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The Real Economy Principle in Islamic Finance: Reconnecting Finance with the Real Economy through Production, Trade, and Investment

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Abstract

The increasing separation between financial markets and the real economy has intensified concerns over financialization, excessive leverage, and the growing dominance of financial transactions over productive economic activity. Although Islamic finance is widely recognized for its prohibition of *riba*, asset-backed financing, trade-based transactions, and risk-sharing principles, these features are generally examined as separate contractual or legal characteristics rather than as components of a coherent economic philosophy. This paper argues that the defining characteristic of Islamic finance is its commitment to maintaining a continuous relationship between financial intermediation and the real economy. Building on this perspective, the study proposes the Real Economy Principle as an integrated conceptual framework that explains the economic orientation of Islamic finance through four interrelated pillars: asset linkage, trade orientation, productive investment, and economic value creation. Together, these pillars illustrate how Islamic finance seeks to align financial intermediation with production, trade, entrepreneurship, and sustainable economic development. The paper further examines the implications of the proposed framework for Islamic financial institutions, central banking, and financial stability. By integrating concepts that are typically examined independently in the existing literature, the Real Economy Principle provides a unified perspective on the underlying economic philosophy of Islamic finance and offers a conceptual foundation for future theoretical and empirical research on the relationship between finance and the real economy.

Keywords

Islamic Finance, Real Economy Principle, Financial Intermediation, Asset Linkage, Productive Investment, Financial Stability

1. Introduction

Finance was originally established to facilitate production, trade, and investment by transferring funds from surplus units to productive economic activities (Schumpeter, 1934; King & Levine, 1993; Levine, 1997). Over time, however, the rapid expansion of financial markets, the increasing complexity of financial instruments, and the growing dominance of purely financial transactions have gradually weakened the connection between finance and the real economy. In many modern financial systems, financial activities can expand independently of the production of goods and services, creating an environment in which speculative transactions, excessive leverage, and the rapid circulation of financial claims may become more prominent than value creation in the real sector (Minsky, 1986; Khan, 1986; Krippner, 2005; Palley, 2007).

Islamic finance emerged as an alternative financial paradigm that seeks to preserve this connection between finance and economic activity (Chapra, 1992; Mirakhor & Askari, 2017; Islamic Financial Services Board (IFSB), 2023). Rather than treating money as a commodity that can independently generate returns, Islamic finance requires financial transactions to be associated with identifiable economic activities, tangible assets, or productive investments (Usmani, 2002; Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023). Under this approach, financial intermediation is designed not as an end in itself but as a mechanism for supporting commercial exchange, entrepreneurship, investment, and sustainable economic development (Mirakhor & Askari, 2017; Iqbal & Mirakhor, 2011).

Although the existing literature has extensively examined the prohibition of interest (*riba*), profit-and-loss sharing, Shariah governance, and the contractual structures employed in Islamic finance (Iqbal & Mirakhor, 2011; Hassan & Lewis, 2007; Usmani, 2002), relatively less attention has been devoted to identifying the broader economic principle that connects these individual elements. These characteristics are often analyzed separately, despite representing different dimensions of a common economic philosophy. Consequently, Islamic finance is frequently described through its legal or contractual characteristics rather than through its underlying economic objective.

This study argues that the defining feature of Islamic finance is its commitment to maintaining a close relationship between financial transactions and the real economy. Building upon this perspective, the paper introduces the concept of the Real Economy Principle, which is proposed as an overarching conceptual framework explaining why Islamic financial transactions are generally asset-based, trade-oriented, investment-linked, and structured to promote genuine economic value creation (see **Figure 1**). Within this framework, principles such as asset backing, risk sharing, and the prohibition of purely speculative transactions are interpreted as complementary mechanisms that collectively reinforce the relationship between finance and productive economic activity.

The paper contributes to the literature by shifting the analytical focus from individual contractual arrangements toward the broader economic philosophy underlying the Islamic financial system. Instead of viewing Islamic finance primarily as an interest-free alternative to conventional banking, the study presents it as a financial architecture designed to reconnect financial intermediation with production, trade, investment, and sustainable economic development. By proposing an integrated conceptual framework, the paper also provides a foundation for future research on financial stability, monetary policy implementation, and the design of Islamic financial markets.

The remainder of the paper is organized as follows. The next section discusses the distinction between the financial economy and the real economy and explains the implications of financialization. The subsequent section develops the proposed Real Economy Principle and examines its core components, including asset-based financing, trade orientation, productive investment, and value creation. The following sections discuss the policy implications of this framework for financial stability and Islamic finance before concluding with the study's main findings and suggestions for future research.

2. Finance and the Real Economy: Understanding the Growing Disconnect

2.1. The Economic Functions of Finance

Finance performs a fundamental role in every economic system by facilitating the efficient allocation of financial resources (Schumpeter, 1934; Gurley & Shaw, 1960; Levine, 1997). Through financial intermediation, savings are transferred from surplus units to households, firms, and governments requiring funds for consumption, investment, and productive activities. In this respect, the financial system serves as a supporting mechanism that enables economic transactions, promotes capital formation, facilitates risk management, and contributes to long-term economic development (Goldsmith, 1969; King & Levine, 1993; Levine, 1997).

The effectiveness of financial intermediation is generally evaluated not by the size of the financial sector itself but by its contribution to the performance of the real economy. Productive investment, technological innovation, business expansion, employment creation, and sustainable economic growth ultimately depend on the ability of the financial system to channel resources toward economically productive activities (Schumpeter, 1934; Levine, 2005). Therefore, finance performs its most valuable function when it facilitates the creation of real economic value rather than merely increasing the volume of financial transactions.

From this perspective, finance should be understood as a means of supporting economic activity rather than as an independent source of wealth creation. Financial transactions derive their economic significance from the productive activities they enable, including investment, production, trade, and entrepreneurship (Merton

& Bodie, 1995). When financial intermediation remains closely connected to these activities, the financial sector contributes directly to the efficient functioning of the broader economy.

2.2. Financialization and the Expansion of the Financial Economy

Over recent decades, the structure of global financial systems has evolved considerably. Financial markets have expanded rapidly, financial instruments have become increasingly sophisticated, and cross-border capital movements have accelerated (Krippner, 2005; Borio, 2012). While these developments have improved market efficiency and broadened financing opportunities, they have also increased the volume of financial transactions that occur independently of the production and exchange of goods and services (Palley, 2007; Rajan, 2010).

This transformation has often been described as *financialization*, referring to the growing importance of financial motives, financial institutions, and financial markets within the economy (Krippner, 2005; Van der Zwan, 2014). As financial activities become increasingly autonomous, the accumulation and trading of financial claims may expand more rapidly than the underlying growth of productive economic activity. Consequently, a larger share of economic resources may circulate within the financial sector without generating corresponding increases in production, investment, or employment (Borio, 2012; Krippner, 2005; Stockhammer, 2004).

The growing complexity of financial markets has also encouraged the expansion of highly leveraged positions, speculative trading strategies, and short-term investment behaviour (Minsky, 1986; Palley, 2007). Although these activities may improve market liquidity under certain conditions, they may also weaken the relationship between finance and productive economic activity, increasing financial vulnerability and amplifying systemic risks during periods of market stress (Minsky, 1986).

2.3. Why the Connection with the Real Economy Matters

The long-term contribution of finance depends on its capacity to support value creation within the real economy. Sustainable economic growth ultimately originates from productive investment, technological progress, entrepreneurship, industrial development, and commercial activity rather than from the continuous expansion of purely financial transactions (Levine, 1997; King & Levine, 1993).

Maintaining a close relationship between finance and the real economy contributes to more efficient resource allocation by directing financial capital toward activities that generate tangible economic output. Investment in productive enterprises expands production capacity, supports employment, encourages innovation, and strengthens the foundations of sustainable growth (Schumpeter, 1934; Levine, 1997). By contrast, when financial resources become concentrated in transactions that are only loosely connected to real economic activity, the ability of the financial system to support long-term development may gradually weaken

(Palley, 2007).

From this perspective, the quality of financial intermediation is determined not only by the availability of financing but also by the extent to which financial transactions contribute to genuine economic value creation. Finance fulfills its economic purpose most effectively when it supports production, trade, investment, and entrepreneurship rather than merely facilitating the circulation of financial claims (Merton & Bodie, 1995; Levine, 1997).

2.4. Toward an Alternative Perspective

The growing separation between financial markets and productive economic activity has stimulated increasing interest in financial models that place greater emphasis on the real economy (Krippner, 2005; Borio, 2012; Van der Zwan, 2014). Rather than viewing finance as an autonomous sector capable of generating value independently, these approaches regard financial intermediation primarily as a mechanism for facilitating economic activity and supporting sustainable development (Levine, 1997; Merton & Bodie, 1995; Chapra, 1992).

Within this context, Islamic finance offers a distinctive perspective by requiring financial transactions to maintain a clear connection with identifiable economic activities, tangible assets, or productive investment (Chapra, 1992; Mirakhor & Askari, 2017; Islamic Financial Services Board (IFSB), 2023). Instead of evaluating individual contractual structures in isolation, the following section argues that these features collectively reflect a broader organizing principle. This study refers to this principle as the Real Economy Principle, which provides a conceptual framework for understanding the economic philosophy underlying Islamic finance.

3. The Real Economy Principle: A Conceptual Framework for Islamic Finance

3.1. Defining the Real Economy Principle

Islamic finance is commonly explained through its contractual structures and legal principles, including the prohibition of *riba*, the avoidance of excessive uncertainty (*gharar*), the prohibition of speculative transactions (*maysir*), and the application of asset-based and partnership contracts (Chapra, 1992; Usmani, 2002; Dusuki, 2012; Hassan & Lewis, 2007; Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023). While these features distinguish Islamic finance from conventional finance, they are often examined individually, leaving the broader economic rationale that connects them less explicitly articulated (Iqbal & Mirakhor, 2011; Mirakhor & Askari, 2017).

This study argues that these principles collectively reflect a common economic objective: preserving a continuous relationship between financial intermediation and productive economic activity. Rather than representing isolated legal requirements, they function as complementary mechanisms that direct financial resources toward activities capable of generating tangible economic value. Viewed from this perspective, Islamic finance represents not simply an alternative contractual system but a coherent economic framework in which finance remains embedded within the processes of production, trade, investment, and entrepreneurship.

Building on this perspective, this paper refers to this underlying objective as the Real Economy Principle. The Real Economy Principle may be defined as the overarching economic orientation of Islamic finance that requires financial transactions to maintain a meaningful connection with identifiable assets, commercial exchange, productive investment, and the creation of genuine economic value. Within this framework, financial intermediation is not regarded as an independent source of wealth creation but as a mechanism that facilitates and supports real economic activity.

The proposed framework does not replace the established principles of Islamic finance. Rather, it provides an integrated conceptual perspective that explains how these principles collectively contribute to maintaining the connection between finance and the real economy. Asset ownership, trade-based financing, investment partnerships, and the avoidance of purely speculative transactions therefore represent complementary dimensions of a broader economic philosophy rather than separate regulatory requirements.

Accordingly, the following sections examine the four interrelated pillars of the proposed framework: asset linkage, trade orientation, productive investment, and value creation. Together, these elements illustrate how Islamic finance seeks to align financial intermediation with sustainable economic development through continuous engagement with the real economy.

3.2. Pillar I: Asset Linkage

The first pillar of the proposed Real Economy Principle is asset linkage, which requires financial transactions to maintain a direct relationship with identifiable tangible assets or clearly defined economic activities (Obaidullah, 2005; Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023; Islamic Financial Services Board (IFSB), 2023). Within Islamic finance, the existence of an underlying asset is not merely a contractual requirement but a mechanism that connects financial intermediation to the real economy.

Unlike purely financial transactions in which money may generate returns independently of productive activity, asset-linked financing requires financial claims to originate from the ownership, transfer, leasing, or development of real assets (Usmani, 2002; Mirakhor & Askari, 2017). Consequently, the creation of financial obligations is associated with transactions involving goods, services, equipment, real estate, infrastructure, or other productive resources that contribute to economic activity.

Asset linkage also influences the way financial institutions participate in economic transactions. Rather than functioning solely as providers of funds, financial institutions become participants in asset-related activities through ownership, acquisition, leasing, construction, or investment. This relationship strengthens the connection between financial intermediation and the production, exchange, and utilization of economic resources (Iqbal & Mirakhor, 2011).

An important implication of asset linkage is that financial expansion becomes more closely associated with developments in the real economy. Since financing is generally supported by identifiable assets or productive projects, the growth of financial transactions tends to reflect underlying economic activity rather than the unlimited expansion of purely financial claims. Although asset linkage does not eliminate financial risk, it contributes to maintaining a closer correspondence between financial activity and real economic value.

This principle is reflected across a wide range of Islamic financial contracts. Trade-based instruments such as *murabaha* and *salam*, leasing arrangements such as *ijarah*, manufacturing contracts such as *istisna*, and partnership structures including *mudaraba* and *musharaka* all involve identifiable assets or productive economic activities, although they differ in their contractual structures and risk allocation mechanisms (Demirtas, 2024; Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023; Islamic Financial Services Board (IFSB), 2023). Their common characteristic is that financial transactions remain connected to activities capable of generating tangible economic value.

Within the proposed conceptual framework, asset linkage therefore represents more than a legal characteristic of Islamic finance. It serves as the fundamental mechanism through which financial intermediation maintains its relationship with the real economy, providing the foundation upon which the remaining pillars of trade orientation, productive investment, and value creation are constructed.

3.3. Pillar II: Trade Orientation

The second pillar of the proposed framework is trade orientation, which reflects the central role of commercial exchange in Islamic financial intermediation. While conventional financial systems frequently establish financing relationships through lending and borrowing arrangements, Islamic finance predominantly employs contractual structures that originate from trade, leasing, manufacturing, or investment activities (Chapra, 1992; Usmani, 2002; El-Gamal, 2006). Financial returns are therefore associated with participation in legitimate economic transactions rather than with the mere passage of time (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023).

Within this framework, trade performs a function that extends beyond the simple exchange of goods and services. It represents the economic mechanism through which financial resources are transformed into productive activity. By linking financing to commercial transactions, Islamic finance encourages the movement of goods, the expansion of markets, and the circulation of productive assets within the economy (Mirakhor & Askari, 2017). Financial intermediation consequently becomes integrated with commercial activity rather than operating independently from it.

The prominence of trade-oriented contracts illustrates this approach. Financing structures such as *murabaha*, *salam*, and *istisna* are all established through commercial transactions involving identifiable goods or productive assets (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023; Islamic Financial Services Board (IFSB), 2023). Although these contracts differ in their contractual arrangements and economic purposes, they share a common objective of facilitating real economic exchange. Financial institutions therefore generate returns through participation in trade-related activities instead of providing capital solely in exchange for predetermined interest payments (Usmani, 2002).

Trade orientation also contributes to strengthening the relationship between finance and production. Every commercial transaction creates demand for production, transportation, storage, distribution, and related economic services. As financial resources are channelled through these activities, financing supports broader economic processes rather than remaining confined to the financial sector itself. In this sense, trade functions as an important transmission channel through which financial intermediation contributes to employment, production, and economic growth.

From the perspective of the proposed Real Economy Principle, trade orientation represents more than a contractual preference. It constitutes an economic mechanism that continuously reconnects finance with the exchange of real goods and services. Rather than viewing trade as one contractual option among many, the proposed framework regards commercial exchange as one of the primary channels through which Islamic finance fulfils its broader objective of supporting productive economic activity and sustainable development.

3.4. Pillar III: Productive Investment

The third pillar of the proposed Real Economy Principle is productive investment, which emphasizes the allocation of financial resources to activities that expand productive capacity and generate long-term economic value (Chapra, 1992; Mirakhor & Askari, 2017). While financial transactions may serve a variety of purposes, Islamic finance encourages the use of capital in ways that support entrepreneurship, business development, infrastructure, technological progress, and the production of goods and services.

Within this framework, financial intermediation extends beyond the provision of liquidity. Its broader economic function is to mobilize savings and transform them into investments that contribute to capital formation and sustainable economic development (Iqbal & Mirakhor, 2011). The economic significance of financing is therefore determined not only by the availability of funds but also by the productive outcomes that those funds make possible.

A distinguishing feature of Islamic finance is that investment is commonly associated with participation in identifiable economic activities rather than with the passive earning of returns from financial claims alone. Partnership-based arrangements such as *mudaraba* and *musharaka* directly support entrepreneurial ventures by linking financial returns to the performance of productive enterprises (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023; Usmani, 2002). Likewise, contracts designed to finance manufacturing, construction, agriculture, and commercial production contribute to the expansion of real economic capacity through investment in productive assets (Islamic Financial Services Board (IFSB), 2023).

The emphasis on productive investment also encourages a longer-term perspective within financial decision-making. Because returns are connected to the success of underlying economic activities, financing naturally becomes more closely aligned with business performance, project viability, and sustainable value creation (Mirakhor & Askari, 2017). This relationship promotes a financial environment in which investment decisions are increasingly evaluated according to their capacity to generate lasting economic benefits rather than short-term financial gains alone.

From the perspective of the proposed framework, productive investment represents the mechanism through which financial resources are transformed into tangible economic outcomes. By directing capital toward entrepreneurship, innovation, industrial development, and productive enterprise, Islamic finance strengthens the relationship between financial intermediation and the real economy. Productive investment therefore serves as the bridge between commercial exchange and broader economic development, reinforcing the central objective of maintaining finance as a catalyst for sustainable growth.

3.5. Pillar IV: Economic Value Creation

The fourth pillar of the proposed Real Economy Principle is economic value creation, which represents the ultimate objective of Islamic financial intermediation. While the preceding pillars explain how financial transactions are structured and conducted, economic value creation explains why these mechanisms exist. The primary purpose of Islamic finance is not simply to facilitate financial exchange or generate financial returns, but to support economic activities that produce lasting value for individuals, businesses, and society (Chapra, 1992; Ahmed, 2010; Mirakhor & Askari, 2017).

Within this framework, financial transactions derive their economic legitimacy from their contribution to productive outcomes. Financing is expected to support activities that increase productive capacity, facilitate commercial exchange, encourage entrepreneurship, create employment opportunities, and contribute to sustainable economic development (Iqbal & Mirakhor, 2011; Islamic Financial Services Board (IFSB), 2023). Financial returns are therefore viewed as outcomes of successful economic activity rather than objectives pursued independently of the real economy.

Economic value creation also broadens the evaluation of financial performance.

The effectiveness of financial intermediation cannot be assessed solely by the profitability or growth of financial institutions. Instead, greater emphasis is placed on the extent to which financial resources contribute to investment, innovation, industrial development, infrastructure, and improvements in overall economic welfare (Chapra, 1992). In this sense, the performance of the financial sector is ultimately linked to its contribution to the performance of the real economy.

This perspective distinguishes Islamic finance from approaches in which financial activity may increasingly become detached from productive economic processes. By maintaining continuous links between financing and real economic activity, Islamic finance seeks to ensure that the expansion of financial transactions is accompanied by corresponding increases in economic output and value creation.

Within the proposed conceptual framework, economic value creation represents the integrating outcome of the preceding pillars. Asset linkage establishes the connection with tangible economic resources; trade orientation channels financing through commercial exchange; productive investment transforms financial capital into productive capacity; and together these mechanisms generate sustainable economic value. The Real Economy Principle therefore presents Islamic finance as a financial system in which financial intermediation is designed to serve the broader objectives of production, investment, entrepreneurship, and long-term economic prosperity.

3.6. An Integrated Conceptual Framework

The four pillars presented in the preceding sections should not be interpreted as independent characteristics of Islamic finance. Rather, they constitute interdependent components of a unified economic framework that collectively explains how Islamic finance maintains its connection with the real economy (Chapra, 1992; Iqbal & Mirakhor, 2011; Mirakhor & Askari, 2017). Each pillar performs a distinct economic function, while simultaneously reinforcing the operation of the others.

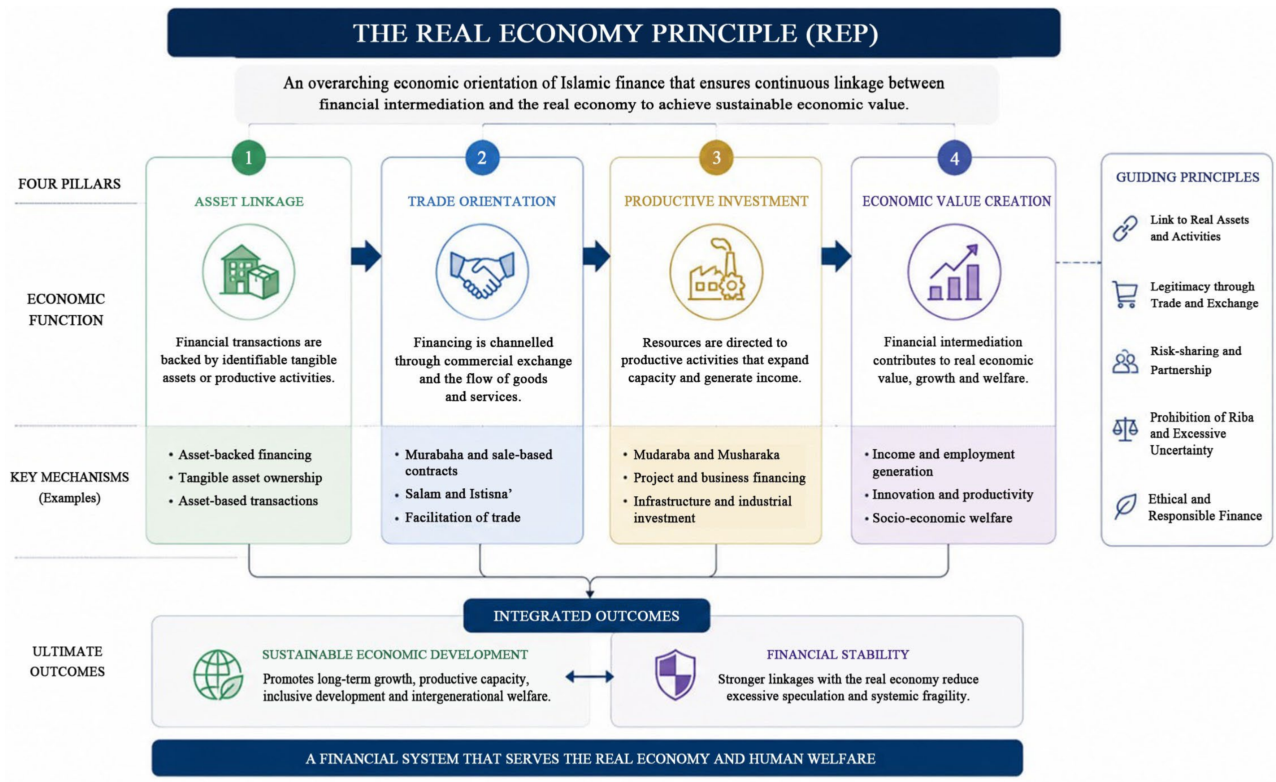
The framework begins with asset linkage, which establishes the foundation by requiring financial transactions to originate from identifiable assets or productive economic activities (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023; Islamic Financial Services Board (IFSB), 2023). This connection prevents financial intermediation from becoming detached from the real economy and ensures that financing remains associated with tangible sources of economic value.

Building upon this foundation, trade orientation provides the principal mechanism through which financial resources circulate within the economy. Commercial exchange transforms asset ownership into productive economic activity by facilitating the movement of goods, services, and productive resources (Usmani, 2002; El-Gamal, 2006). Financing therefore becomes integrated with real market transactions rather than existing solely as an exchange of financial claims.

The third pillar, productive investment, extends this process by directing financial resources toward activities that expand productive capacity. Investment in entrepreneurship, industrial production, infrastructure, technology, and business development enables financial capital to generate tangible economic outcomes that contribute to long-term economic growth and development (Chapra, 1992; Mirakhor & Askari, 2017).

The interaction of these three pillars ultimately leads to economic value creation, which represents the overarching objective of the proposed framework. Economic value is generated not by the expansion of financial transactions alone, but by their contribution to production, employment, innovation, investment, and the efficient allocation of economic resources. Financial returns are therefore understood as outcomes of successful productive activity rather than objectives pursued independently of the real economy.

Viewed collectively, these pillars describe a coherent process through which financial intermediation supports sustainable economic development. Asset linkage anchors finance in the real economy; trade orientation activates commercial exchange; productive investment expands economic capacity; and economic value creation represents the cumulative outcome of these interconnected mechanisms. Rather than functioning as isolated contractual principles, they operate together as complementary dimensions of a single economic philosophy (see **Figure 1**).



Note: The framework illustrates how the four pillars of the Real Economy Principle interact to generate sustainable economic development and financial stability.

Figure 1. Real economy principle framework.

Accordingly, the proposed Real Economy Principle provides an integrated conceptual framework for interpreting Islamic finance as a financial system that continuously reconnects financial intermediation with productive economic activity. This perspective shifts the analytical emphasis from individual contractual structures toward the broader economic logic that underlies the Islamic financial system, offering a unified explanation for the design and operation of its principal financing mechanisms.

4. Implications of the Real Economy Principle

The proposed Real Economy Principle offers a broader perspective for interpreting the objectives of Islamic finance and provides a useful framework for evaluating the design of financial institutions, public policy, and financial regulation (Chapra, 1992; Iqbal & Mirakhor, 2011; Mirakhor & Askari, 2017). Rather than assessing Islamic finance solely through the compliance of individual contracts, the framework emphasizes whether financial intermediation consistently supports productive economic activity and sustainable value creation.

4.1. Implications for Islamic Financial Institutions

For Islamic financial institutions, the proposed framework suggests that the effectiveness of financial products should be evaluated not only according to their contractual compliance but also according to their contribution to the real economy (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023; Islamic Financial Services Board (IFSB), 2023). Financing structures that facilitate productive investment, commercial activity, entrepreneurship, and capital formation are more closely aligned with the broader objectives of Islamic finance than transactions that merely replicate conventional financial outcomes through alternative contractual forms (Chapra, 1992; Siddiqi, 2006). The Real Economy Principle therefore encourages greater emphasis on the economic purpose of financial innovation in addition to its legal structure.

4.2. Implications for Central Banking

The proposed framework is equally relevant for central banking in jurisdictions operating Islamic financial systems. Monetary policy implementation and liquidity management require financial instruments that are capable of transmitting policy decisions while preserving the connection between finance and the real economy (Islamic Financial Services Board (IFSB), 2023; International Islamic Liquidity Management Corporation (IILM), 2023). Instruments such as *sukuk*, *wakala*, *commodity murabaha*, and Shariah-compliant repo structures illustrate how central bank operations can support liquidity management without abandoning the asset-linked nature of Islamic finance (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2023; Islamic Development Bank (IsDB), 2020). From this perspective, the effectiveness of Islamic monetary operations should be evaluated not only by their operational efficiency but also by their consistency with the broader economic philosophy underlying the financial system.

4.3. Implications for Financial Stability

The Real Economy Principle also provides a useful perspective for understanding financial stability. Financial systems in which financing remains closely connected to identifiable assets, productive investment, and commercial activity may be less vulnerable to the accumulation of purely speculative financial claims (Mirakhor & Askari, 2017; Islamic Financial Services Board (IFSB), 2023). Although no financial system is immune to crises, maintaining stronger links between financial intermediation and the real economy may contribute to more sustainable patterns of financial development. Financial stability therefore emerges not only from effective regulation and supervision but also from institutional arrangements that encourage finance to remain closely connected with productive economic activity.

5. Challenges and Future Research

The Real Economy Principle proposed in this study is intended as a conceptual framework for interpreting the economic philosophy of Islamic finance rather than as a comprehensive theory explaining the performance of Islamic financial systems. Accordingly, several limitations and challenges should be acknowledged.

First, the practical implementation of Islamic finance does not always fully reflect its underlying economic objectives. In many jurisdictions, Islamic financial institutions rely heavily on trade-based financing, while partnership-based financing and equity participation remain comparatively limited (Demirtas, 2026; Islamic Financial Services Board (IFSB), 2023). Consequently, the degree to which financial intermediation contributes to productive investment may vary across institutions and countries (Demirtas, 2024).

Second, the proposed framework does not imply that asset linkage alone is sufficient to ensure financial stability or sustainable economic development. Macroeconomic conditions, regulatory quality, institutional capacity, legal infrastructure, and governance remain critical determinants of financial system performance (Mirakhor & Askari, 2017; Chapra, 1992). The Real Economy Principle should therefore be understood as one important institutional characteristic rather than the sole explanation for economic outcomes.

Finally, the framework presented in this paper is conceptual in nature and requires empirical validation. Future research may examine whether stronger adherence to the Real Economy Principle is associated with differences in investment behaviour, financial stability, resource allocation, or long-term economic growth across Islamic financial systems. Comparative cross-country studies and institution-level analyses may provide useful evidence for assessing the explanatory power of the proposed framework (Demirtas, 2024).

By identifying these directions, the present study aims not only to offer a conceptual interpretation of Islamic finance but also to encourage further theoretical and empirical research on the relationship between financial intermediation and the real economy.

6. Conclusion

This paper has argued that Islamic finance can be more comprehensively understood through its underlying economic orientation rather than solely through its individual contractual structures or legal principles. While existing studies have extensively examined concepts such as the prohibition of *riba*, asset-backed financing, and risk-sharing arrangements, these features are often discussed separately. This study has proposed that they collectively reflect a broader organizing logic that continuously connects financial intermediation with productive economic activity.

To provide a more integrated interpretation, the paper introduced the Real Economy Principle as a conceptual framework for understanding the economic philosophy of Islamic finance. The framework identifies four mutually reinforcing pillars—asset linkage, trade orientation, productive investment, and economic value creation—which together explain how Islamic finance seeks to align financial intermediation with the processes of production, trade, entrepreneurship, and sustainable economic development. Rather than viewing these characteristics as isolated contractual requirements, the proposed framework interprets them as complementary components of a coherent economic system.

The paper has also discussed the broader implications of this perspective for Islamic financial institutions, central banking, and financial stability. By emphasizing the continuous relationship between finance and the real economy, the proposed framework offers a broader analytical perspective for evaluating financial products, liquidity management instruments, and institutional design within Islamic financial systems.

The Real Economy Principle should not be interpreted as a replacement for the established principles of Islamic finance or as a claim that Islamic financial systems are immune to financial instability. Instead, it provides a conceptual lens through which the economic objectives underlying Islamic finance may be interpreted more systematically. In doing so, the framework contributes to the literature by integrating previously fragmented concepts into a single explanatory perspective.

Future research may further develop and empirically evaluate the proposed framework by examining whether stronger adherence to the Real Economy Principle is associated with differences in financial development, investment behaviour, resource allocation, or macroeconomic performance across Islamic financial systems. Such studies may contribute to a deeper understanding of how financial intermediation can more effectively support sustainable and inclusive economic development.

Ultimately, the contribution of Islamic finance extends beyond the avoidance of interest. Its broader significance lies in its institutional aspiration to maintain finance as a mechanism that serves production, trade, investment, and the creation of genuine economic value. Interpreted through the Real Economy Principle, Islamic finance may therefore be understood not simply as an alternative financial model, but as an economic framework that seeks to preserve the enduring relationship between finance and the real economy.

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Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

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