PROSPECTS FOR THE APPLICATION OF THE ISLAMIC BANKING SYSTEM IN THE REPUBLIC OF NORTH MACEDONIA: OPPORTUNITIES AND CHALLENGES

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Abstract

This paper addresses the prospects for the application of the Islamic banking system in the Republic of North Macedonia (RNM), focusing on its potential to contribute to the diversification of the financial system, as well as the opportunities and challenges associated with the development of this banking model. Islamic banking is based on principles such as the prohibition of interest (riba), risk and profit sharing, linking financing to real economic activity, and compliance with Sharia principles. The aim of the study is to assess citizens' level of knowledge, attitudes, and willingness to use Islamic banking products and services, as well as to identify the main factors that may influence its application in the RNM. The research is based on theoretical and empirical approaches. Primary data were collected through a structured questionnaire consisting of 18 questions, administered to 150 respondents, while the data were analyzed using descriptive statistics and comparative interpretation. The results show a considerable level of interest in and willingness to use Islamic banking services, while a lack of knowledge, institutional support, and a clear regulatory framework emerge as the main challenges. The findings suggest that the establishment of appropriate legal, institutional, and professional conditions could create opportunities for the development of Islamic banking in the RNM and for expanding the financial alternatives available in the country.

Keywords: Islamic banking, financial system, Islamic finance, RNM, Islamic banks, application of Islamic banking.

1. Introduction

Interest in alternative and ethical financial models has increased attention to Islamic banking, which is based on the prohibition of interest (riba), risk and profit sharing, linking financing to real economic activity, and avoiding excessive uncertainty and speculation. The main instruments include murabaha, mudaraba, musharaka, and ijara. In addition to its economic objectives, this model emphasizes justice, transparency, social responsibility, and the compliance of investments with Sharia principles.

In the Republic of North Macedonia (RNM), the banking system operates mainly according to the conventional model of interest-based financing. Therefore, the main issue addressed by this study is whether legal, institutional, and economic opportunities exist for the development of Islamic banking, what conditions would be required, and what obstacles could make its implementation more difficult. The importance of the topic is related to the possibility of diversifying the range of financial services, expanding alternatives for clients seeking ethical services or services consistent with their religious beliefs, and potentially encouraging investment in the real economy (Rexhepi & Ramadani, 2017).

The main objective is to assess the opportunities and limitations of applying Islamic banking in the RNM and the role it could play in the financial system. In particular, the study examines the main Islamic principles and products, the level of knowledge and attitudes among potential clients, the compatibility of the legal and regulatory framework, and the perceived obstacles to the operation of this model.

The research is guided by four questions: What is the current and potential role of Islamic banks in the financial system of the RNM? Is there legal and institutional scope for their operation? How familiar are citizens with the concepts of Islamic banking? Is there demand for its

products, and what conditions could influence their use? In line with these questions, three hypotheses are examined: H1, that Islamic banking can be implemented without insurmountable legal or institutional obstacles; H2, that respondents demonstrate a willingness and preference to use its services; and H3, that there is interest in various Islamic banking products and that they are perceived positively.
The conceptual framework combines three dimensions: the theoretical principles and instruments of Islamic banking; the legal and institutional framework of the RNM; and empirical data on respondents' knowledge, attitudes, and willingness. This combination aims to provide a more substantiated assessment of the opportunities for implementation and the challenges that need to be addressed.

2. Theoretical Part

2.1 The Concept and Principles of Islamic Banking

Islamic banking represents a financial model in which banking activities, investments, and transactions are organized in accordance with the principles of Sharia and the rules of fiqh al-muamalat (Islamic jurisprudence governing transactions). At the core of this system are the prohibition of interest (riba), the linkage of financing to real economic activity, risk-sharing, and the orientation of financial activities toward the principles of justice, transparency, and social responsibility (Rexhepi & Ramadani, 2017; Kabir & Lewis, 2007).
In the literature, Islamic finance is not presented merely as a technical alternative to interest-based lending. It is built upon a broader ethical and economic concept in which the relationship between capital and real activity must be clear and linked to an identifiable transaction or asset. This approach is associated with the profit and loss sharing (PLS) model, in which the financier and the entrepreneur participate in the outcomes of the activity according to the terms of the contract (Chapra, 1979; Rexhepi & Ramadani, 2017).
The main principles of the system include the prohibition of riba, the avoidance of gharar, the prohibition of maysir, the permissibility of halal activities only, and the implementation of social responsibility mechanisms, including zakat. Compliance with Sharia is monitored through Sharia supervisory mechanisms, while the Qur'an and the Sunnah are presented as the fundamental normative sources of the system (Kabir & Lewis, 2007; Rexhepi & Ramadani, 2017).

2.2 Islamic Banks and the Main Financing Instruments

An Islamic bank can be defined as a financial institution whose rules and procedures aim to ensure that it operates in accordance with the principles of Sharia and, in particular, avoids receiving or paying interest in its operations (Khir, Gupta, & Shanmugam, 2008). The modern development of Islamic banks gained momentum during the twentieth century and subsequently expanded to various countries in the Middle East, Asia, and Europe. In the literature used in this study, Bahrain, Malaysia, Kuwait, Qatar, Saudi Arabia, and the United Arab Emirates are mentioned as important centres of development (Rexhepi & Ramadani, 2017).
Unlike the model in which the bank acts primarily as a lender and the client as a debtor, in a significant part of Islamic financing, the relationship is conceived as cooperation between capital and entrepreneurship. A bank may finance the purchase of assets, goods, and services or participate in investment projects, linking the financial return to the structure of the contract and to real economic activity (Al-Jarhi, 2003).

The main instruments include murabaha, ijara, mudaraba, musharaka, and bayʿ al-salam. Murabaha is a sale at a declared cost plus profit, in which the bank purchases an asset and subsequently sells it to the client at a specified price. It is essential that the asset be real and that the structure of the transaction be clear to the parties (Rosly, 2001; Hasani, 2013). Ijara is based on leasing an asset for a specified period in exchange for a predetermined payment, and it may also be structured in such a way that it ultimately leads to the transfer of ownership to the client (Salih, 1992; Tuhmaz, 2016).

Mudaraba represents a partnership in which one party provides the capital, while the other manages the activity. Profit is shared according to a ratio determined in advance, whereas, under normal contractual conditions, the financial loss is borne by the invested capital. Musharaka, on the other hand, involves the participation of two or more parties who contribute capital and engage in an activity; profit is shared according to the agreement, while losses are borne in proportion to each party's share of the invested capital. These two instruments are particularly important for the risk-sharing dimension of Islamic finance (Khan, 1991; Hasani, 2013; Aliu, 2020).

In addition to business financing, Islamic principles can also be applied to deposit and savings products. Savings and investment accounts can be structured on the basis of mudaraba, while current accounts may operate according to the principle of an interest-free loan (qard hasan), while respecting investment restrictions and Sharia supervision (WSBI/ESBG, 2009; Rexhepi & Ramadani, 2017).

2.3 Differences Between Islamic Banks and Conventional Banks

The fundamental difference between the two models concerns how financial returns are generated. In conventional banking, the lending relationship is generally based on interest and the obligation to repay the principal together with the cost of financing. In Islamic banking, the return must be linked to a permissible transaction, a real asset, a lease, or a partnership agreement and cannot be based on interest (El Gawady, 2012; Rexhepi & Ramadani, 2017).

Another difference concerns the treatment of risk. The Islamic model places risk-sharing and the sharing of outcomes at the centre of certain contracts, whereas the conventional system generally distinguishes more clearly between the role of the lender and that of the borrower. For this reason, Islamic banks aim to link financing to the real economy and to activities that can be identified and assessed economically (Al-Jarhi, 2003).

The difference is also evident in the ethical dimension. In Islamic banking, not every economic activity is considered eligible for financing; investments must comply with Sharia restrictions and avoid prohibited activities. This gives the system an additional social and ethical dimension, alongside the economic objectives of sustainability and profitability (Seznec, 2009). In this respect, Islamic banks aim not only to provide financial intermediation but also to link capital to real economic activity, finance entrepreneurship, and support social objectives.

Table 1. Main Differences Between Islamic and Conventional Banking

Element	Islamic Banking	Conventional Banking
Basis of financial return	Profit from trade, leasing, or partnership	Interest on borrowed capital
Treatment of risk	Risk-sharing and, in certain models, profit/loss sharing	Risk is primarily allocated between the lender and borrower
Link to the real economy	Financing is linked to real assets or activities	Financing may be based directly on monetary loans

Financeable activities	Only activities consistent with Islamic principles	No Sharia-based restriction applies
Bank–client relationship	May take the form of a sale, lease, or partnership	Primarily a creditor–debtor relationship
Ethical/social dimension	Includes ethical and social considerations	The main focus is financial intermediation and profitability

2.4 The Role of Islamic Banks in the Financial System

The role of Islamic banks in the financial system can be analyzed through several interconnected functions: the intermediation of savings and investments, the financing of the real economy, the diversification of banking services, and the creation of alternatives for clients seeking products consistent with their ethical or religious principles. The literature notes that Islamic finance has expanded beyond Muslim clientele, as some products may attract investors because of their ethical character and their connection to real economic activities (IOSCO, 2004).

An important role is related to the financing of enterprises and projects. Partnership instruments, especially mudaraba and musharaka, create a structure in which capital and entrepreneurship are combined and outcomes are distributed according to the agreement. In theory, this may encourage the financing of productive projects and strengthen the link between the financial sector and the real economy (Khan, 1991; Aliu, 2020).

The social dimension is also part of the system's role. Through zakat and ethical investment restrictions, Islamic banking aims to incorporate social considerations into financial activity. However, in a scientific analysis, it is necessary to clearly distinguish between the model's normative objectives and empirical effects that can be measured in a particular economy. Therefore, in the case of the RNM, the potential impact on investment, financial inclusion, and economic development must be assessed alongside actual market conditions.

2.5 International Experience and Development Models

International experience shows that Islamic banking has developed through different institutional models. The literature used in this study mentions the early development of modern institutions in Egypt and their subsequent expansion to the United Arab Emirates, Bahrain, Malaysia, Qatar, Kuwait, Jordan, and other countries. This expansion shows that Islamic banking is not limited to a single institutional model but can be adapted to different financial and regulatory structures (Rexhepi & Ramadani, 2017).

An important factor in this development has been the establishment of specialized institutions and standards. In this context, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has played a role in standardizing Islamic finance practices. International experience also shows that conventional institutions can offer Islamic products or cooperate with Islamic finance, creating hybrid models and expanding the market (Rexhepi & Ramadani, 2017).

For the RNM, these experiences are important not to be copied mechanically, but to identify elements that can be adapted to the domestic structure: banking licensing and supervision, accounting standards, tax treatment, Sharia supervisory mechanisms, and the adaptation of products to market needs.

2.6 The Possibility of Applying Islamic Banking in the Republic of North Macedonia

The issue of applying Islamic banking in the RNM should be examined at two levels: legal-institutional and economic-commercial. According to the literature included in this paper, the analysis of the legal framework has indicated that there is no explicit prohibition that would exclude an Islamic bank from the market solely because of its financing model. A 2008 study by Shukarov, cited by Rexhepi and Ramadani (2017), concludes that there were no significant legal restrictions on the entry and operation of Islamic finance in Macedonia.

Along the same lines, the analysis of the provisions of the Law on Banks Article 2, Paragraphs 1, 3, and 23 as presented in the literature used, indicates that a bank must be established and operate with permission from the competent banking authority, while the definition of a deposit allows deposits with or without interest. These elements are relevant to this study's hypothesis concerning legal scope, but they do not automatically mean that every Islamic product can be implemented without regulatory adjustments. In particular, the treatment of asset sales and purchases, leasing, partnerships, taxes, and accounting requires separate analysis (Rexhepi & Ramadani, 2017).

From an economic perspective, the potential of Islamic banking is linked to the possibility of expanding sources of financing and attracting clients who seek interest-free products. Furthermore, such an offering could create scope for new investments and for diversifying the financial market. However, success does not depend solely on the existence of legal scope. It requires real demand, capital, expertise, client trust, clear supervisory standards, and competitive products.

Therefore, in the context of the RNM, the possibility of implementation should be understood as a multidimensional issue. In addition to legal analysis, the level of awareness of Islamic banking, clients' willingness to use its products, perceptions of their fairness and ethics, and practical obstacles identified by market participants must be taken into account. For this reason, the theoretical and legal analysis in this section is complemented by the empirical research presented in the later sections of the paper.

3. Research Methodology

The study uses a combined theoretical, institutional, legal, and empirical approach. Quantitative analysis forms the main part of the questionnaire processing, while the review of literature and documents includes qualitative elements. Thus, respondents' perceptions are analyzed alongside academic literature and the legal and regulatory provisions related to the banking system in the RNM.

The research focuses on four variables: the level of knowledge about Islamic banking; attitudes and perceptions toward its products; willingness to use its services; and perceptions of legal, institutional, and economic obstacles. These indicators are used to assess the hypotheses concerning the possibility of implementation, clients' willingness, and interest in Islamic products.

The sample includes 150 respondents from various fields, mainly the financial and banking sector, as well as economics, business, administration, and academia. The selection was non-probabilistic, based on respondents' accessibility and availability. For this reason, the sample cannot be considered fully representative of the population of the RNM, and the results should be generalized with caution.

Primary data were collected through a structured questionnaire consisting of 18 questions, mainly closed-ended, distributed electronically through Google Forms and professional networks. The questionnaire aimed to measure knowledge of Islamic banking, attitudes toward its products, willingness to use them, and perceptions of the possibility of developing this

model in the country. Secondary data were obtained from academic literature, scientific articles, reports by financial institutions, central bank data, and legal and regulatory documents. The process involved designing the questionnaire, distributing it and collecting responses electronically, and then organizing and processing the responses. Participation was voluntary; respondents were informed of the study's purpose, and their responses were treated anonymously and confidentially, for academic purposes only. The data were analyzed using descriptive statistics, frequencies, and percentages, as well as comparison and interpretation of responses. The results were presented in tables, figures, and charts and interpreted in relation to the research questions and hypotheses.

4. Data Analysis and Results

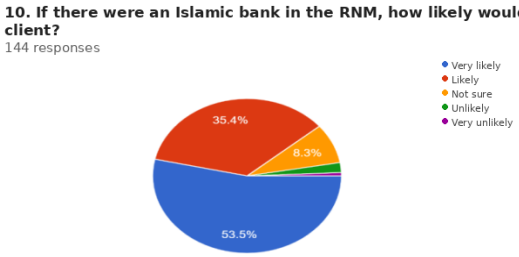
4.1 Sample Characteristics and Knowledge of Islamic Banking

The sample consists of 150 respondents; its characteristics were examined by gender, age, education level, and professional field. Most participants are associated with the financial and banking sector. Regarding awareness of the concept, 66.4% stated that they had heard of Islamic banking. However, more in-depth knowledge remains limited: 52.1% said they knew little about how Islamic banks operate, while 24% stated that they did not know at all. This indicates a need for greater public information and financial education.

4.2 Willingness to Use Islamic Services

The results indicate considerable interest in using Islamic banks if they were to operate in the RNM. For this reason, Hypothesis H2 is supported; that is, Islamic banking services are preferred by clients. The results are presented below in Figure 1.

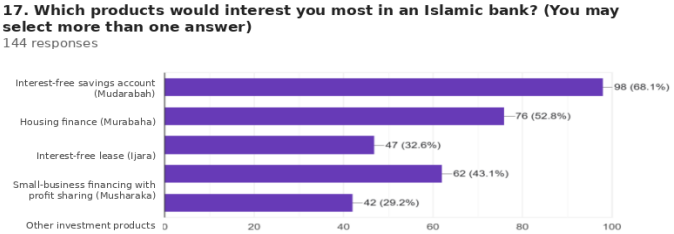
Figure 1. Respondents' Willingness to Use the Services of an Islamic Bank (Question 10)



4.3 Preferences for Islamic Banking Products

Respondents' interest extends to several Islamic banking products. The results are presented below in Figure 2. Consistent with this finding, Hypothesis H3, concerning the positive perception of Islamic products, is supported.

Figure 2. Respondents' Preferences for Islamic Banking Products (Question 17)



4.4 Obstacles and the Legal and Institutional Framework

The main perceived obstacle was the lack of government support, selected by 64.6% of respondents. The results also indicate a lack of a clear legal framework (16%) and a lack of public awareness (11.8%), alongside other factors such as client skepticism, the way legislation defines banking activity, lack of trust, and bureaucracy. These results are also based on the 144 responses recorded for the relevant question. They show that client interest is not enough without institutional support, regulatory clarity, and public information.

The legal analysis presented in the paper examines Article 2, paragraphs 1, 3, and 23 of the Law on Banks. According to the interpretation of the sources used, the provisions examined do not contain an explicit prohibition excluding the development of an alternative financial model, while the definition of deposits allows deposits with or without interest. This supports Hypothesis H1 in the sense that no insurmountable obstacles were identified in the analysis conducted. However, this does not mean that every Islamic product can be implemented automatically without adjustment. Licensing, banking supervision, the structure of sales and leases, partnerships, tax and accounting treatment, and supervision of Sharia compliance require further examination.

4.5 Summary of Findings

Overall, the empirical results and legal analysis provide an initially positive outlook for the development of Islamic banking in the RNM: there is considerable willingness to use it and interest in various products, while the analysis of the legal framework identifies no insurmountable obstacles. Thus, all three hypotheses receive support from the analysis conducted. At the same time, limited knowledge, the lack of government support, and the need for clear rules and professional expertise remain key challenges. Islamic banking may help diversify financial services, increase competition, and potentially attract investment from international markets, but the actual economic impact is not measured directly by this study.

5. Conclusions

This study analyzed the prospects for the application of the Islamic banking system in the Republic of North Macedonia (RNM), drawing on theoretical, legal, and institutional analysis, as well as empirical data collected through a questionnaire involving 150 respondents. The findings indicate that Islamic banking could represent a potential alternative for diversifying the country's financial system, although the level of knowledge about this model remains relatively limited.

The empirical results indicate a considerable level of interest in and willingness to use Islamic banking services. Specifically, 53.5% of respondents stated that they would be "very likely" to become clients of an Islamic bank, while 35.4% considered this possibility "likely." In total, 88.9% of respondents expressed a positive attitude toward using the services of an Islamic bank. These results support the hypothesis related to respondents' interest and willingness to use Islamic banking if such services were available in the RNM market.

Preferences for Islamic banking products also indicate potential demand. The most preferred product was an interest-free savings account based on Mudarabah, selected by 68.1% of respondents, followed by housing finance through Murabaha at 52.8%, financing for small businesses through Musharakah at 43.1%, and Ijara at 32.6%. These results indicate interest in a range of products and suggest the possibility of offering new financial alternatives in the RNM market.

On the other hand, the results also highlight significant obstacles to the development of Islamic banking. The lack of government support was identified by 64.6% of respondents as one of the main obstacles, alongside the lack of a clear legal and institutional framework and the limited level of public information and knowledge about Islamic banking. This indicates that market interest, although important, is not sufficient without appropriate legal, institutional, regulatory, and professional conditions.

With regard to the hypotheses, the study's findings provide support for all three alternative hypotheses, taking into account the different ways in which they were assessed. The first hypothesis, concerning the possibility of applying Islamic banking in the RNM, is supported by the analysis of the legal and institutional framework, in which no insurmountable obstacles to the potential development of this model were identified. The second hypothesis is supported by the empirical results on respondents' willingness, while the third is supported by their interest in various Islamic banking products. However, these findings should be interpreted as support for the hypotheses rather than as definitive proof, due to the descriptive nature of the analysis and the limitations of the sample.

From an economic perspective, the development of Islamic banking could contribute to diversifying the financial system of the RNM, expanding financing alternatives for individuals and businesses, and potentially creating opportunities to attract investment from institutions and investors operating according to Islamic finance principles. However, realizing this potential requires further analysis of licensing, supervision, the treatment of financial products, and their adaptation to the existing regulatory framework.

The study has several limitations. The sample of 150 respondents cannot be considered fully representative of the population of the RNM, while the use of an electronic questionnaire may have limited the participation of some groups. Furthermore, since Islamic banking does not operate directly in the country's financial system, respondents' perceptions are based mainly on theoretical knowledge and general information. In addition, the analysis is primarily descriptive and does not include inferential statistical tests; therefore, the results should be interpreted within the limits of this research design.

Based on the findings, it is recommended that public information and financial education about Islamic banking be increased, professional expertise in Islamic finance be developed, and the possibilities for developing financial products consistent with this model's principles be examined institutionally. At the same time, relevant state institutions, the financial sector, and the academic community could cooperate in further analyzing the legal, regulatory, and economic aspects of the potential development of Islamic banking in the country.

In conclusion, the results suggest that the Islamic banking system could represent an opportunity to diversify the financial system of the Republic of North Macedonia. Respondents' interest and preferences for different products provide a basis for further examination of this model. However, its application should not be considered a predetermined outcome, but rather a possibility that requires further assessment of economic, legal, and institutional feasibility, as well as the establishment of appropriate regulatory and professional conditions.

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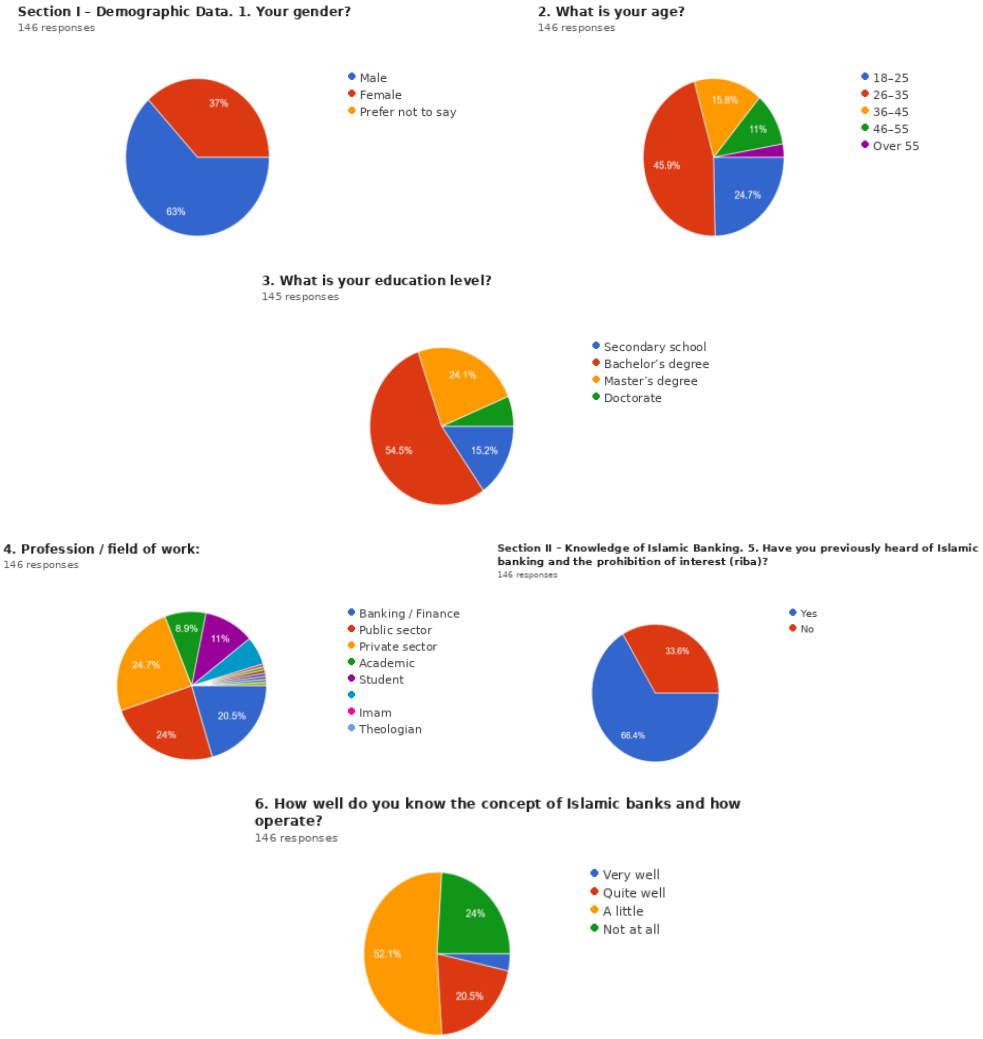
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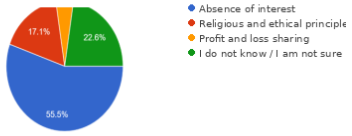
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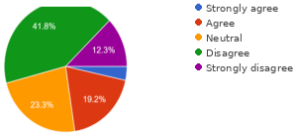
Appendix 1. Questionnaire Results



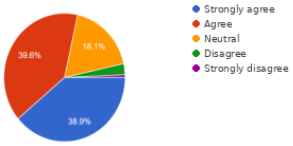
7. In your opinion, what is the main difference between Islamic banks and conventional banks?
146 responses



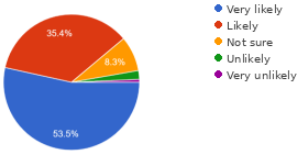
8. Do you think there is sufficient public awareness in the RNM about the concept of Islamic banking?
146 responses



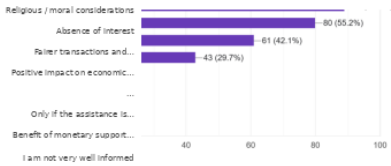
Section III - Attitudes and Perceptions Toward Islamic Banking. 9. How much do you agree with the statement: "Islamic banks offer a fair and sustainable alternative to the traditional banking system."
144 responses



10. If there were an Islamic bank in the RNM, how likely would you be to become its client?
144 responses



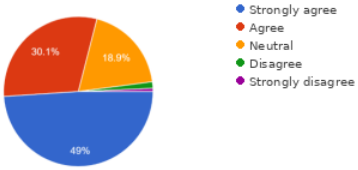
11. In your opinion, what are the main benefits of Islamic banking? (You may select more than one answer)
145 responses



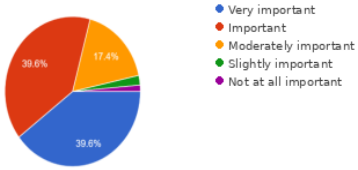
12. What do you think is the main obstacle to the development of Islamic banking in the RNM?
144 responses



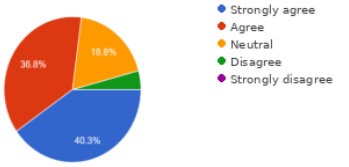
13. Do you agree with the statement: "The integration of Islamic banks would positively affect the stability of the financial system in the RNM."
143 responses

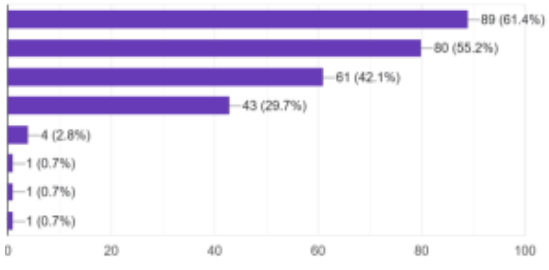


14. How important do you think Sharia supervision (Sharia Board) is for ensuring transparency and trust in Islamic banks?
144 responses

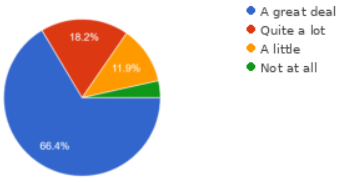


Section IV - Opinions on the Role and Opportunities of Islamic Banking in the RNM. 15. Do you agree with the statement: "The establishment of Islamic banks in the RNM will increase competition and diversification in the financial sector."
144 responses

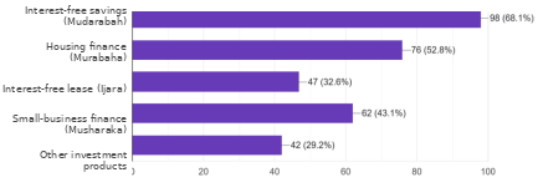




16. To what extent do you think the government and the Central Bank should supp the development of Islamic banks?
143 responses



17. Which products would interest you most in an Islamic bank? (You may select more than one answer)
144 responses



18. In your opinion, what would be the main impact of introducing Islamic banking the RNM?
144 responses

