1) The referee wrote "**Literature review: the introduction barely covers a few papers, and misses out a few, notably Imam and Kpodar (2015) "Is Islamic Banking Good for Growth" (IMF Working Paper). The motivation of the paper needs to be enhanced, why is Islamic banking better for growth than conventional banking in the GCC? This is poorly motivated. "**

Authors' reply

a. Recent studies (e.g. Imam and Kpodar (2015) will be added to the literature review section.

b. The following paragraphs will be added to the literature review section to show why Islamic banking is better for growth than the conventional banks in GCC countries:

"Four channels may explain how Islamic banks can contribute to the economic growth more than conventional banks do. The first channel is by directly linking between the real sector and the financial sector. Specifically, in Islamic banking, the flow of money is always associated with the flow of goods and services. The second channel is by encouraging entrepreneurship and small and medium sized enterprises (SMEs). Imam and Kpodar (2010) indicate that small and new firms can get finance from Islamic banks even if they have no credit history. This may increase competition, innovation, and output growth. The third channel is by promoting equality. The use of Islamic financial instruments promotes equality and reduces unemployment. For example, Salam (advance purchase) is used in agriculture sector to offer finance to farmers through forward sales contracts between Islamic banks and farmers. Based on this contract, buyers pay in advance for agriculture goods that will be supplied latter. This promotes development, and reduces inequality and unemployment in the rural sector (El-Ghattis 2010), which in turn promotes economic growth (Stiglitz 2012). The fourth channel is through the ethical values of Islamic banking, which are well-known as based on religious beliefs. Weber (1905 [1930]) argues that religion promotes ethical principles (such as thrift, charity, social justice, and fighting corruption), which can have positive impacts on investment and economic growth (Barro and McCleary 2003)."

2) The referee wrote **"Growth Model: This is the weakest part of the paper. The authors simply use a growth model, but (i) don't include conventional banking in it (ii) don't derive why Islamic banking should be more powerful than conventional banking. They need to show, to be consistent with their main argument, that in the steady state, Islamic banking is in a higher equilibrium than conventional banking, something they currently don't do."**

Authors' reply

The referee is right that in our growth model we do not include conventional banking and Islamic banking simultaneously. Actually, we wanted to analyze two cases using our model.

Case 1: What if we only have Islamic banks in the economy

Case 2: What if we only have conventional banks. (Case 2 is already analyzed in the literature since most existing papers abstract from the Islamic banks.)

By comparing the two cases, we can compare the contributions of the two banking systems to economic growth.

Our model is an extension of a well-known simple endogenous growth model developed by Pagano (1993). We did not include the two banking systems simultaneously in our model to be able to (analytically) obtain the linear relations between:

a) the growth rate and Islamic financial development.

b) the growth rate and commercial banking development

In this paper, we do not aim to show that Islamic banking contributes to the growth more than the commercial banking analytically. We aim to compare the contributions of the two systems through using an econometric method and data. That is why, we don't derive why Islamic banking should be more powerful than conventional banking.

We still introduced the growth model to show the reasoning behind our econometric model.

3) The referee wrote "**Econometrics: Just doing a simply Granger causality test is highly simplistic. Given that the share of Islamic banking is so small in most GCC countries, the results appear to be highly suspicious/spurious, especially given the limited number of observations. Also, what is "value of Islamic finance", is it assets of Islamic banks? This should be specified?"**

Authors' reply

a. The Islamic finance variable is the sum of all Islamic financial instruments (see section 3). In addition, the seven Islamic financial instruments will be discussed: (1) Murabaha (mark-up financing or cost-plus financing), (2) Mudaraba (trust financing), (3) Musharaka (joint venture or profit and loss sharing "PLS"), (4) Ijara (leasing), (5) Salam (advance purchase), (6) Istisna (commissioned manufacture), and (7) Bai bi-thamin ajil (deferred payment financing).

b. Robustness checks section will be added

4) The referee wrote "**The authors do not provide the policy implications of their findings, something that they need to elaborate on"**

Authors' reply

a. Section 4 has the following paragraph: "Our empirical results also have four implications for understanding the political economy of banking sector reforms in GCC countries. Firstly, the presence of Islamic banks increases the competition and efficiency in the banking sector. Secondly, the main principles of Islamic banking (e.g., zero nominal interest rate) result in efficient allocation of resources. This point is consistent with Friedman (1969). Thirdly, the presence of Islamic banks encourages innovation activities by providing risk sharing, which positively affects economic growth (Pagano 1993). Fourthly, the use of interest-free loans can reduce the income gap and improve socio-economic development".

b. Additional policy implications will be added (e.g. the performance of Islamic banks and Conventional banks during the financial crisis).