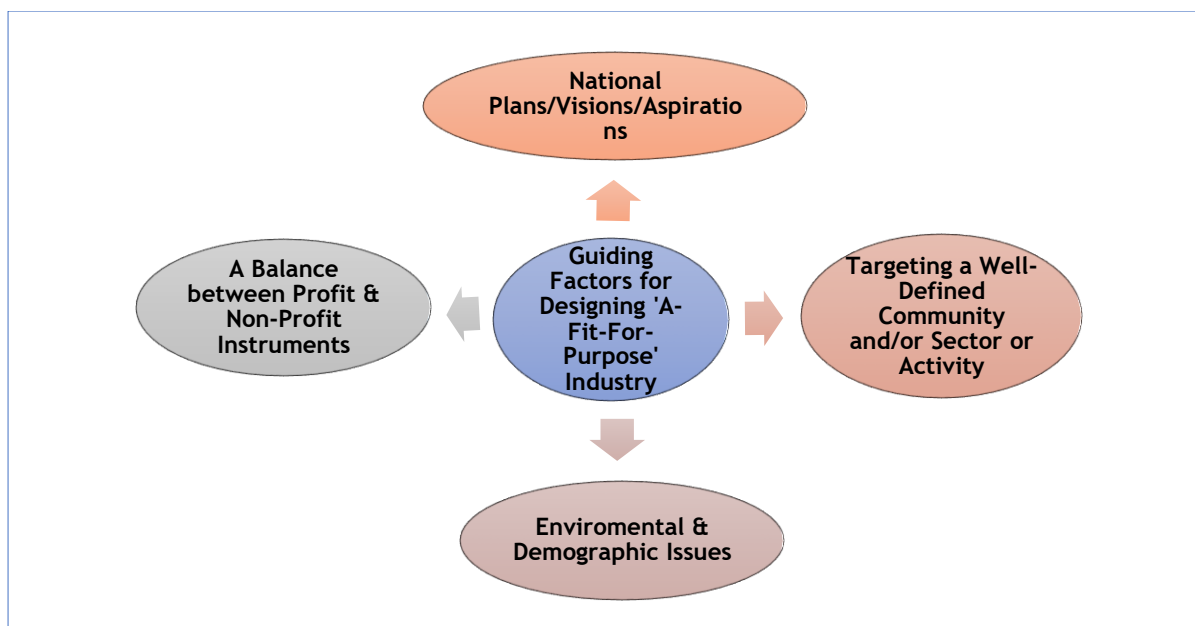
### **LESSONS FOR FUTURE DIRECTION OF INDUSTRY IN THE AGE OF AI AND DIGITIZATION**

The primary purpose of this revisiting study, which looks back at the beginnings of IFIs in the 1960s and 1970s, is not to reinvent the wheel, nor to call for a simple reproduction of the basic operational model of local savings banks (LSBs) as it was initially implemented in *Mit-Ghamr*, in Egypt, which is not entirely the case. However, there are strong arguments for a total or partial replication of the Tabung Haji (Hajj Fund) in Malaysia to provide a mechanism that improves the well-being of pilgrims in Muslim-majority countries. This has already happened in some Muslim and Arab countries, such as Jordan, with the creation of a national Hajj fund, the *Hajj Fund for Saving and Investment* (<https://www.hajjfund.gov.jo/en>). This initiative serves a well-defined community goal of great importance to Muslims, namely, to make the journey of a lifetime to the holy sites of Makkah and Madinah in order to fulfill the fifth pillar of the Islamic faith, in addition to other socio-economic objectives that can be achieved by pooling pilgrims' savings and reallocating them into local and national investment opportunities.

Moreover, this revisiting does not seek to call for the abolition or abandonment of commercial banking activities. The case is simple and clear in light of the realities, challenges, and opportunities that engulf Muslim-majority economies and societies in a delicate, dynamic sphere shaped by technological, environmental, and demographic dimensions that influence the future directions of human societies as a whole, not just Muslims. In this context, the "lesson of all lessons" for the Islamic finance industry is to leverage the diverse and rich portfolio of instruments and tools that underpin its fundamental principles, rather than limiting clients' options to a very few and limited financing methods derived from a well-centered banking business model, and/or diverting all objectives and aspirations toward this business model, as most academics advocate. It is therefore necessary to move away from this synthesis by strategically integrating the diversity and flexibility inherent in the core principles in order to achieve the public good (*Maslahāh*) of societies and countries.

What is so striking about this approach is the diversity and flexibility offered by technological developments. Both ends offer a golden opportunity to create an interactive and forward-looking bridge between the two flexibilities, which would provide a variety of options that would overcome the deadlock surrounding the nature and role of Islamic commercial banks and the outcome of the risk-sharing doctrine that most academics and some practitioners have overemphasized in assessing the socio-economic contribution of these banks.

To establish a "fit-for-purpose" and sustainable framework for the industry's priorities, the target audience must be clearly and categorically defined. The important factors for determining these priorities have been summarized in Figure (5).



**Figure (5): Elements for Determining Priorities for the Build-Up of IFIs in the Digital and AI Age**

Source: Author's Own

- 1 **Alignment of IF products and services with host countries' national plans/visions.** IFs do not operate in a vacuum, but within the specific jurisdictions of certain countries that have identified this industry as an important driver of economic development and growth. In recent years, most countries have embarked on highly ambitious initiatives to improve their societies. Financial systems have been targeted by these initiatives in order to support continued economic growth and diversity. Saudi Arabia, for example, launched Vision 2030 in 2016. Financial sector development (FSD) is a crucial component of the various programs launched under Vision 2030 (DFSP, 2025; Vision 2030). The main objective of the FSD is to contribute significantly to diversifying revenue and economic sources beyond the oil industry by offering a variety of financial instruments that align with this objective. IFIs must therefore seize the opportunities created by this vision to play an important role through a variety of instruments designed around the industry's fundamental principles. What has been said about Saudi Arabia also applies to other countries in different regions, including active countries in the GCC and Southeast Asia, as well as emerging regions such as North Africa and Sub-Saharan Africa.
- 2 **Targeting a well-defined community and/or sector/activity with appropriate and effective instruments and modes of financing.** In addition to serving national economies at large, the Islamic finance industry must adopt a flexible approach to meet local financial needs and aspirations. In this context, the two initiatives that marked the beginnings of Islamic finance in the 1960s can be considered important sources of lessons for designing highly effective and relevant services and products tailored to the socio-economic characteristics of specific communities and/or activities. It goes without saying that the appropriate instruments must be carefully designed to adapt to the cultural and socio-economic realities of these communities,

whether they are technology-based. For example, when designing initiatives based on digital developments and artificial intelligence, it is essential to design the initiative around very specific, well-articulated activities and/or communities, so that trust and interconnection are built on solid foundations, fostering resilience and effectiveness from the outset. In this regard, the Local Exchange Trading System (LETS)<sup>‡</sup> and the Community Exchange System (CES)<sup>§</sup> can provide valuable lessons for improving the socio-economic conditions of impoverished communities and societies. For example, under such systems, traditional or national currencies are just one of many means of facilitating the exchange of goods and services. Various methods exist: “record keeping, time exchange, direct exchange, barter, exchange, gifting, and sharing” are adopted in these ecosystems. Given that an adequate and effective recording system is in place, making it possible to “know who receives what from whom,” blockchain and other technologies enable the establishment of reliable and secure connections among members of a given community. More sustainable and fairer, this system works for people, not against them. Resilience is intrinsically built into these ecosystems.

- 3 **Environmental and demographic concerns must receive due attention they deserve.** In a report recently published at the request of the COMCEC\*\* of the Organization of Islamic Cooperation (OIC), environmental concerns in OIC member countries and the role that financial institutions can play in helping policymakers in these countries reduce the adverse effects of these problems have been addressed thoroughly and comprehensively (Asutay *et al.*, 2025). Through an analysis of environmental concerns in a few selected countries, the report demonstrates that “climate change and natural disasters pose systemic risks to OIC member countries, significantly affecting financial stability, food security, public health, and critical infrastructure” (Asutay *et al.*, 2025, p. 133). Besides, there exists abundant literature on Islamic finance addressing various aspects related to environmental risks and shocks and promoting the role of this paradigm in mitigating the severe effects of the top priorities on the environmental agenda at the local and international levels (see, for example, SCM & WB, 2019; Harahap, *et al.*, 2023; WB & IsDB, 2025). On the other hand, the demographic challenges facing many Muslim countries have received little or no attention despite their long-term impacts, as has been the case in many developed economies, particularly in the EU and Japan. For example, a recent policy briefing note stated that “by 2050, 22 of the 27 EU countries are expected to experience a decline in their working-age population (aged 20 to 64). At the same time, the EU will see a sharp increase in the share of its population aged 85 and over relative to the total population” (Pinkus & Ruer, 2025, p. 3). This demographic shift is putting considerable pressure on the labor force, health care, and social safety nets of these countries' economies (DGEFA, 2021). Current trends and projections regarding the demographic composition of OIC countries have begun to take on alarming proportions. According to an OIC document on the member countries' strategy for older persons, “since 2010, population aging in OIC countries has

<sup>‡</sup> LETS: <https://livingeconomies.nz/solutions/lets>.

<sup>§</sup> CES; <https://www.community-exchange.org/home/>.

\*\* Standing Committee for Economic and Commercial Cooperation of the Organization of Islamic Cooperation; Ankara-based organization (<https://www.comcec.org/>).

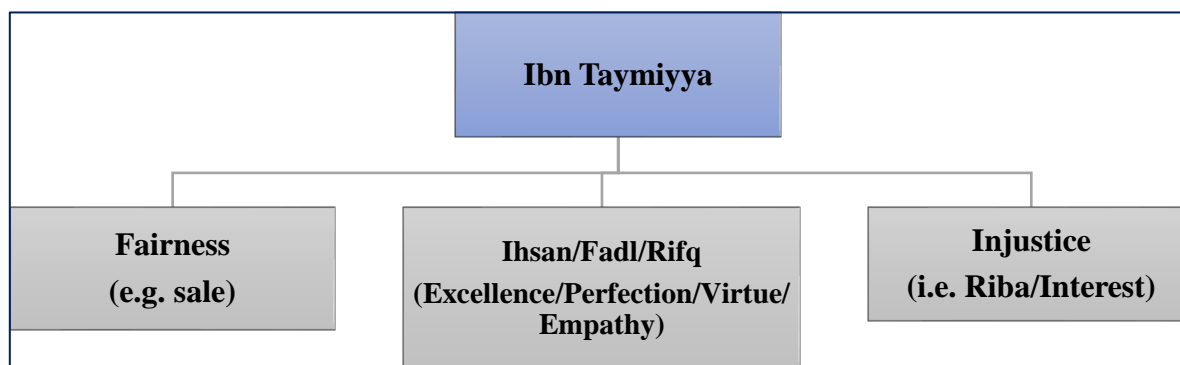
accelerated, and by 2030, the share of older persons is expected to reach 9.6% of the total population. [And by] 2050, in a significant number of OIC countries, the number of older people is expected to exceed that of young people. Combined with declining fertility rates in the OIC member countries and increasing life expectancy, aging will have a significant impact and pose a challenge to the economy, social relations, and cultural issues" (OIC, 2019, p. 3). A recent report by SESRIC, a subsidiary of the OIC, confirmed the trends predicted in the strategy document regarding the increase in the proportion of older people in the population and declining fertility rates in OIC member countries (SESRIC, 2023). Hence, if no strategic measures or policies are enforced, Islamic countries are heading for the same fate as many advanced economies. In this regard, Islamic finance can play a role in designing appropriate policies and financing methods by creating favorable conditions that encourage higher fertility rates and family stability as the fundamental and profound unit of society, from an Islamic perspective and in light of current realities. Shari'āh considers the protection of offspring (*Hifz An-Nasl*) one of the five ultimate objectives of Shari'āh. Therefore, the Islamic finance will contribute to achieving the ultimate objectives of Shari'āh, from a hierarchical perspective, in a manner superior to the protection of wealth (*Hifz Al-Maal*). Finally, it should be noted that there is a close link between environmental preservation and the preservation of humanity (Abdul Aal, 2023). They go hand in hand, serving each other.

- 4 **A balance between profit and non-profit instruments/institutions in the financial industry.** The structural flaws of contemporary financial systems—rooted in interest (the dominant form of *riba*) and speculation (the dominant form of *Ghārar*)—cannot be resolved by mere introduction of “Islamic-looking” for-profit instruments or institutions. From the outset, a balance must be sought between these instruments and institutions, on one hand, and not-profit complements, on the other. Failure to take this balance into account will lead to an inherently distorted structure and form of the financial system. With this in mind, the author of this research proposes a holistic approach to the fundamentals of Islamic finance, grounded in the rules set out in the strongest condemnation of *riba* in the longest chapter of the Quran. The renowned scholar Ibn Taymiyya states that these verses contain three rules relating to property (*Amwal*), as shown in Figure (6)<sup>††</sup>.

As a result, the Islamic finance value proposition advocates fairness in the form of sale and other form exchange contracts and benevolence in order to eradicate injustice in financial transactions. It should be noted that *riba* and sales are to be regarded as examples of permitted and prohibited practices in economic transactions respectively. The absence of such an approach may explain the current stalemate of the debate surrounding the role that ICBs are playing and being criticized for by the advocates of the PLS paradigm. These institutions, as a neutral observer noticed “are incorporated as listed companies rather than

<sup>††</sup> The rules are the permissibility of the sale described by the scholar as “fair,” as it serves the objectives of the contracting parties, i.e., the seller and the buyer (win-win), kindness on the part of parties/entities able to help others in times of difficulty, such as financial crises and pandemics, and deferrals by various means, tolerance, charity (obligatory (*Zakah*) and non-obligatory), and finally non-permissible dealings involving *riba* and others, which have been described by Ibn Taymiyya as an injustice due to the individual and social suffering that can result from the prevalence of such practices.

being mutual or co-operative organizations as some Islamic economists advocate”, (Wilson, 2020).



**Figure (6): Main Rules of Property (*Amwal*) in Verses of Surat Al-Baqarah [Q2:275-281]**

Source: Al-Ghamdi (2017)

Given the opportunities that AI and other digital technologies have shown to provide and deliver it has become easier and smoother to materialize this aspiration with care and full awareness of the limits and/or risks associated with these developments. For preliminary illustrative purposes I provided, in the appendix, few questions that I had posed to MS Copilot AI application and their answers. Answers seem to be in line with the general trends and developments that are taking place in many jurisdictions, Such as Saudi Arabia and other Gulf states, in benefitting from these technologies in the expansion of the base of donors in Waqf and other charity purposes where contributions are made by various parties of societies , not the rich ones alone.

Moreover, AI applications seem to provide a golden opportunity in product development and risk management for the small and medium contributions from middle and lower classes of societies the backbone of the local economy and the charity sectors, to flourish and play a significant role in the socio-economic development of societies. Therefore, creating an enabling environment for the genuine and appropriate implementation of PLS and other modes of Islamic finance that transcends the current discourse on Islamic economics literature that concentrates on commercial banking as the exclusive vehicle for the delivering of socio-economic aspirations of people and societies.

Time has come to let these banks do what they have been designed to do in the current legislative and prudential regulations, and move beyond these limitations through the expansion of the horizons provided by AI and other technologies with care and due diligence to the limitations and risks associated with their implementation.

## CONCLUSION

This research paper revisited the origins of IFIs in the 1960s and 1970s to draw lessons for the future in the era of digitalization and AI. The business models of the two phases of development were carefully compared using selected dimensions. Based on what has been discussed in the previous sections of the paper, the following findings can be stated:

- 1 *The Tabung Haji* (Malaysian pilgrimage fund) experiment is unique and distinct in its purpose and mechanisms. It therefore differs profoundly from the other two experiments. It was designed to serve a very noble purpose: the fifth pillar of Islam, using local resources collected from participating members. It served the community and the economy as a whole. It showed how cooperation and commitment can have a radical and positive impact on the lives of local communities.
- 2 Although the local savings bank in *Mit-Ghamr* was based on the business model of the *Sparkassen* savings banks in Germany, it was quite unique and distinct, to a certain extent, in some respects, thanks to the considerable and significant efforts of El-Naggar and his team, who spent a lot of time mingling with the local population before the bank was established. This allowed the team to analyze the characteristics and needs of farmers in their local context at that time. The *Mit-Ghamr* bank did not follow a ‘mechanical’ approach of the ‘Islamization’ of the model that was copied from Germany through the ‘window dressing and terminology changing of some contractual arrangements to make them ‘Shari’ah compliant’. The approach went further than that. It sought to change local residents' financial behavior, particularly in savings and investment. It instilled the "We" approach: as a community, i.e., we can come together and make a difference by joining forces, regardless of the size of our financial resources. The paper excerpted a few quotes from the 1967 Ford Foundation report and from the work of Alonso (2013), who met with the son of the bank's founder, Khaled bin Ahmed El-Naggar.
- 3 The experiments of the 1970s adopted the universal business model of commercial banks. It is evident from the long history of these institutions that their business model is commercial and that deposits, which represent the bulk of the money supply in many jurisdictions, are the main source of their liabilities. Given this specific nature, it would be a serious mistake to expect these entities to achieve results that span both economic and social dimensions, as well as lucrative and non-lucrative ones. The time has therefore come to create institutions with different objectives, made ‘fit-for-purpose’ to the tailored goals and/or objectives.
- 4 The experiments of the 1960s show that Islamic finance can only reach its potential if profit and non-profit organizations are created jointly. Moreover, debt instruments that are genuinely compliant with equity and Shari’āh law work hand in hand, responding to the diverse and dynamic aspirations of human societies as a whole, not just Muslims; Islam is a mercy to all worlds “*And We have not sent you, [O Muhammad], except as a mercy to the worlds,*” (Quran 21:1070). Without such a holistic and comprehensive approach, the debate over the "perceived" role of ICBs and the superiority of the “risk sharing doctrine” will continue indefinitely in an environment where bias in favor of debt has distorted the image of finance through financialization, wealth inequality, and resource misallocation in favor of short-term speculative activities.
- 5 The main conclusion and direction for the future development of Islamic finance should be guided and inspired by the wise proverb, "Think Globally. Act Locally." Hence, provincialism and the community-centered approach are stronger, more effective, and better suited to driving positive, impactful transformation. I will quote here the "ordeal" that the late economist Siddiqui suggested as a topic to a

doctoral student at Umm Al-Qura University in Saudi Arabia in the 1990s: *“I pause here to narrate an experience belonging to the 1990s. By then, I had become aware of such shortcomings and wanted to rectify the situation. To a would-be Ph.D. student at Ummul Qura University, Makkah al-Mukarramah, I suggested a subject involving some fieldwork alongside textual studies: the evolution of the concept of (isrāf = excessiveness/profusion) over the ages and across regions. In accordance with established practice in modern universities, I wanted the student to conduct some fieldwork in his city of residence by getting questionnaires filled out by members of different income groups. But the proposal was turned down ...”*

- 6 This quote is not intended to find out who rejected the proposal or why; rather, the ultimate objective is to emphasize the importance of a thorough and accurate study and understanding of the reality on the ground at the local level. Once this formidable task has been accomplished, the proposal that corresponds to a given geographical location in specific contexts follows, surrounded by temporal, social, and cultural specificities. El-Naggar, for his part, has clearly indicated that family ties in the Muslim world are of paramount importance (Schönenbach, 1982, p. 33).

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ScienceDirect: Savings bank. <https://www.sciencedirect.com/topics/social-sciences/savings-bank>

## APPENDIX

### Questions to MS Copilot AI about the Future of IF and Role of AI

On January 10<sup>th</sup>, 2026, I posed the following questions to MS Copilot AI, and I had the subsequent answers. It must be acknowledged that the exercise is not meant to seek neither definite nor accurate answers. It is just for a very preliminary discovery of the opportunities offered by the unprecedented development of AI applications and other digital technologies.

1. Do you think that you pose a threat to specific areas of business model of Islamic finance?
2. In what way you can help in enhancing the presence and development of Islamic finance?
3. What is the future of Islamic finance industry in the digitalization era?

\*\*\*\*\*

### MS Copilot AI Responses:

#### 1. Do I pose a threat to specific areas of the business model of Islamic finance?

AI systems like me don't threaten the *principles* of Islamic finance, but we do challenge certain *business models* that rely heavily on manual processes, information asymmetry, or slow decision cycles. Examples include:

- **Credit assessment and risk scoring:** AI can automate what many Islamic banks still do manually.
- **Shariah compliance review:** Some routine screening tasks can be automated, reducing reliance on large compliance teams.
- **Customer service and onboarding:** Digital-first fintech's can outperform traditional Islamic banks in speed and user experience.

The threat is not to Islamic finance itself, but to institutions that fail to modernize.

#### 2. How can AI enhance the presence and development of Islamic finance?

AI can be a powerful enabler for industry:

- ◇ **a. Shariah Compliance Automation**
  - Screening contracts for prohibited elements (riba, gharar, maysir).
  - Ensuring product structures follow AAOIFI or IFSB standards.
- ◇ **b. Product Innovation**
  - Designing new digital Shariah-compliant products (e.g., smart sukuk, tokenized assets).
  - Simulating risk-return profiles for Mudarabah, Musharakah, and Wakalah structures.
- ◇ **c. Financial Inclusion**
  - AI-powered microfinance models aligned with Islamic principles.
  - Personalized financial guidance for underserved populations.
- ◇ **d. Global Visibility**
  - Generating multilingual content, research, and educational material to expand Islamic finance's reach.

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**3. The future of Islamic finance in the digitalization era.** Digitalization is not optional – it is existential.

#### Key Trends Shaping the Future

##### **a. Islamic Fintech Expansion**

- Digital banks offering Shariah-compliant accounts, investments, and payments.
- AI-driven robo-advisors for halal portfolios.

##### **b. Tokenization and Blockchain**

- Smart sukuk with automated profit distribution.
- Tokenized waqf and zakat platforms.

##### **c. Embedded Islamic Finance**

- Shariah-compliant financing integrated directly into e-commerce, travel, and gig-economy platforms.

##### **d. Hyper-Personalization**

- AI-driven financial planning tailored to Muslim consumers' ethical and religious preferences.

##### **e. Regulatory Evolution**

- Digital Shariah governance frameworks.
- Cross-border digital Islamic finance standards.

Islamic finance will thrive if it embraces technology while preserving its ethical foundations.