# Does Economic Freedom Affect the Islamic Bank's Profitability?

# A Comparison of IOC Countries

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**Abstract: Objectives:** This study examines the impact of economic freedom on the profitability of Islamic banks in OIC countries from 2010 to 2020. **Methodology:** Employing a balanced panel dataset and a static panel data regression model, the analysis yields intriguing findings. Notably, both the overall economic freedom index and financial freedom exhibit a significant negative effect on the profitability of Islamic banks. **Results:** The results suggest that greater economic freedom intensifies competition within the banking sector, thereby reducing the profitability of Islamic banks. Conversely, an important finding highlights that monetary freedom has a significant positive effect on profitability. This indicates that in environments with high economic freedom, rising interest rates create opportunities for Islamic banks to leverage their specialized financial products, ultimately enhancing their profitability. **Recommendations:** This research contributes to the existing literature by providing a comprehensive analysis of the relationship between economic freedom and the performance of Islamic banks in OIC countries.

**Keyword:** Economic Freedom; Islamic Bank; Profitability; OIC; Investment.

# هل تؤثر الحرية الاقتصادية في ربحية البنوك الإسلامية؟ دراسة مقارنة بين دول منظمة التعاون الإسلامي

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**الملخص: الهدف:** تهدف هذه الدراسة إلى تحليل أثر الحرية الاقتصادية على ربحية البنوك الإسلامية في دول منظمة التعاون الإسلامي خلال الفترة الممتدة من عام 2010 إلى عام 2020. **المنهجية:** ولتحقيق هذا الهدف، استُخدم نموذج البيانات اللوحية الثابتة (Panel Data Regression) مستندًا إلى بيانات متوازنة. **النتائج** وقد أسفر التحليل عن نتائج ذات دلالة إحصائية مهمة؛ إذ أظهر كل من مؤشر الحرية الاقتصادية الكلي والحرية المالية تأثيرًا سلبيًا ومعنويًا على ربحية البنوك الإسلامية. **التوصيات** وتدل هذه النتائج على أن زيادة مستويات الحرية الاقتصادية تؤدي إلى تعزيز المنافسة داخل القطاع المصرفي، مما يفضي في نهاية المطاف إلى تراجع مستويات الربحية لدى البنوك الإسلامية.

**الكلمات المفتاحية:** الحرية الاقتصادية؛ البنوك الإسلامية؛ الربحية؛ منظمة التعاون الإسلامي؛ الاستثمار.

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## INTRODUCTION

The 2008 financial crisis was one of the most damaging financial disasters in history. It began in September 2008, accelerated structural changed (Straulino et al., 2024). The financial crisis has profoundly affected credit supply, bank profitability, and asset prices. During the crisis, financial institutions encountered significant challenges in rapidly disbursing loans. Consequently, in developing countries, various regulatory reforms have been implemented to enhance banking performance and ensure financial stability. (Bangarwa & Roy, 2023). During the post-crisis period, several large conventional banks collapsed. On the other hand, Islamic banks are not directly affected (Uppal & Mangla, 2010;Hasan & Dridi, 2011). This crisis has highlighted the shortcomings of the conventional financial system, leading to the recognition of Islamic finance as a viable alternative (Rosman et al., 2014).

Several studies suggests that the current financial crisis can actually be averted had Islamic banking taken the place of conventional money, as the latter provides a substitute and guarantees a more optimistic future for humanity (Beck et al., 2013). To ensure the global financial system efficient operation, it is necessary to fix the deficiencies of conventional finance. Consequently, evaluating Islamic money appears to be a remedy for numerous issues (Trad et al., 2017). This spectacular expansion and performance of Islamic banks heightened curiosity about their capacity to avert crises and sparked more interest in their profitability, efficiency, and risk.

Islamic bank is resistant to shocks due to its intrinsic balance and is most desirable without usury and gambling (Maliha & Marlina, 2019). Islamic finance is the best approach to economic intermediation because the capital also participates in the profit and loss of a project (Yusof & Bahlous, 2013). Theoretically, the incorporation of the Islamic legal framework (Sharia) in finance and banking has enhanced economic productivity. The Islamic banking and finance industry is inherently comprehensive, given its direct involvement in investment and trade, partnerships, and financial intermediation (Abdullah et al., 2016).

There is a lack of research on Islamic financial institutions to investigate the relationship between economic freedom and bank performance. Given the importance of bank lending to economic development, the minimal study in this field is somewhat unexpected. Most experts concur on the significance of the role of the Islamic finance industry in national GDP (Majid & Kassim, 2015;Boukhatem & Ben Moussa, 2018). Most important in financial sector is allocating financial resources to industries with high growth potential. On the other hand, more financial resources are allocated to genuine, productive investments that encourage economic expansion (Zarrouk et al., 2017).

In the context of Islamic banking, financial freedom had a beneficial impact on the profitability of Islamic banks in the MENA region (Sufian & Zulkhibri, 2015). Conventional and Islamic banks exhibit similar risk-taking conduct. Nevertheless, traditional banks are less stimulated by using financial freedom than Islamic banks. Therefore, it's far vital to behavior a whole to have a look at the impact of economic freedom on the overall of Islamic banks performance, particularly in terms of profitability.

Therefore, this have a look at intends to fill the void by measuring the achievement of Islamic banking within the Organization of Islamic Cooperation (OIC) international locations that evaluate their economic policies

primarily based at the oil enterprise (Paltrinieri et al., 2021). This study adds to previously conducted research. First, this paper explains the relationship between economic freedom and the performance of Islamic banking following the global financial crisis. Research on economic freedom is limited to its use as a control variable, lacking thorough analysis. This is the first attempt to assess the impact of economic freedom and its subcomponents on the success of Islamic banking in OIC nations during the global financial crisis. Second, this research on Islamic banking utilized historical and contemporary data. The period from 2010 to 2020 corresponds to one business cycle (Yang & Yuan, 2021).

Existing research focuses on traditional finance in industrialized countries such as Europe and the United States (Mavrakana Maria, 2019;Asteriou et al., 2021), MENA Countries (Sufian & Zulkhibri, 2015). Therefore, this research contributes to the expansion of the literature and investigates the effect of economic freedom on the performance of Islamic banking in OIC nations. This research contributes to a greater comprehension of the nexus of economic freedom and performance of Islamic banks. The second section analyzes the relevant literature on the effect of bank performance and its economic freedom, while the third section describes the study's data on variables and methodologies. Fourth, gives descriptive statistics and evaluates the empirical outcomes. Section five wraps up the paper.

**LITERATURE REVIEW**

The Economic Freedom Index measures a nation's economic policy flexibility (Harkati et al., 2020). An indicator of a nation's free market-friendly economic policy is the economic freedom index. The evaluation is based on 12 quantitative and qualitative characteristics, which are divided into four categories: Open markets, governmental size, regulatory effectiveness, and rule of law. The economy is rated from 0 to 100, with 100 denoting complete freedom and the lower the number, the less free it is. 80–100 is the free zone; 70–79.9 is largely free; 60–69.9 is total freedom; 50–59.9 is largely inaccessible; and 0-49.9 is the repressed zone. The more favorable a nation's policies are to the economy and competition, the higher the index score. The Econ Free Index is an overall indicator of a nation's economic freedom. The index of economic freedom is calculated on a scale from 0 to 100, with a score of 100 representing the greatest degree of freedom. Therefore, there is no bias toward any one component or policy orientation; the score is evenly balanced. Higher scores—whether for the whole score or a specific category—indicate less government involvement in the market and more policies that promote economic freedom and a favorable business climate.

Freedom of business refers to a person or organization's right to establish and operate a business with minimal government interference. These three actions hinder business and employment creation (Sufian & Habibullah, 2010). Excessive regulation imposed by the state is a major obstacle to companies operating without restriction. A higher score for business freedom indicates that there are fewer regulations imposed on people and organizations, or that the cost of production is lower. When businesses have greater flexibility in terms of productivity and profitability, the business environment becomes more predictable (Harkati et al., 2020). This index evaluates the ease of starting and closing a business and obtaining necessary permits (Masrizal et al., 2023).

The economic freedom index takes into account both price stability and price management evaluations. Any distortion in the market caused by inflation and price

regulations can be corrected through microeconomic intervention, thereby creating an ideal market environment (Sufian & Zulkhibri, 2015). Its score is determined by two factors: average inflation rate over the past three years and pricing controls. This index assesses the autonomy of economic policies since inflation and price controls can restrict market activity (Sufian & Habibullah, 2010).

Financial freedom is important for a strong financial system. It ensures credit availability, diverse savings options, convenient payment methods, and high-quality services for individuals. A competitive banking system helps establish a more effective connection between those who have a surplus of money (individuals, businesses, and governments) and those who need money (investors and entrepreneurs). The market operates according to the laws of supply and demand, which means that it provides up-to-date information about prices, especially for correcting bad decisions. The success of this process depends on how transparent the market is and how reliable the information provided is. A responsible and effective regulatory framework is maintained through strict disclosure requirements and independent auditing. The government is primarily responsible for ensuring transparency, honesty, and openness in the banking sector (Harkati et al., 2020). The financial security and autonomy from government control are measured by an index. It is ineffective for the state to own banks and other financial institutions like capital markets and insurance, and political favoritism has no place in the capital market (Sufian & Habibullah, 2010).

The government has implemented deregulatory measures, financial modernization, and automation which have led to an increase in competition among banks. This has caused a decline in expenses and profits for both conventional and Islamic banks

as they navigate through a rapidly transforming operating environment. As a result, it is expected that this will have an impact on the factors that determine their performance (Nawaz & Haniffa, 2017). Due to the essential position banks play in the economy, the banking industry has been accorded particular protection. There are number one dreams of law and oversight. First, make certain the financial system's security and health. Furthermore, the second objective is to ensure that financial service companies meet their fiduciary duties. eventually, these capabilities fall in the jurisdiction of the government's court docket, which is liable for enforcing contracts and shielding residents from fraud via requiring financial establishments to put up economic accounts showed through impartial audits so that borrowers, depositors, and different monetary gamers could make knowledgeable choices. However, when government pressure exceeds the minimal level, it becomes corrosive to freedom, with economic freedom being the first to suffer. Heavy bank rules reduce possibilities and limit economic freedom (Nguyen, 2024).

Freedom of investment refers to the freedom of funding that represents market opportunities and incentives for the diffusion of economic activities, production in high level, and job opportunities. Regardless of size or nature, are treated similarly, and there is a strong emphasis on equality and transparency in the companies. This encourages competition and innovation. On the other hand, Limitations on capital movement, both domestic and international, can lead to reduced productivity, unstable decision-making, and misallocation of resources (Harkati et al., 2020). A high score for investment freedom indicates easy access to the market, which will result in cost savings and efficiencies.

Over the years, several studies examined the relationship between various indicator in

economic freedom. The economic freedom index has been used by researchers to investigate whether macroeconomic factors have an impact on economic growth (Gwartney, 2009; Brkić et al, 2020). Other research focuses on FDI (Azman-Saini et al., 2010;Kwablah & Amoah, 2022), stock volatility (Luo, 2014), business cycles (Murphy, 2020), and trade flows (Seyoum & Ramirez, 2019). On the other hand, economic freedom has impact on profitability and risk-taking (Sufian & Habibullah, 2010;Sufian & Zulkhibri, 2015;;Mavrakana Maria, 2019;Harkati et al., 2020), firm performance (Liao, 2018), and the performance of microfinance institutions (Mohamad Anwar et al., 2020).

Economies with higher financial freedom provide banks with greater cost advantage and overall efficiency (Chortareas et al., 2013). Moreover, contrary to the quiet life theory, banks' market influence positively affects cost efficiency. It has been observed that banks with greater market dominance are more cost-effective. However, it's interesting to observe that bank efficiency is mostly negatively impacted by financial independence, especially when it comes to cost efficiency (Sarpong-Kumankoma et al., 2017). This indicates that reduced regulations in the banking industry are linked to a decrease in the cost-effectiveness of banks. As banks confront intensified competition, they may incur higher expenses in their quest for resources.

Financial freedom and technical efficiency seem to be in conflict, economic freedom positively influences business and monetary freedom as well as bank efficiency (Sufian & Shah Habibullah, 2014). In other hand, Competition freedom negatively affected only the social efficiency of MFIs. However, business freedom and monetary considerations had no impact on it. The research also revealed that investment and financial independence had

a positive impact on the financial efficiency of MFIs, and a negative effect on their social efficiency. Additionally, research indicates that, especially concerning government spending and tax burden, a larger government significantly enhances the social efficiency of microfinance institutions (MFIs). (Hussain et al., 2021). Understanding the fundamental factors influencing the success of the Islamic banking industry is essential given the rising importance of Islamic banking and finance in the world's financial markets. The literature has examined several bank performances using bank-specific characteristics, financial structure, risk, and macroeconomics. Previous research has focused mostly on the aspects of financial institution performance in a rural setting by contrasting conventional banks or a select group of industrialized nations, like the United States and Europe (Ibrahim, 2020;Paltrinieri et al., 2021;Yunan, 2021). However, there is currently relatively little research on economic freedom.

In the MENA banking market, financial and economic flexibility positively impact the profitability of Islamic bank performance (Sufian & Zulkhibri, 2015). Nonetheless, Studies have shown that government intervention has a different effect on economic freedom for Islamic banks compared to conventional banks. This suggests that various factors, such as tax burden, monetary flexibility, corporate freedom, and government integration, have a significant impact on the level of risk-taking for conventional banks. Government dignity, business, and investment freedom are more important than Islamic banks when evaluating bank risk. Higher levels of financial freedom may lead to fewer banks.

This research hypothesis is, Economic freedom positively influences Islamic banks profitability.

## METHODOLOGY

To investigate how the level of economic freedom affects the profitability of Islamic banks, this study collected data from 28 Islamic banks in Organization of Islamic Cooperation (OIC) member states, where Islamic banks represent well-established and significant financial organizations (table 1). The Heritage Foundation was consulted for information on economic freedom. Two measures of economic freedom include the Wall Street Journal and the Fraser Institute's Annual World Report, as well as the Heritage Foundation's Index of Economic Freedom, as the most comprehensive measure. Researchers have extensively used the Heritage Foundation's measure of economic freedom (Sarpong-

Kumankoma et al., 2017;Mavrakana Maria, 2019;Harkati et al., 2020). The Bloomberg database containing the annual reports of the sampled banks was mined for financial and bank-specific information. Meanwhile, macroeconomic information was gathered from the World Bank database (see table 2).

**Table (1):** Number of samples.

| Country | Number of Islamic banks |
|---|---|
| Bahrain | 5 |
| Jordan | 1 |
| Saudi Arabiah | 2 |
| Pakistan | 2 |
| Qatar | 3 |
| UAE | 4 |
| Kuwait | 2 |
| Indonesia | 4 |
| Bangladesh | 5 |
| Total | 28 |

**Table (2):** Variable description.

| Dependent Variable | Variable definition | Expectation | Source |
|---|---|---|---|
| Reurn on Asset | Net profit divided by total assets | | Bloomberg |
| **Variable economic freedom** | | | |
| Overal indeks | Index of economic freedom of all components | +/- | Heritage Foundation's |
| Business Freedom | Business freedom assesses an entrepreneur's ability to start a firm, obtain permission, and close a business. Obstacles to any of these three activities hinder business and, therefore, job development. | + | Heritage Foundation's |
| Monetary freedom | Monetary independence incorporates price stability and an evaluation of price control. The market is distorted by inflation and price regulations. The optimum condition for a free market is price stability without microeconomic interference. | + | Heritage Foundation's |
| Financial freedom | Financial freedom is the condition of being secure and independent from government influence. Government control of financial institutions such as banks, insurance companies, and capital markets is often inefficient. | + | Heritage Foundation's |
| Investment freedom | Freedom to invest represents business opportunities and motivation for economic diversity, high levels of production, and job chances. | + | Heritage Foundation's |
| **Bank specific variables** | | | |
| LNTA | Logaritma natural total asset | +/- | Bloomberg |
| Growth_Asset | The annual growth rate of total assets | | Bloomberg |
| EQTA | Equity dibagi total aset | +/- | Bloomberg |
| Growth_Interest | The annual growth rate of total interest | +/- | Bloomberg |
| Deposit_TA | Equals annual customers' deposits to total assets ratio | +/- | Bloomberg |
| **Macroeconomic Variables** | | | |
| LNGDP | Percentage change in the country's GDP from one year to the next. | + | WDI |
| INF | Annual inflation rate of the country expressed as a percentage. | + | WDI |

This research used panel data regression to determine the connection between dependent and independent variables to evaluate the impact of economic freedom on the profitability of Islamic banks. The panel data methodology was employed due to the nature of the data used in this study. Various techniques can be used to identify the elements that affect bank profitability. The most popular is the Generalized Panel Method of Moments (GMM), which has been utilized by a number of prior studies (Yunan, 2021; Paltrinieri et al., 2021). Nevertheless, the number of cross-sectional units used (n=28) is insufficient for GMM. Small sample size and a low number of observations (n<40) can result in severe bias. Consequently, a static panel data technique is used for this paper because it is deemed suitable.

Panel data is a method that consists of gathering observations in cross-sectional units over various time periods and delivering findings that are, in essence, not supported by pure time series or pure cross-section investigations (Harkati et al., 2020). Following is an illustration of the form of panel data regression:

$$Y_{i,t} = \acute{\alpha}_i + \beta X_{i,t} + \in it \qquad (1)$$

In this model, $Y_{i,t}$ represents the dependent variable for unit I in time t; $\acute{\alpha}_i$ is a constant or intercept value for unit i; $\beta$ is the slope coefficient (degree of slope) $X_{i,t}$ contains the set of independent variables for unit i in time t; i denotes the i; t is the t-th time-series period t; $\in$ is a residual (error term).

Random effects, on the other hand, utilize constants for each component, but not as fixed parameters, but as random ones. Random effects have fewer parameters to estimate than fixed effects, which is their primary benefit (Shawtari et al., 2018). The following equation reveals the estimation of the model in this study:

$$ROA_{it} = \beta_1 + \beta_2 Overal\_Indeks_{jt} + \beta_3 Buss\_Free_{jt} + \beta_4 Monet\_Free_{jt} + \beta_5 Finan\_free_{jt} + \beta_6 Invest\_free_{jt} + \beta_7 LNTA_{it} + \beta_7 Growth\_Asset_{it} + \beta_7 EQTA_{it} + \beta_7 Growth\_Interest_{it} + \beta_7 Deposit\_TA_{it} + \beta_7 LNDGP_{jt} + \beta_7 LNINF_{jt} + \varepsilon_{it} \dots\dots\dots (2)$$

I j, and t represent the bank, nation, and time, respectively. Economic freedom county's level is determined by dividing its net income by its total assets, and this yields the index of economic freedom. In addition, economies of scale necessitate that larger banks lower expenses, resulting in superior performance (Nizam et al., 2019). Second, throughout the current year, we limit the bank's balance sheet expansion compared to last year by using the growth rate of total assets, which is known as growth assets. This ratio represents the bank's growth and expansion strategy. Thirdly, growth interest, we anticipate that older banks will be more lucrative as a result of their extended service life, during which banks can create a positive reputation and customer base.

This research used a static panel design. Using fixed and random effects approaches is the best way to deal with static panel data structures. Using the Hausman specification test, the initial study contrasted the random effects model and the fixed effect model on a static panel of panel analysis. Using the Hausman test structure, we also evaluated whether a model with a fixed or random effect was more appropriate. If the p-value of the Hausman test is less than the level of significance (5%), the fixed effect is more acceptable.

## RESULT AND DISCUSSION

The summary statistics for all variables are provided in Table 3. The average ROA sample value for the dependent variable is 1.01 with a standard deviation of 1.29 and a maximum value of 4.11. In addition, the key independent

variable, economic freedom, has a mean value of 64.39, a standard deviation of 8.12, and a maximum of 77.70. This suggests substantial economic freedom. In addition, Table 4 displays the Pearson and Spearman correlation matrices used to examine the presence of multicollinearity in the correlation matrix of the dependent and explanatory variables in OIC nations. If the correlation matrix is smaller than 0.95, there is no serious multicollinearity issue. Consequently, all explanatory factors may be incorporated into the regression.

**Table (3):** Descriptive statistic.

|  | roa | overall_score | Depositta | growthasset | growthinterest | lnta | equityta | debt_ta | gdp_growth | inflation |
|---|---|---|---|---|---|---|---|---|---|---|
| Mean | 1.013 | 64.398 | 71.260 | 15.687 | -18.579 | 8.769 | 0.095 | 12.277 | 4.473 | 3.605 |
| Median | 1.035 | 64.900 | 76.340 | 11.640 | 11.481 | 8.653 | 0.088 | 7.616 | 4.730 | 3.198 |
| Maximum | 4.119 | 77.700 | 90.412 | 121.934 | 594.555 | 11.536 | 0.446 | 80.713 | 19.592 | 12.938 |
| Minimum | -11.144 | 51.100 | 8.852 | -34.393 | -10696.70 | 4.713 | 0.000 | 0.000 | -4.712 | -2.425 |
| Std. Dev. | 1.290 | 8.122 | 17.172 | 18.394 | 644.847 | 1.275 | 0.066 | 14.970 | 2.972 | 2.887 |
|  |  | 278 |  |  |  |  |  |  |  |  |
| Observations | 278 | 28 | 278 | 278 | 278 | 278 | 278 | 278 | 278 | 278 |
| Cross sections | 28 |  | 28 | 28 | 28 | 28 | 28 | 28 | 28 | 28 |

**Table (4):** Correlation Test.

| ROA | 1 |  |  |  |  |  |  |  |  |  |
|---|---|---|---|---|---|---|---|---|---|---|
| OVERALL_SCORE | 0.0057 | 1 |  |  |  |  |  |  |  |  |
| DEPOSITTA | 0.2132 | -0.3970 | 1 |  |  |  |  |  |  |  |
| GROWTHASSET | 0.1725 | -0.3706 | 0.1364 | 1 |  |  |  |  |  |  |
| GROWTHINTEREST | 0.0887 | -0.0703 | 0.0844 | 0.0653 | 1 |  |  |  |  |  |
| LNTA | 0.3650 | 0.4309 | 0.0596 | -0.3948 | -0.0306 | 1 |  |  |  |  |
| EQUITYTA | 0.1790 | 0.4486 | -0.3646 | 0.1044 | 0.0347 | -0.0371 | 1 |  |  |  |
| TOTAL_DEBTTA | -0.2775 | 0.3173 | -0.9310 | -0.1591 | -0.0267 | -0.0947 | 0.2550 | 1 |  |  |
| GDP | 0.0907 | -0.2810 | 0.1393 | 0.2748 | 0.0457 | -0.2429 | 0.0921 | -0.1741 | 1 | 0.1901 |
| INF | -0.0734 | -0.7100 | 0.2897 | 0.3292 | 0.0482 | -0.5206 | -0.3608 | -0.2297 | 0.1901 | 1 |

## Panel Regression Analysis

Specifically, Table 5, Pool 1, presents a regression model that looks at the economic freedom variable on Islamic bank profitability (ROA). The coefficient of economic freedom pools 1 in table 3 and shows that overall economic freedom has a statistically significant adverse effect on the profitability of Islamic banks. These results contradict the research of (Chortareas et al., 2013;Sufian & Shah Habibullah, 2014;Sarpong-Kumankoma et al., 2017).

**Table (5):** Regression model.

| Variabel | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 | Model 6 |
|---|---|---|---|---|---|---|
| Constant | -3.249*** | -0.884 | -3.245 | -4.731*** | -2.404 | -1.111 |
| **Overall_Score** | **-0.033**** | **-0.043*****| **-.0037**** | **-0.033**** | **-0.034**** | **-0.039*****|
| LNTA | 0.602*** | 0.541*** | 0.658*** | 0.609*** | 0.598*** | 0.523*** |
| Equity_TA | 8.976*** | 9.353*** | 8.629*** | 9.905*** | 8.558*** | 7.785*** |
| Deposit_TA |  | -0.011 | -0.003 | 0.015** | -0.008 | -0.008 |
| Growth_Asset | 0.014*** |  | 0.008** | 0.015*** | 0.014*** | 0.015*** |
| Growth_Interest | 2.770 | 3.990 |  | 2.140 | 3.240 | 3.850 |
| Debt_TA | -0.017** | -0.032** | -0.018 |  | -0.025 | -0.026 |
| GDP_Growth | 0.008 | 0.014 | 0.018 | 0.010 |  | 0.003 |
| INF | 0.067** | 0.074** | 0.082** | 0.069** | 0.065** |  |
| Observations | 278 | 278 | 278 | 278 | 278 | 278 |
| R-squared | 0.271 | 0.235 | 0.224 | 0.265 | 0.272 | 0.263 |
| Adjusted R-squared | 0.250 | 0.213 | 0.201 | 0.243 | 0.251 | 0.241 |
| Durbin-Watson | 1.691 | 1.581 | 1.652 | 1.699 | 1.675 | 1.617 |
| F-statistic | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |

This finding is fascinating. In order to foster an atmosphere that encourages innovation, entrepreneurship, and long-term cycles of sustainable economic growth and development, economic freedom is essential. Furthermore, the GDP per capita and the standard of living are higher in economies with a high degree of independence. Additionally, Countries that have high economic freedom tend to have lower rates inflation and unemployment (Sufian & Habibullah, 2010). Economic freedom also enhances the profit margins of businesses (Liao, 2018). A high level of economic freedom is more beneficial to companies from emerging markets. If the business works, it will certainly benefit more from a greater economic freedom's degree. Nonetheless, this study demonstrates that a greater degree of economic liberty can lower the profitability of Islamic banking. This suggests that greater economic freedom generates severe competition in the economy, hence exposing Islamic banking activities to competition (Harkati et al., 2020). Stating that a larger degree of economic freedom tends to lower obstacles to entry for banks, hence diminishing the effectiveness of Malaysian banks (Sufian & Shah Habibullah, 2014).

This research confirms that financial independence has a substantial impact on the profitability of Islamic banking. A high level of freedom allows for greater flexibility in the introduction of new competitors into the banking industry, hence stimulating competition. Empirical themes establish restrictions on bank activities, ensuring effective financial intermediation between households, businesses, investors, and entrepreneurs (Sufian & Shah Habibullah, 2014). Furthermore, hardly surprising given that Islamic banking is still in its infancy. Islamic banks employ fewer instruments than normal banks due to their adherence to sharia law and the prohibition on interest (Harkati et

al., 2020). Based on the proportion of equity to total assets (EQTA), there is an anticipated correlation between bank capitalization and profitability due to the likelihood of well-capitalized banks engaging in cautious lending (Rakshit & Bardhan, 2022). Fifthly, we employ the Deposit TA ratio, where the ratio of the size of deposits (short-term liabilities) to total assets indicates the liquidity risk associated with withdrawing deposits. Typically, liquidity risk is employed as a performance measure for banks (Nizam et al., 2019). Lastly, macroeconomic conditions are typically crucial to the profitability and general soundness of a bank; we account for this influence by incorporating two variables (GDP and INF) that quantify the growth of GDP and the country-level inflation rate, respectively.

In addition, monetary liberty has a considerable favorable effect on Islamic banking's profitability. The more monetary independence a bank has, the more profitable it can be in Islamic banking. A stable and dependable monetary policy is vital for the business climate because it enables enterprises and society to make investments, savings, and other long-term goals (Sufian & Habibullah, 2010). Not only can high inflation rates seize money, but they also distort pricing, misallocate resources, and raise corporate expenses. Moreover, the value of a country's currency is significantly influenced by its monetary policy. Monetary policy that seeks price stability and prevents inflation enables businesses to base their future investment decisions on market prices. As monetary flexibility increases, MFIs can change loan interest rates and make more profits (Mohamad Anwar et al., 2020). Therefore, increased monetary independence can boost the earnings of MFIs and hence their financial efficiency.

However, in the framework of interest-free Islamic banking, a rise in monetary liberty will not result in inflation and excessive interest

rates. It will improve the profitability of Islamic banks since countries with a majority of Muslims will employ Islamic bank financing. This result is consistent with the behavioral assumption that customer religiosity plays a crucial role. In the Islamic banking sector, particularly in the dual banking system, the profit-driven mentality of the client is a crucial behavioral influence.

Studies have found positive or negligible relationships between the freedom of companies to invest. Firm freedom refers to the liberty to operate a business with minimal interference from the government. Enterprise activities are hindered by stringent rules. Individuals will face less regulation the higher the company's freedom score. As a result, lower output costs can increase productivity, profitability, and overall performance

efficiency. Similarly, investment freedom represents investment freedom's potential. In an environment that encourages transparency and equality, treated equally regardless of their size or type of companies. This fosters competition and innovation. When there is freedom of investment, capital flow, allocation, and utilization become more effective, leading to larger returns. Increased cost efficiency and simpler market access result from increased investment freedom, which raises bank profitability.

Table 6 shows the robust test, suggest that controlling for bank-specific and macroeconomic variables in models 1 through 6 confirms that economic freedom has a substantial negative impact on the profitability of Islamic banks in OIC nations.

**Table (6):** Robust test.

| Variabel | Model 1 | Model 2 | Model 3 | Model 4 | Model 5 |
|---|---|---|---|---|---|
| Constant | -2.560 | 03.126* | -4.893*** | -9.592** | -8.255** |
| Deposit_TA | 0.007 | -0.004 | -0.003 | 0.045 | 0.036 |
| Growth_Asset | 0.014*** | 0.013*** | 0.016*** | 0.015*** | 0.015*** |
| Growth_Interest | 3.185 | 3.335 | 3.800 | -6.830 | -1.180 |
| LNTA | 0.603*** | 0.543*** | 0.514*** | 0.288 | 0.407* |
| Equity_TA | 8.495*** | 8.067*** | 6.807*** | 15.584*** | 14.622*** |
| Debt_TA | -0.024 | -0.020 | -0.022 | 0.030 | 0.021 |
| Overal_Score | -0.033** | | | | |
| Finan_Free | | -0.022*** | | | |
| Buss_Free | | | 0.009 | | |
| Monet_Free | | | | 0.033* | |
| Invest_free | | | | | 0.017 |
| GDP_Growth | 0.008 | -0.003 | 0.015 | 0.011 | 0.009 |
| INF | 0.066** | 0.046 | 0.074** | 0.060* | 0.067* |
| Observations | 280 | 280 | 280 | 280 | 280 |
| R-squared | 0.273 | 0.294 | 0.262 | 0.574 | 0.571 |
| Adjusted R-squared | 0.249 | 0.271 | 0.237 | 0.510 | 0.508 |
| Durbin-Watson | 1.681 | 1.643 | 1.714 | 1.832 | 1.838 |
| F-statistic | 0.000 | 0.000 | 0.000 | 0.000 | 0.000 |
| LM Test | 0.000 | 0.000 | 0.000 | - | - |
| Husman Test | 0.075 | 0.138 | 0.0503 | 0.027 | 0.034 |
| Estimation technique | REM | REM | REM | FEM | FEM |

## CONCLUSION

This study determined how free the economy and money flow are from governmental interference. To examine the relationship between economic freedom and

bank profitability, we used the Panel data regression method from 2010 to 2019. Furthermore, a robustness test that accounts for particular and macroeconomic factors that are frequently employed in research. The results demonstrate a strong detrimental impact of

general economic and financial freedom on the profitability of Islamic banks in OIC nations.

Moreover, the result shows that when economic and financial freedom is high, other banks will enter, resulting in stiff competition in the banking industry. Other findings also show that monetary freedom significantly affects the profitability of Islamic banking in the OIC countries. This shows that when monetary freedom is high, it will lead to high loan interest rates by conventional banks. For the recommendation, Islamic banking in Muslim-majority countries will take advantage of this condition to offer their products to increase bank profitability. In the other hand, this result suggests that policymakers have crucial good governance in creating great macroeconomics and bank regulatory approaches. This paper's limitation is cannot explain good governance's impact as a control variable in economic freedom and a bank's profitability. Further research could add more macroeconomics and quality institutional variables.

Examine how financial sector liberalization and reform affect the government. Financial intermediaries often engage in competitive activities that result in increased operations and profitability when they operate in constrained environments. Government control over economic freedom is predicted. Consequently, when economic freedom is regulated, Islamic banks will be able to compete with regular banks, given the recent emergence of Islamic banking. In conclusion, this study is a recent effort to examine the profitability of Islamic banks in OIC nations and economic freedom. Further research could compare the economic freedom required for the stability and effectiveness of Islamic banking against traditional financial institutions.

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