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## Promoting Shared Prosperity In Developing Countries: The Relevance Of Governance From Islamic Perspective

Nor Hazila binti Ismail<sup>1</sup>, Maizura Mohd Isa<sup>2</sup> and Associate Professor Dr Mohamed Eskandar Shah Mohd Rasid<sup>3</sup>

<sup>1</sup>Senior Lecturer, Finance Department, Faculty of Business and Management, Universiti Teknologi Mara (UiTM) Johor, Segamat, Johor, Malaysia  
[norha884@johor.uitm.edu.my](mailto:norha884@johor.uitm.edu.my)

<sup>2</sup>Senior Lecturer, Finance Department, Faculty of Business and Management, Universiti Teknologi Mara (UiTM) Johor, Segamat, Johor, Malaysia  
[maizura2610@gmail.com](mailto:maizura2610@gmail.com)

<sup>3</sup>Associate Professor, International Center for Education in Islamic Finance (INCEIF), Kuala Lumpur, Malaysia  
[eskandar@inцейf.org](mailto:eskandar@inцейf.org)

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### Abstract

The extreme inequality in the distribution of wealth, income and opportunity undermines and distorts the sharing of prosperity, democracy, economic health and vitality, ecological balance, physical health and culture of the nations. In April 2013, the issue of greater inequalities and social exclusion reckoned to be the result of economic growth led the World Bank to set the new goals, to end extreme poverty and promote shared prosperity. Interestingly, the approach of the contemporary solution is largely in consonance with the *maqasid* or objectives of the *Shari'ah*. Islam is a universal religion and addresses the entire mankind not the believers alone. It is, therefore, no surprise that people irrespective of faith do often think along Islamic lines. This study analyzed the impact of the governance from Islamic perspective on poverty, by adopting a cross-country approach. Specifically, the study examined the impact of Islamic governance structures on the poorest quintiles of the population by evaluating the relationship between the factors and the changes in the per capita income of the poor of the developing countries. This study applied panel regression to examine the significance of the pillars of the governance from the Islamic perspective towards the shared prosperity of the developing countries. It is hoped that this study will help determine if the Islamic pillars of the Islamic Governance can serve as an effective mechanism for poverty eradication in the respective countries.

**Keywords:** Poverty, Shared Prosperity, Developing countries

## 1. Introduction

In April 2013, the issues of greater inequalities and social exclusion led the World Bank to set the two new goals which are first to end extreme poverty and second is to promote shared prosperity. As defined by World Bank, promoting the shared prosperity means working towards the increments of the income and welfare of the poorer segments of society wherever they are, be it the poorest of nations or thriving, middle income countries. The shared prosperity goal has become pertinent: as developing countries grow their economies and lift millions out of poverty, they tend to experience growing inequality. Therefore, in order to demote inequality and fostering the shared prosperity, continuous efforts by the government are specifically required, from the perspective of economy and social. Both the Al Quran and sunnah indicated that the principles in the areas of constitutional affairs cannot be omitted from any government system. The application of these constitutional principles and guidelines in the Islamic political system are considered as the highest value that will bring a major impact in promoting an inclusive economy and prosperous society.

### 1.1 Poverty and Shared Prosperity

It is reported in the World Bank Report that poverty has declined rapidly over the past three decades. Dollar and Kraay (2014) revealed that the reduction in poverty has been due to contribution by a fast growth initiated by developing countries especially in China and India as well an evidence of the association between a rapid growth and a sharp decline in absolute poverty in all regions of the world. However, the humanity is still in exigent and defy atmosphere. It was stated that 1 billion of the world community is still in the state of poverty even in the availability of resources and technology today (Worldbank, 2013). Furthermore, the issue of inequality and social exclusion complement the escalating of prosperity in many countries. Hence, the World Bank Group has established two goals to guide its strategy in tackling these issues. The first goal is to end extreme poverty, as defined by the global extreme poverty measure of \$1.25 a day, adjusted for Purchasing Power Parity (PPP). More specifically, the World Bank Group seeks to orient its programs so that the global extreme poverty rate declines to below 3 percent by 2030. The second goal is to promote “shared prosperity” by helping every country to foster income growth of the bottom 40 percent of the population (World Bank, 2013).

Shared prosperity is defined “in terms of the growth rate of incomes in the bottom 40 percent of households”, and the World Bank has made a public commitment to support policies that foster shared prosperity in the developing world. Concerns about shared prosperity are also widespread in advanced economies, where many fear that growth no longer benefits the bottom half in terms of income distribution (World Bank, 2013). The shared prosperity goal focuses on the promotion of a combination of growth and greater equality to complement the poverty mitigation target. It is crucial to consider that the process in achieving these two goals are sustained over time and across generations - which requires promoting social justice, equality and maintain distribution of wealth. The situation brought this study that aims to investigate how the elements of the governance from the Islamic perspective can supplement the shared prosperity in mitigating poverty.

## 1.2 Shared Prosperity and Governance from Islamic Perspective in Mitigating Poverty

There is a general consensus that economic growth is necessary but not sufficient for poverty reduction. Conventionally, economists have quantified growth as an increasing *per capita* income or gross domestic product. But if the distribution of income is skewed and the poor part of the population is getting poorer even while the average income increases, people would hesitate to call this as development (Dollar and Kraay, 2014). Hence, GDP is an incongruous and even misrepresentative measure for sustaining well-being continuously. A numerous level of current income does not promise the same in the future. Undeniably, it may actually diminish the tomorrow well-being if it consumed the capital basis of the current society. Consequently, GDP *per capita* is not comprehensible with any approach to sustainable development.

Evidently, income inequality is excessive and escalating in many developing countries (Rauniyar and Kanbur 2010; Milanovic and Lakner 2013; Chen and Ravallion 2013; Ravallion 2012). The status quo makes unfeasible for the developing countries to achieve less than 3 percent poverty target by 2030 (World Bank, 2014). Economic growth would be helpful in reducing poverty as well as promoting prosperity if the growth becomes more sustainable and inclusive in all countries especially developing economies.

As noted by Ahmad et al (2013), Islam is a universal religious and provides the path to lead life. Therefore, Islam brings prosperity not only in the worldly life but also in the hereafter. They mentioned that some studies conclude that religions have relationship with economic growth and human development. If the glorious principles of Islamic teachings are implemented, then there will be peace and prosperity all over the world. Islam explains the role of state, social and economic justice, concept of brotherhood, principles of earning and spending and all other related rules and regulations for the smooth running of social and economic systems. These principles ultimately establish economic growth all over the world.

Sayed (2004) concluded that a good Islamic governance commands societies and individuals alike to promote social justice, equality and maintain distribution of wealth. He continued that Shariah laws are dynamic in that they are everlasting and not bound by individualistic interest. In addition, the vital role of a good governance from Islamic perspective also allows people to earn their living in a fair and profitable way without exploitation of others, therefore the whole society may benefit. As mentioned by Esfandiar et. al.,(2017), Islam emphasises the practice of justice and equality, truthfulness and transparency, as well as protection of minorities, accountability and adequate disclosure, just as it prohibits all forms of exploitation, inn all walks of life including business dealing.

Ali (2015) explained that Islamic view of good governance is a qualitative approach and not mechanical. According to him, the major features of good governance can be precised under seven fundamentals components which are includes the rules of law, khilafah, accountability, transparency, justice, equity and Al-amr bil maruf wa nahi an al-munkar.

### 1.3 Governance and Sustainable Development from Islamic Perspective.

Interestingly, the extensively discussed literatures prove that the approach of the Sustainable Development from Islamic Perspective is largely in consonance with the principles of governance in Islam. Islam is “a universal religion and addresses the entire mankind not the believers alone”. The main objectives of the Islamic law put broadly are “to promote the well-being of *all* mankind which lies in safeguarding their faith (*din*), their human self (*nafs*), their intellect (*aql*), their posterity (*nasl*) and their wealth (*maal*)” (Hasan, 2006).

It is appropriate to focus upon the oft-neglected Islamic perspectives and its wisdom on sustainable development, and allied fields of social justice, man’s spirituality and his role as *khalifat Allah fi al-Ard* with responsibility to restore the eco-balance and ensure the well-being of the living earth and its creatures. Human welfare objectives from Islam’s perspective should also be pursued in line with its Unitarian vision of *tawhid* and for the realization of human dignity (*karamah*). Al Jayyousi (2014) affirmed the four approaches of the sustainable development based on the carrying capacity approach (*mizan*), ratio approach (*lhsan*), Socio approach (*Arham*) and Eco approach (*Tasbeeh*). He stressed that the sustainable development should be seen as a progression rather than as a project or product since the real world is dealing with complex problems that need multiple solutions and perspectives.

The application of the teachings of Al-Quran and Sunnah safeguards sustainable development, not only for the Muslims but also for the world on a just basis. Islam reaches out through the Quran and Sunnah on how to achieve sustainable Development. Several texts or verses of the Quran and the Sunnah of the Prophet SAW provide the general guidelines and principles pertaining to economic development.

Surah al-Qasas (28), verse 77: “*But seek, with the (wealth) which Allah has bestowed on thee, the Home of the Hereafter, nor forget thy portion in this world: but do thou good, as Allah has been good to thee, and seek not (occasions for) mischief in the land: for Allah loves not those who do mischief*”, provides evidence that Allah prohibits actions of damaging the earth. It is clear in this verse that Allah encourages us to enjoy His earthly provisions but warns against actions that would ruin this world because Allah hates those who damage the earth.

The perspective of Islam on sustainability may be further grasped through an examination of the “teachings” and “lifestyles” of *Prophet Muhammad (PbUH)* and how his teachings be the principal to the development of Islamic civilization. “He taught the Muslims to take education seriously, engage in social development by developing the characters of piety, humility and leadership”. “His teachings condemn isolation, alienation, greed and discrimination while replacing them with the positive concepts of social interaction, integration and inclusiveness, volunteerism and equality”. Prophet Muhammad SAW reported to have said: “*if the Hour (Judgment Day) is about to be established and one of you is holding a palm shoot, let him take the advantage of even one second before the Hour is established to plant it*”.

Sustainable development as defined from an Islamic perspective, “as a multi-dimensional process that seeks to strike a balance between economic and social

development on one side, and the environment on the other”. It urges mankind to use resources in the best possible way, accounting for the environment upon which those resources rely (Nouh, 2011). This concept of sustainable development is deemed to refer “to the balanced and simultaneous realization of consumer welfare, economic efficiency, social justice, and ecological balance in the framework of an evolutionary knowledge-based, socially interactive model”.

There are some elements that are considered by Shari’ah as a unique perspective of Islam in matters of value society and these elements are necessary for social cohesion. These elements are the main indicators of sustainable development for the betterment of individuals and society. These elements are: *Faradh* (Responsibility), *Shura* (Empowerment) and *Al’adl wal ihsan* (Equilibrium). The elaboration of these elements is discussed further in the Research Methodology section under the Theoretical Framework segment.

Concisely, the relationship between these governance and the sustainable development from the Islamic perspective, to the extent that they are important, comes mostly through their effects in promoting an inclusive economy and prosperous society. This is extensively discussed in the poverty and governance nexus literature. However, there is a dearth of empirical studies in developing countries on the impact of these macroeconomic policies and institutions, incorporating the elements of economic growth and human development from an Islamic perspective that might be particularly conducive to promoting shared prosperity for mitigating poverty. Therefore, this study represents an attempt to provide the analysis empirically.

## **2. The objective of the study**

This study attempts to analyze the impact of the pillars of governance from Islamic perspective on shared prosperity, adopting a cross-country approach. Specifically, this study will examine the relationship between the governance pillars from Islamic perspective and the shared prosperity of the developing countries. It is hoped that this study will help to determine the Islamic pillars of governance that can be served as an effective mechanism for prosperity sharing in the respective countries.

## **3. Research Methodology**

### **3.1 Data Collection and Sample**

The used sample roughly consists of 15 developing countries namely Bulgaria, Costa Rica, Dominican Republic, Ecuador, El Salvador, Moldova, Montenegro, Panama, Paraguay, Peru, Romania, Serbia, Thailand, Turkey and Ukraine. The period of study is from 2005 to 2014.

### **3.2 The Empirical Model**

To achieve the objective of the study, there are two stages of procedure that need to be applied which first is the estimation procedure and second is the index development.



Firstly, this study uses panel regression static model to examine the significance of the governance pillars from the Islamic perspective towards the shared prosperity of the developing countries. We made estimations by Least Square method. This allows checking the problem of heterogeneity of countries. Then, we proceed with the Hausman test which allows of choosing the specific fixed or random effects model. This general formulation of the model used in this study can be specified as follows:

$$SP_{it} = \alpha + \beta(IP_{it}) + \mu t ;$$

Where,  $SP_{it}$  = **Shared Prosperity**<sub>it</sub> is proxied by Shared Prosperity Indicator developed by Rosenblatt and McGavock (2013) as the **dependent variables**. The shared prosperity indicator has its intellectual origins in the concept of quintile income. Defined as the per capita income of the poorest quintile (bottom 20 percent) of the population, quintile income was proposed as a simple welfare measure that is both easy to calculate and easy to understand. It draws on Rawlsian notions of promoting the welfare of the least fortunate members of society, and also has the pragmatic feature of comparability with traditional macroeconomic welfare measures such as per capita income.

Therefore;

$$SP(x) = \left( \frac{s(x)}{0.4} \right) * y(x)$$

(Equation 1)

Where;

$SP(x)$  = shared prosperity index  
 $s(x)$  = share of total income accruing to the bottom 40% of the population  
 $y(x)$  = the per capita income of the total population of a country with income profile  $x$

This expression shows that the shared prosperity indicator is similar to the Sen index of real income which is the product of inequality measure (the income share of the poorest 40 percent) and the per capita income of the total population. In discrete time, the percentage change in the shared prosperity indicator is simply the sum of two growth rates: the growth rate of the share of income accruing to the poorest 40 percent and the growth rate of the per capita income of the total population.

**The independent variable ( $IP_t$ )** is the dimension of Islamic Pillars of Governance quoted by Aburouni and Sexton (2004) and Ahmad et al (2013). These elements are:

1. *Faradh* (Responsibility)
2. *Shura* (Empowerment)
3. *Al'adl wal ihsan* (Equilibrium)

**Faradh (Responsibility)**

“Individual and society have the responsibility to make use of welfare in a responsible way”. “Humans are responsible as God’s vicegerents (*Kalifah*) for the care of the earth”. God says in the *Qur’an*: “*It is God who has created for you all that is on earth....And remember when your Lord said to the angels: ‘Verily, I am going to place a viceroy (mankind) on earth.’ They said: ‘Will You place therein those who will make mischief therein and shed blood, -while we glorify You with praise and sanctify You?’ God said: ‘‘Verily, I know better what you do not know’’* (Al-Baqara (2), 29- 30:5-6).

**Shura (Empowerment):**

“Human beings should fully participate in decision making and implementation in their life. In Islamic perspective the empowerment means the consultative (*Shura*) decision making of all levels of the Islamic society”. It pertains collectively to the decision making on social matters. Such a role of *Shura* is close to its meaning in the *Qur’an*: “*And who (conduct) their affairs by mutual consultation*” (Ash-Shura (42), Verse.38:487).

**Al’adl wal ihsan (Equilibrium):**

“Individuals have the freedom to act, but must do so with manner from welfare of the present and future generation”, God says: “*if you loan God beautiful loan, He will double it in your credit, and He will grant your forgiveness*”. This is in reference to interest-free loans which God calls “beautiful loans” (Qard Hasan).

The indicators used in this study are generally retained in the Democracy Barometer Database (2016). We proposed the indicators as below:

**Table 1: Proposed Dimensions and Indicators**

<b>Dimension</b>	<b>Indicator</b>
<i>Faradh</i> (Responsibility)	Government Effectiveness
	Regulatory Quality
	Control Of Corruption
	Political Stability & Absence Of Violence
	Transparency
	Military Expenditure.
<i>Shura</i> (Empowerment)	Voice & Accountability
	Competitiveness Of Election
	Openness Of Election
	Mutual constitution of power
	Equality Of Participation.
	Effective Participation.
	Representation
<i>Al’adl Wal Ihsan</i> (Equilibrium)	Rule Of Law
	Right To Physical Integrity
	Right To Free Conduct Of Life
	Freedom To Associate
	Freedom Of Opinion

Second, to facilitate the construction of the index, this study applied the construction of Financial Inclusion Index by Mandira (2015) in order to develop our Islamic Prosperity Index (IPI). The IPI will explain the implication of Islamic pillars of governance towards the shared prosperity of the country based on the ranking of the index. The Index expectantly reveals which countries function more sustainably, promoting the shared prosperity based on the Islamic Pillars of governance.

To define the index, firstly is to construct an individual index based on the dimension (faradh ( $F_i$ ), shura ( $S_i$ ) and Al'adl wal Ihsan.

As in the case of these indexes, our proposed IPI is computed by first computing a dimension index for each dimension of prosperity. The dimension index  $d_i$ , (equation 2) measures the country's achievement in the  $i^{\text{th}}$  dimension of prosperity.

We start with applying the max-min procedures constructing the individual index as formally below:

$$d_i = \frac{A_i - m_i}{M_i - m_i}$$

(Equation 2)

where,

- $A_i$  is the observed indicator value(after imposition of bounds), and
- $d_i$  is the new, rescaled, index-number representation with a value ranging from 0 to 100.

Subsequently, if all of the variables are available for country  $i$ , an equal weight will be given to each variable. The higher the value of  $d_i$ , higher is the country's achievement in dimension  $i$ . If  $n$  dimensions of Islamic Prosperity are considered, then, a country's achievements in these dimensions will be represented by a point  $X = (d_1, d_2, d_3, \dots, d_n)$  on the  $n$ -dimensional space. In the  $n$ -dimensional space, the point  $O = (0, 0, 0, \dots, 0)$  represents the point indicating the worst situation (zero achievement) while the point  $W = (w_1, w_2, \dots, w_n)$  represents an ideal situation indicating the highest achievement in all dimensions. The location of the achievement point  $X$  vis-à-vis the worst point  $O$  and the ideal point  $W$  will together determine a country's level of IPI. An inclusive economy system will have an achievement point close to  $W$  and away from  $O$ . In our proposed IPI, we use a simple average of the normalized Euclidian distance between  $X$  and  $O$  and the normalized inverse Euclidian distance between  $X$  and  $W$ . By construction, this Islamic Pillars of Prosperity lies between 0 and 1. Eventually, the Islamic Pillars of Prosperity Index for country  $i$  is defined as:

$$IPI = \frac{F_i + S_i + AAW_i}{3}$$

(Equation 3)

## 4. Data Analysis and Results

### 4.1 Estimation results

This section describes the indicators of each dimensions of Islamic Prosperity Index which provides the static panel regression results of the *faradh*, *shura* and *al adl'wal ihsan* dimension for developing countries. The techniques of estimations used to study the link between the shared prosperity and the indicators of the dimensions (*Faradh*, *Al Adl'Wal Ihsan* and *Shura*) are Fixed effect and Random Effect model. We did the estimation test for all indicators mentioned beforehand. As shown in Table 2, 3 and 4, the majority of the regression test appreciates the relevance of random effects ( $p > 5\%$ ) for developing countries intended for *faradh*, *al adl'wal ihsan* and *shura* respectively. It shows that in developing countries, the level of *faradh* (responsibility) is more translated by the how effective the government, the regulation quality of the countries and level of corruption being controlled in the countries. The more the people able to participate in selecting their government indicated how the government are accountable and leads to less corruption. The most relevant indicators that explain the level of *shura* (empowerment) promoted in developing countries are voice and accountability and equality of participation where both indicators positively influence the inclusiveness of the economy. Whereas in maintaining *al adl'wal ihsan* (equilibrium) the right to free of conduct and freedom to associate are significantly positive fostering the prosperity sharing to the poor in the developing countries. Yet, the countries rule of law negatively related to shared prosperity in mitigating the poverty.

Hence, based on the estimation results, we believed that it is sufficiently to explain the significant effect of *faradh* (responsibility), *Shura* (empowerment) and *al adl' wal ihsan* (equilibrium) to promote shared prosperity in the developing countries. Therefore we proceed with the construction of the index.

	(OLS)	(Random Effect)	(Fixed Effect)
Government Effectiveness	-1.543* (-2.07)	0.414*** (6.32)	0.419*** (6.41)
Regulation Quality	3.043*** (5.03)	0.399*** (5.15)	0.398*** (5.17)
Control of Corruption	-3.094*** (-5.19)	-0.153** (-2.84)	-0.149** (-2.79)
Transparency	-0.848* (-2.61)	0.0598 (1.54)	0.0607 (1.57)
Military Expenditure	0.639 (1.82)	0.0596 (0.80)	0.0604 (0.81)
_cons	15.49*** (7.84)	4.992*** (6.84)	4.910*** (13.78)
<i>No of observation</i>	118	118	118
<i>No. of group</i>	15	15	15
<i>R<sup>2</sup></i>	0.4037	0.4629	0.4553
<i>Post Estimation Test</i>			
<i>F Test (Wald Test)</i>		0.0000	0.0000
<i>LM Test</i>	0.0000		
<i>Hausman Test</i>		0.3051	

*t* statistics in parentheses  
 \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

**Table 2: Faradh Dimension: Developing Countries**

	(OLS)	(Random Effect)	(Fixed Effect)
Voice & Accountability	1.282 (1.36)	0.619*** (3.73)	0.617*** (3.68)
Equality of Participation	0.720 (0.57)	0.395** (3.00)	0.394** (2.97)
_cons	-0.127 (-0.02)	3.929*** (3.73)	3.817*** (4.79)
<i>No of observation</i>	135	135	135
<i>No. of group</i>	15	15	15
<i>R<sup>2</sup></i>	0.0173	0.0172	0.0172

<i>Post Estimation Test</i>			
<i>F Test (Wald Test)</i>		0.0000	0.0000
<i>LM Test</i>	0.0000		
<i>Hausman Test</i>		0.9100	

*t* statistics in parentheses  
 \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$

**Table 3: Al Adl Wal Ihsan Dimension: Developing Countries**

	(OLS)	(Random Effect)	(Fixed Effect)
Rule of law	7.150*** (5.18)	-0.926**** (-1.85)	-1.023* (-2.05)
Right to free conduct of life	2.035** (2.78)	0.114**** (1.66)	0.113 (1.65)
Freedom to associate	-2.169** (-2.73)	0.195* (2.19)	0.201* (2.27)
_cons	-22.31** (-2.71)	10.69*** (4.93)	10.94*** (5.33)
<i>No of observation</i>	124	124	124
<i>No. of group</i>	15	15	15
<i>R<sup>2</sup></i>	0.2662	0.1606	0.1628
<i>Post Estimation Test</i>			
<i>F Test (Wald Test)</i>		0.0207	0.0162
<i>LM Test</i>	0.0000		
<i>Hausman Test</i>		0.1705	

*t* statistics in parentheses  
 \*  $p < 0.05$ , \*\*  $p < 0.01$ , \*\*\*  $p < 0.001$ , \*\*\*\*  $p < 0.1000$

**Table 4: Shura Dimension: Developing Countries**

## 4.2 Islamic Prosperity Index Development

Once the significant indicators are anticipated, we replicate Mandira (2015) financial inclusion index development method, in constructing the Islamic Prosperity Index (IPI) where consist of three main dimension index known as faradh index, shura index and al adl' wal ihsan index.

Figure 1 presents the IPI values computed for various developing countries for the year 2005 until 2014. In contrast with Mandira (2015) , the numbers of countries for which the IPI values are computed are similar in both analysis (time series and cross countries), as the data is available on the component dimensions that we are consider here in computing the IPI.

As evidenced from Figure 1, the increasing pattern of the IPI for developing countries indicate that the effort shared prosperity is promoted. The sign is correct for developing countries as reported by World Bank (2013) that the prosperity sharing in developing countries is in increasing pattern. This evidences the countries' effort in promoting an inclusive economy in order to improve the standard of living of poor.

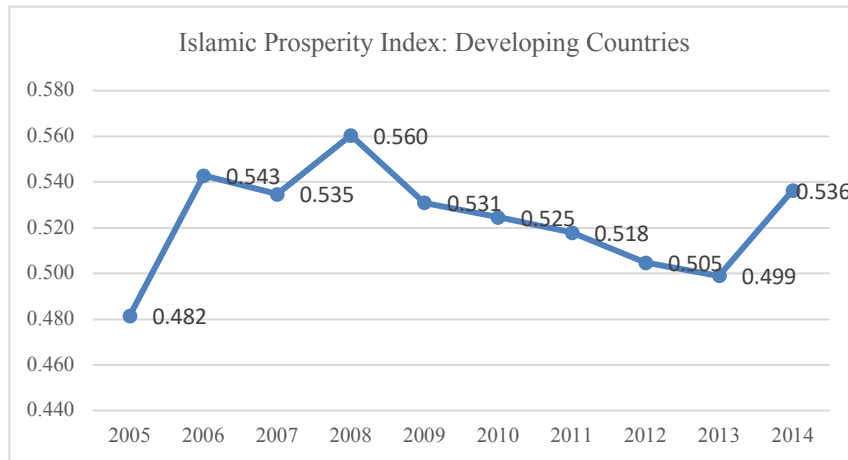


Figure 1: Islamic Prosperity Index (IPI) for Developing Countries

Figure 2 shows the IPI ranking for the developing countries for average of 10 years (2005 to 2014). Among the 15 countries, level of shared prosperity as measured by the IPI, varied from 0.344 for Ukraine to 0.604 for Montenegro. Among all of the countries, Turkey is only muslim country included in the analysis and ranked at the top five among the sample of countries at 0.572.

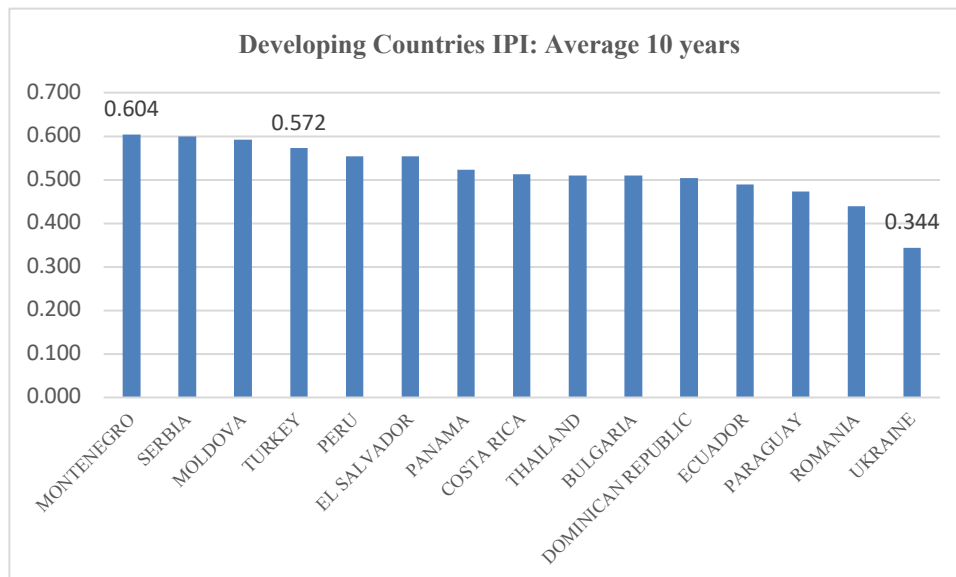


Figure 2 : Islamic Prosperity Index for Developing Countries: Average 10 years

In this brief discussion of the results, we conclude that the ranking obviously conveys a moderate level of prosperity sharing among developing countries as no countries achieve more than 70 percent of the ranking. Nevertheless the IPI adequately shows that, by practising a good governance based on the Islamic perspective, the countries is in efforts in cultivating an inclusive economy for the betterment of whole society.

## 5. Conclusion

The findings of this study should provide evidence in explaining the most significant governance pillar indicators from the Islamic perspective that provides a significant impact towards increasing the prosperity sharing of a country. It is therefore enable the developing countries to also focus on human development that will continue helps in poverty eradication and on raising the material standard of living.

This paper is designed by the researchers to conduct research in the concept and approach from Islamic perspectives of governance in mitigating poverty and promoting shared prosperity. Although this is principally aimed at academicians, it is very much relevant for policymakers, as policy targets for inclusive economy are increasingly being formulated at national and international levels. Policy makers and economists must understand this holistic approach to enable them to formulate economic policy and programs that comply with the requirements of Islam. Analysis is only useful once its inferences are adopted by the governments and placed at the heart of credible growth strategies. It is believed that there is a great deal of room for improvement by the governments in strengthening the effort to promote an inclusive economic growth.

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