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Why Islamic finance could provide an ethical model for funding the green transition

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In recent years, green finance has become a key policy in developed countries. The term refers to the loans and investments that fund the transition to a low-carbon economy. But one of the main challenges in this area is the gap between environmental claims and realities – so-called “greenwashing”.

Because of this, alternative finance models that emphasise a direct link between capital and actual economic activities have been receiving more attention. The Islamic financial system is one such alternative. In this system, financing (in other words, lending) is legitimate when it is linked to real economic activities that benefit people and society.

Islamic finance, with its core values of fairness and social responsibility, could be a means of enhancing credibility and transparency within green finance. In other words, its principles could be seen as more than just an ideological or faith alternative to the conventional system.

Unlike other models, Islamic finance emphasises a direct link between financing and actual assets or activities. Profits must come from work – simply lending money to make a profit is not permitted. This allows for a clearer definition of green projects, helping to ensure that resources are spent on activities with a specific economic and social purpose.



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Or are you curious about the connection between insurance and the climate crisis?*

Green Your Money is a new series from the business and environment teams at The Conversation exploring how to make money really matter. Practical and accessible insights from financial experts in the know.

The requirement for transparency, the prohibition on excessive uncertainty, speculation, and the emphasis on social responsibility mean that the “green” claim must be linked to observable and measurable financial activities.

Green finance and green sukuk

One of the most tangible links between Islamic finance and green finance is green sukuk (Islamic bonds). Conventional bonds are based on a debt commitment – the investor provides money and receives regular fixed interest payments before the debt is repaid. But sukuk represent real ownership or a real interest in an asset or project.

In simple terms, sukuk’s investors will focus on real economic activities rather than an abstract financial contract. For example, the invested capital could be directed into projects like renewable energy, sustainable infrastructure, solar power plants, wind energy initiatives, water treatment facilities or clean technology. This means earning profit from a tangible work in real financial projects.

Conversely, with a conventional bond, a significant part of the invested capital might go into “non-real” projects. For example, a stakeholder might use the invested capital to buy shares. They might expect the shares to increase in value and they could then sell them for a profit. The earnings here would come from the fluctuations in the share price, not from real economic activities like industries, production or entrepreneurship.

Through green sukuk, assets and economic activities must be environmentally focused – things like solar power plants, wind projects or clean transport initiatives. This makes the project’s greenness an intrinsic part of the financial instrument.

ESG (environmental, social and governance) sukuk is expected to surpass US\$70 billion (£52 billion) globally this year. Green sukuk could play a bridging role in the UK – the country is a global hub for both green and Islamic finance.

The UK’s green sukuk market would not have to replace the green bond market. But it could complement it, particularly for investors (both Muslim and non-Muslim) who value transparency and a direct link between capital and environmental impact.



In green sukuk, there must be a direct link between the investment and climate-friendly activities.
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Islamic fintech (financial technology) also has a role. Fintech is not just about digitising financial services; by using technology to make transactions cheaper, more convenient and more secure, it changes how finance products are accessed, monitored and trusted. Islamic fintech operates in accordance with Islamic finance principles and values.

In green finance, Islamic fintech allows crowdfunding, asset tokenisation (turning real assets into digital currency), and rapid information sharing with investors. This can cut costs and increase transparency, and provide a foundation for individual investors and small institutions such as credit unions to access investment opportunities.

Islamic fintech's main difference lies in its ethical framework. Conventional fintech mainly focuses on speed, scalability and profitability. But from the outset, Islamic fintech is shaped by ethical limitations – things like avoiding speculation, emphasising transparency and linking crowdfunding to projects that make profits from real economic activities.

The UK has strong fintech infrastructure, flexible and supportive financial regulation and a prominent place in Islamic finance. This environment gives the country a unique opportunity to test ethical finance in a modern and secular context. This in turn could create more opportunities for green finance projects.

Measuring, monitoring and verifying the environmental impact of projects over time are significant challenges. Initially, most green financial commitments are clear, but determining whether a project reduces carbon and improves sustainability is time consuming and costly.

In these situations, AI can also play a role. Ethical AI in this context means that algorithms are used for analysis and accountability within green projects. Machine-learning algorithms, for instance, can continuously analyse the environmental data for projects financed through green sukuk and identify deviations between goals and results. This reduces the risk of greenwashing and can increase investor confidence.

To comply with Islamic finance, the use of AI must serve specific ethical purposes. This means AI decision-making should not compromise transparency, justice or accountability. This view is consistent with emerging UK approaches to AI regulation, which emphasise trustworthy AI aligned with the public interest.

Applying Islamic finance does not have to be an identity or political project. Rather, it can be a practical and ethical framework for financing the green transition. In short, it can complement current financial systems to address some of humanity's most pressing economic and environmental challenges.

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