

The Role of Profit and Loss Sharing (PLS) in Establishing Economic Stability

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Abstract

This study aims to analyze the role of profit and loss sharing (PLS) as a monetary instrument in supporting financial and macroeconomic stability within the framework of the Islamic economic system. Unlike conventional approaches that rely on interest rates, PLS offers a financing alternative based on the principles of justice, partnership, and risk-sharing. Employing a qualitative method through library research, this study examines classical and contemporary literature on Islamic monetary systems using a multidisciplinary approach, including theological, Islamic legal (*fiqh al-muamalat*), and macroeconomic perspectives. The findings reveal that PLS can enhance resource allocation efficiency, reduce speculative practices, and strengthen the link between the financial and real sectors. Furthermore, PLS contributes to financial inclusion and the growth of productive sectors, particularly micro, small, and medium-sized enterprises (MSMEs), thereby promoting more resilient and sustainable economic stability. Optimizing the role of PLS in Islamic monetary policy requires adaptive regulatory support, increased institutional capacity of Islamic financial institutions, and the development of innovative PLS-based financial products. These findings are expected to contribute to the advancement of Islamic economic theory and offer policy recommendations to foster an inclusive and equitable path toward economic stability.

Keywords : Economic stability, financial stability, Islamic finance, Islamic monetary policy, profit and loss sharing.

1. Introduction

Economic stability is an ideal condition that consistently serves as the primary objective of macroeconomic policies across nations (Zulaikah, 2025), given its significant contribution to the broader achievement of societal welfare (Rizky, Nasution, & Rusiadi, 2024). In maintaining this stability, monetary policy plays a strategic role through the management of liquidity, inflation control, and exchange rate stabilization (Jalil, Kasnelly, & Agustia, 2024). In conventional economic systems, monetary policy predominantly relies on interest rate mechanisms as its main instrument (Endaryono, Susilo, & Djuhartono, 2024). However, this approach has been widely criticized, particularly from the perspective of Islamic economics, due to its incompatibility with Sharia principles that prohibit *riba* (interest). As an alternative, Islamic economics offers a set of Sharia-compliant monetary instruments

that emphasize justice, partnership, and risk-sharing (Dainy, Hasanah, Sopia, & Sari, 2025). One of the most promising instruments in fostering economic stability is the profit and loss sharing (PLS) mechanism (Faiz, 2010; Joudar, Msatfa, Metwalli, Mouabid, & Dinar, 2023).

PLS is a financing system rooted in the principle of partnership (Yanti, Lubis, & Az zakiyyah, 2025), wherein profits and losses are shared between the capital provider (e.g., Islamic banks) and the business operator according to a pre-agreed ratio. Unlike the conventional interest-based system, which typically offers fixed returns irrespective of business performance, the PLS system necessitates active participation and shared responsibility between both parties in managing risks and business outcomes. This approach not only fosters equity in financial relationships but also promotes more productive and accountable economic behavior. Consequently, PLS is regarded as a mechanism capable of enhancing resource allocation efficiency and minimizing speculative practices that often contribute to instability in conventional financial systems.

Furthermore, PLS is believed to play a pivotal role in promoting inclusive and sustainable economic growth (Yusri, Chairina, & Dara, 2023). By channeling partnership-based financing, PLS can reach productive sectors that are frequently underserved by conventional banking systems, such as micro, small, and medium-sized enterprises (MSMEs) (Manzilati, 2015). This has implications for improved access to capital, job creation, and a more equitable distribution of income. Additionally, the direct involvement of financial institutions in business activities contributes to better governance and oversight of financed projects. As such, PLS serves not only as a Sharia-compliant financial instrument but also as a potentially effective tool for economic stabilization.

Nevertheless, most existing studies tend to focus on the microeconomic aspects of PLS implementation, such as its impact on firm profitability or financing efficiency (Kurniawansyah, 2016; Ramadhani, Burhany, & Setiawan, 2024; Sutrisno & Widarjono, 2022). Research exploring the relationship between PLS and macroeconomic stability remains relatively scarce, indicating a need for further investigation to comprehend the broader contributions of PLS. This gap opens avenues for comprehensive studies that examine the impact of PLS on macroeconomic indicators such as inflation, economic growth, and unemployment, while also identifying the supporting factors that determine its effectiveness in achieving stability.

Against this background, the present study aims to analyze the influence of the profit and loss sharing mechanism on financial and macroeconomic stability. The primary focus is to evaluate the impact of PLS implementation on various macroeconomic indicators and to identify key variables that influence the success of

PLS as an Islamic monetary instrument. The expected contribution of this study extends beyond the theoretical development of Islamic monetary policy, offering practical policy recommendations for regulators and Islamic financial industry practitioners in designing a stable, just, and sustainable monetary framework.

2. Research Method

This study employs a qualitative approach using a library research method focused on theoretical analysis. This approach is selected to achieve the primary objective of the study, which is to gain a deep understanding of the Islamic monetary system, particularly the role of *profit and loss sharing* (PLS) in promoting economic stability. A qualitative method allows the researcher to explore and interpret normative, historical, and conceptual meanings found within Islamic economic literature in a holistic and contextual manner. The initial stage of this research involves a systematic literature review of both classical and contemporary sources in the field of Islamic economics. The references consulted include authoritative works by Muslim scholars, peer-reviewed journal articles—both national and international—as well as other relevant academic publications. To ensure academic validity, only peer-reviewed literature and sources with high relevance to the research focus are included as primary references.

All selected literature is analyzed thoroughly by considering various perspectives, including theological, Islamic legal (*fiqh al-muamalat*), and macroeconomic viewpoints. This multidisciplinary approach is intended to develop a comprehensive understanding of the position of PLS within the broader Islamic monetary framework and its potential contribution to economic stability. Furthermore, the analysis critically engages with contemporary scholarly debates on the effectiveness of PLS as an instrument of Islamic monetary policy. The data collected through the literature review is analyzed using a content analysis technique. This method is employed for its capacity to systematically and objectively identify, categorize, and interpret the meanings embedded in the texts. The analysis involves organizing the data into key themes related to the Islamic monetary system and economic stability, followed by synthesizing the findings to construct coherent arguments that support the research objectives.

Thus, the research methodology adopted in this study enables the conceptual, analytical, and argumentative exploration of *profit and loss sharing* as a sharia-compliant monetary instrument. The final outcomes are expected to contribute to the development of Islamic economic thought, particularly in the area of sharia-based monetary policy that is inclusive, equitable, and oriented toward macroeconomic stability.

3. Results and Discussion

3.1 The Islamic Monetary System

The Islamic monetary system is fundamentally built upon the principles of justice ('*adl*), mutual cooperation (*ta'awun*), and the prohibition of exploitation in all forms, particularly *riba* (interest), *gharar* (excessive uncertainty), and *maysir* (speculation). Unlike the conventional monetary system which relies heavily on interest rates to control money supply and influence macroeconomic indicators, the Islamic monetary framework promotes risk-sharing, real asset backing, and ethical investment as key foundations of financial stability (Mubarok, Wibowo, & Latif, 2024; Taleb, Salhaoui, Argabi, & Khater, 2024).

Money in Islam is viewed not merely as a commodity but as a medium of exchange and a measure of value that must be integrated with productive economic activities (Darussalam & Muhammad, 2025). Therefore, Islamic monetary instruments are designed to ensure that the expansion of money supply is closely linked to the growth of real economic sectors (Juhro, Syarifuddin, & Sakti, 2025). This foundational approach prevents artificial inflation and excessive financialization, which are often considered root causes of instability in conventional financial systems.

In the context of monetary policy, Islam proposes alternative tools such as *zakat*-based redistribution, *qard al-hasan* (benevolent loans), *sukuk* (Islamic bonds), and *profit and loss sharing* (PLS) mechanisms (Avdukić & Smolo, 2024; Rabbani et al., 2021). Among these, PLS stands out due to its dual function as a financing model and a macroeconomic stabilizer. By promoting equitable sharing of risk and return, PLS aims to reduce income inequality and enhance resilience in times of economic shocks.

3.2 The Islamic Monetary System

Table 1. The Role of Profit and Loss Sharing (PLS) in Financial Stability of Islamic Banking

No	Aspect of Stability	Academic Explanation
1	Elimination of Cash Flow Gaps	PLS eliminates the gap between cash flow and payment obligations, as returns depend on project performance
2	Risk Sharing	Risk is distributed among all parties involved in the funded project
3	Credit Risk Transfer	Asset-side risks are absorbed by the liability side due to the non-guaranteed nature of capital and return
4	Active Bank Involvement	Banks actively monitor and manage funded projects
5	Diversification into Productive Sectors	PLS investments are directed to productive sectors to reduce potential risks

Source: (Joudar et al., 2023)

Based on Table 1, it can be explained that profit and Loss Sharing (PLS) is a fundamental characteristic of Islamic banking that is theoretically considered to contribute significantly to financial stability (Athief, Anisa, Hadi, & Alam, 2024; Nugraheni & Alimin, 2022). Within Islamic banking theory, PLS mechanisms are designed to eliminate the cash flow–payment gap, which is commonly regarded as a key source of instability in conventional financial systems. By making the return to capital contingent upon actual project outcomes, PLS creates a more resilient financial structure that is inherently linked to the performance of real economic activities, rather than fixed interest-based obligations.

Furthermore, the PLS approach allows financial risks to be distributed more equitably among all participants involved in a financed project (Bilgin, Danisman, Demir, & Tarazi, 2021). In a PLS arrangement, both the bank and the capital provider share in the profits and losses of the venture, thereby avoiding the concentration of risk on a single party, as often seen in traditional debt-based finance (Sutrisno & Widarjono, 2022). As a result, in the event of project failure, the financial burden is not solely borne by the bank, thus reducing the likelihood of systemic instability.

PLS also facilitates the transfer of credit risk from the asset side to the liability side of the bank's balance sheet. This is because investment deposits under PLS schemes such as *Mudarabah* and *Musharakah* do not guarantee either the principal or the expected return. Consequently, any losses arising from underperforming assets can be absorbed by adjusting the value of investment deposits, which directly aligns liability-side values with asset-side performance. This built-in flexibility mitigates exposure to default risk and enhances the bank's ability to maintain liquidity under stress conditions.

An additional stabilizing feature of PLS is the active involvement of banks in managing the financed projects. Since the profitability of the bank depends on the project's success, there is a strong incentive for banks to undertake rigorous due diligence, monitoring, and oversight. This engagement transforms the role of the bank from a mere financial intermediary to a strategic partner in project implementation, thereby improving the overall governance of financial intermediation.

Moreover, PLS-based financing encourages investment diversification across productive sectors of the economy. Islamic financial institutions that adopt PLS principles are more inclined to fund real-sector activities such as manufacturing, agriculture, and trade, which generate tangible economic value. This strategic allocation reduces sectoral concentration risk and strengthens the link between the financial sector and the real economy, contributing to broader macroeconomic stability.

In essence, the PLS framework in Islamic banking offers a theoretically robust model for achieving sustainable financial stability. By realigning incentives, promoting shared risk-taking, and ensuring active stakeholder involvement, PLS enhances the systemic resilience of Islamic financial institutions. Nevertheless, the effectiveness of PLS in practice hinges on institutional quality, regulatory frameworks, and the operational capacity of banks to perform participatory finance roles efficiently. Strengthening these aspects is essential for realizing the full stabilizing potential of PLS in the Islamic financial system.

3.2 The Role of Profit and Loss Sharing in Achieving Macroeconomic Stability

Profit and loss sharing (PLS), as manifested in contracts such as *mudarabah* and *musharakah* (Khan, Siswantoro, & Ur Rahman, 2020), represents the cornerstone of Islamic financial intermediation (Joudar et al., 2023). Unlike interest-based systems that reward capital providers regardless of business outcomes, PLS requires both capital providers and entrepreneurs to share the risks and returns of an economic venture. This principle creates a strong alignment of incentives and fosters more prudent and responsible financial behavior.

From a macroeconomic perspective, PLS contributes to stability through several interrelated mechanisms. First, it enhances **allocative efficiency**, as funds are channeled toward ventures with sound business models and realistic profit expectations. Second, it mitigates **moral hazard** and excessive risk-taking, since all parties are directly affected by the success or failure of the business. Third, it improves **financial inclusion**, particularly for micro, small, and medium-sized enterprises (MSMEs) that are often excluded from conventional financing due to a lack of collateral or credit history.

Moreover, PLS can function as an automatic stabilizer during periods of economic downturn. In contrast to fixed interest obligations that can exacerbate default risks during recessions, PLS contracts allow for flexible adjustments in returns based on actual performance. This built-in flexibility reduces systemic risk and supports economic continuity, particularly in sectors most vulnerable to external shocks.

However, the effective implementation of PLS at the macroeconomic level is contingent upon several enabling factors, including a robust legal and regulatory framework, sound corporate governance, adequate risk assessment mechanisms, and strong institutional support from central banks and financial authorities.

In essence, PLS is not merely a financial contract, but a comprehensive framework that embodies the ethical and economic goals of Islamic finance. Its emphasis on fairness, risk-sharing, and productivity makes it a powerful instrument for enhancing macroeconomic stability in an Islamic monetary system. Future policy design in

Islamic finance should therefore prioritize the integration of PLS principles in broader monetary and fiscal strategies to achieve sustained economic stability.

4. Conclusion

The findings of this study demonstrate that profit and loss sharing (PLS) instruments within the Islamic monetary system contribute significantly to economic stability, both at the financial sector level and the broader macroeconomic context. PLS offers a financial approach grounded in justice, risk-sharing, and a direct connection to real economic activities. By eliminating cash flow mismatches, distributing risks equitably, and encouraging the active involvement of financial institutions in project management, PLS creates a more resilient financial structure capable of withstanding economic shocks. Moreover, the orientation of PLS towards productive sectors strengthens the linkage between the financial and real sectors, thereby enhancing resource allocation efficiency and reducing systemic risks.

To optimize the role of PLS in achieving sustainable economic stability, it is essential to strengthen institutional aspects, including supportive regulatory frameworks, good corporate governance, and the technical capacity of Islamic financial institutions to implement participatory financing. Governments and monetary authorities in countries with Islamic financial systems are advised to actively promote the integration of PLS principles into broader fiscal and monetary policy strategies as part of long-term efforts to achieve economic stability and equity. Additionally, efforts to enhance financial literacy and develop innovative PLS-based products should be intensified to expand financial inclusion, particularly for micro, small, and medium-sized enterprises (MSMEs).

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