

Determinants of the Shadow Economy with an Islamic Orientation: An Application to Organization of Islamic Cooperation and Non-Organization of Islamic Cooperation Countries

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Abstract : The main objective of Islamic Finance is to promote social justice through financial inclusion and redistribution of economic resources between rich and poor. The approach of Islamic finance is more comprehensive in nature and covers both formal and informal sectors of the economy, first, through reducing the gap between both sectors, and second by using specific Islamic values to reallocate the wealth between formal and informal sectors. Applying Generalized Method of Movements (GMM) to the annual data spanning from 1995-2015 for 141 countries, this study explores the determinants of informal business sector in Organization of Islamic Cooperation (OIC) countries and then compares with Non-OIC countries. Economic freedom and institutions variables as well as economic growth and money supply are found to reduce informal business sector in both OIC and Non-OIC nations while government expenditure are found to increase informal business sector in both group of nations. Informal Business sector remain the same in both types of countries but still the majority Muslim population in OIC economies create main difference between both groups of nations and justify the potential role of Islamic Finance in informal business sector in OIC nations. The study suggests that institutions quality should be improved and entrepreneurs' friendly business environment must be provided. This study refines the main features of informal business sector and discuss their implications on policy designing and implementation, particularly in the context of Islamic finance fight against poverty, inequality and improving living standards of informal sector participants in OIC countries.

Keywords : Islamic finance, informal Business Sector, Generalized Method of Movements (GMM) and OIC

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