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The Role of Islamic Financial Institutions in Encouraging Sustainable Economic Growth in Indonesia

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Abstract: This research focuses on the role of Islamic financial institutions in promoting sustainable economic growth in Indonesia. In recent years, the Islamic economy has shown significant growth alongside increasing public awareness of Sharia-compliant financial principles. Islamic financial institutions, such as Islamic banks and financing institutions, are expected to contribute to inclusive and sustainable economic development. This study aims to analyze the contribution of Islamic financial institutions to sustainable economic growth in Indonesia and to identify the challenges they face. A quantitative method with a case study approach is used. Secondary data is gathered from annual reports of Islamic financial institutions, Statistics Indonesia, and Bank Indonesia, focusing on the period from 2015 to 2024. A regression model is applied to examine the relationship between the growth of Islamic finance and economic indicators such as GDP, investment rates, and poverty reduction.The findings show that Islamic financial institutions play a significant role in driving sustainable growth. They not only expand financial access but also support the development of sustainable sectors such as agriculture, renewable energy, and micro-enterprises. However, challenges like low financial literacy and incomplete regulatory support remain obstacles.

Keywords: Sharia, Growth, Sustainability.

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A. INTRODUCTION

As the country with the largest Muslim population in the world, Indonesia has great potential to develop Islamic financial institutions as a driver of sustainable economic growth. In recent years, the Indonesian government has shown a strong commitment to strengthening the Islamic financial sector through various strategic policies and initiatives. One important step is the establishment of Bank Syariah Indonesia (BSI) in 2021, the result of a merger of three state-owned Islamic banks, which aims to make BSI one of the ten largest Islamic banks in the world. This move reflects the government's serious efforts to integrate Shariah principles into the national financial system in the hope of promoting inclusive and sustainable economic growth.

The growth of the Islamic finance sector in Indonesia is showing a positive trend. According to the Financial Services Authority (OJK), Indonesia's Islamic financial assets reached Rp 2,375.84 trillion in 2022, an increase from Rp 2,050.44 trillion in the previous year. This increase reflects the public's confidence in the Islamic financial system, which is considered more fair and transparent. In addition, the contribution of the Islamic economy to the national gross domestic product (GDP) has also increased significantly, reaching 46.71%

in the second quarter of 2023. This shows that the Islamic economy is not only growing in the financial sector, but is also having a real impact on the national economy as a whole.

Islamic financial institutions play an important role in supporting sustainable economic growth through various Shari'ah-compliant financial instruments. One example is the Green Zakat initiative launched by BSI in collaboration with the National Zakat Agency of Amil (BAZNAS) and the United Nations Development Programme (UNDP). The programme aims to channel zakat funds into projects that support environmental conservation and climate resilience, such as the construction of micro-hydro power plants and organic farming. Such initiatives demonstrate how Islamic financial institutions can contribute to achieving the Sustainable Development Goals (SDGs), through an approach that is consistent with Islamic values.

In addition, the development of Islamic financial technology (fintech) also offers new opportunities to expand access to inclusive and sustainable finance. Studies conducted by UNDP and the Indonesian Sharia Fintech Association (AFSI) show that sustainability-oriented financing in the Islamic fintech sector can have positive social and environmental impacts while providing financial returns to investors. With a large population and high internet penetration, Indonesia has great potential to leverage Islamic fintech to support inclusive and sustainable economic growth.

However, to maximise the role of Islamic financial institutions in promoting sustainable economic growth, a concerted effort is required from various parties, including the government, regulators, industry players and the community. Increasing Islamic financial literacy is one of the most important keys to expanding the adoption of Islamic financial services in the community. The Government of Indonesia, through the National Committee for Sharia Economics and Finance (KNEKS), has formulated a national strategy to improve Islamic financial literacy and inclusion, which is expected to be the main guide for all stakeholders in developing the Islamic financial sector in Indonesia. With a strong synergy among various stakeholders, Islamic financial institutions can play a strategic role in driving Indonesia's inclusive, equitable and sustainable economic growth.

B. METHOD

This research uses a quantitative approach with descriptive analysis method to examine the role of Islamic financial institutions in promoting sustainable economic growth in Indonesia. The data used in this study consists of secondary data obtained through official reports from the Financial Services Authority (OJK), Bank Indonesia (BI), the Central Statistics Agency (BPS), as well as international publications such as UNDP and Islamic Development Bank (IsDB) reports over the past five years. This study also adopts multiple linear regression analysis techniques to examine the relationship between the performance variables of Islamic financial institutions and indicators of sustainable economic growth. The independent variables in this study include Islamic financing, third-party funds (DPK), and Islamic financial inclusion, while the dependent variables are indicators of sustainable economic growth, such as Gross Domestic Product (GDP), unemployment rate, and sustainable development index (SDGs Index). In addition, this research uses documentation and literature study techniques to strengthen the theoretical foundation and interpret the findings contextually.

Table 1. Assessment Indicators

Variable	Indicator	Data Source	Measuring Scale
Islamic Financing	Total productive financing (micro small medium enterprises, agriculture, renewable energy, etc.)	Financial Services Authority, Annual Report of Bank syariah indonesia	Ratio (%)
Third Party Funds (DPK)	Growth of Third Party Funds in Islamic financial institutions	Bank Indonesia Islamic Banking Statistics	Ratio (%)
Islamic Financial Inclusion	Number of active customers and sharia products used	National Survey of Finance	Number/Percentage
Economic Growth (GDP)	Annual growth of Indonesia's GDP (in %)	Indonesia Central Bureau of Statistics, Bank Indonesia	Ratio (%)
Sustainable Development Goals (SDGs)	National SDGs index scores especially on Goals 1, 8, and 13	SDGs Center, National Development Planning Agency	Score (0–100)
Unemployment Rate	Decrease in open unemployment rate	central statistics agency of indonesia	Ratio (%)

Description of Assessment Indicator:

1. Islamic Financing: This indicator measures how much Islamic financing contributes to productive sectors such as MSMEs, the agricultural sector, and green energy projects. This data is important to assess the role of Islamic financial institutions in supporting the real sector.
2. Third Party Funds : The growth of third-party funds shows the public's trust in Islamic financial institutions. This ratio is also a measure of how much the institution's intermediation capacity is in channeling funds to the productive sector.
3. Islamic Financial Inclusion: Refers to the extent to which people, particularly in rural areas and economically weaker groups, have access to Islamic financial services. This is important to measure the impact of economic inclusiveness.
4. Economic Growth (GDP): A macro indicator used to see whether the contribution of the Islamic finance sector has a significant impact on increasing overall national output.
5. Sustainable Development Goals (SDGs): This indicator assesses how the contribution of Islamic finance supports the sustainable development agenda, specifically on poverty alleviation (SDG 1), inclusive economic growth (SDG 8), and climate action (SDG 13).

6. Unemployment Rate: A decrease in the unemployment rate would indicate that economic activities driven by Islamic finance have succeeded in creating new jobs, thus supporting sustainable growth.

C. RESULTS AND DISCUSSION

1. Islamic Financing and Economic Growth

Multiple linear regression analysis shows that Islamic financing has a positive and significant influence on Indonesia's Gross Domestic Product (GDP) growth. Data from the Financial Services Authority (OJK) and Bank Indonesia (BI) show an increase in total Islamic financing of 12.5% by 2023 compared to the previous year. The sectors receiving the largest financing include Micro, Small and Medium Enterprises (MSMEs), agriculture, and renewable energy. This increase in financing contributes to national economic growth, with Indonesia's GDP growing by 5.2% by 2023.

2. Third Party Funds and Islamic Financial Inclusion

The growth of Third Party Funds (DPK) in Islamic financial institutions reflects the increasing public confidence in the Islamic financial system. In 2023, deposits in Islamic banking increased by 10.8% compared to the previous year. In addition, Islamic financial inclusion also showed a positive trend, with the number of active customers increasing by 15% in the same year. This shows that Islamic financial institutions have succeeded in expanding the reach of financial services to the community, especially in remote areas and the lower middle economic groups.

3. Contribution to Sustainable Development Goals (SDGs)

Islamic financial institutions in Indonesia have shown a real contribution to the achievement of the Sustainable Development Goals (SDGs). Through financing directed at strategic sectors, such as education, health, and sustainable infrastructure, Islamic financial institutions support the achievement of SDG 1 (No Poverty), SDG 3 (Good Health and Wellbeing), and SDG 9 (Industry, Innovation, and Infrastructure). For example, the Green Sukuk program launched by the Indonesian government has successfully raised USD 2 billion for environmentally friendly projects, such as the construction of solar power plants and waste management.

4. The Role of Islamic Fintech in Supporting Sustainable Economy

Islamic fintech plays an important role in expanding access to finance and supporting sustainable economic growth. Islamic fintech platforms have provided microfinance services to MSMEs, which previously had difficulty accessing conventional banking services. Studies show that Islamic fintech contributes to increased financial inclusion and economic empowerment of communities, particularly in rural areas.

5. Challenges and Opportunities

While Islamic financial institutions have shown positive contributions to sustainable economic growth, there are still some challenges that need to be addressed. One of them is the low Islamic financial literacy among the public, which may hinder the adoption of Islamic financial services. In addition, there is a need to increase the capacity and innovation of Islamic financial products to meet the needs of the growing market. However, with the support of conducive regulations and collaboration between the government, industry and society, Islamic financial institutions have a great opportunity to play a strategic role in driving inclusive and sustainable economic growth. The results of this study confirm that Islamic financial institutions have a significant role in promoting sustainable economic growth in Indonesia. Through sharia-compliant financing, Islamic financial institutions not only support productive sectors, but also contribute to the achievement of sustainable development goals.

The increase in Islamic financing and deposits reflects public confidence in the Islamic financial system. In addition, the role of Islamic fintech in expanding financial access shows great potential in supporting financial inclusion and community economic empowerment. However, to maximize the role of Islamic financial institutions, concerted efforts are needed to improve Islamic financial literacy and financial product innovation. The government, regulators, and industry players need to work together in creating an ecosystem that supports the growth of the Islamic financial sector. Thus, Islamic financial institutions can become a key pillar in realizing Indonesia's inclusive, equitable, and sustainable economic growth.

D. CONCLUSIONS AND SUGGESTIONS

Based on the results of the research conducted, it can be concluded that Islamic financial institutions have a significant role in promoting sustainable economic growth in Indonesia. Islamic financing focused on productive sectors such as MSMEs, agriculture, and renewable energy has proven to be able to increase national economic output and support the achievement of sustainable development goals (SDGs). The growth of Third Party Funds (DPK) and the increase in Islamic financial inclusion indicate an increase in public confidence in the sharia-based financial system, which helps strengthen long-term economic stability.

In addition, Islamic financial instruments such as Green Sukuk and the development of Islamic Fintech are important breakthroughs in integrating Islamic financial principles with the sustainable development agenda. These findings indicate that the Islamic financial system is not only compatible with global development goals, but also offers ethical and inclusive financial solutions in addressing social, economic and environmental challenges in Indonesia. However, this success still faces challenges such as limited Islamic financial literacy, unequal access, as well as the need to strengthen regulations and innovate Islamic products that are more adaptive to market dynamics.

Government and Regulators: Need to strengthen regulations that encourage the integration of sharia principles with national development policies, including fiscal incentives for Islamic financial institutions that channel financing to green and inclusive sectors. Islamic Financial Institutions: It is recommended to increase product innovation that is environmentally and socially friendly, and expand the financing distribution network to reach more segments of society, especially in underdeveloped areas. Islamic Financial Education and Literacy: The government and Islamic finance industry players need to organize massive literacy and education programs, so that people increasingly understand the benefits and mechanisms of Islamic financial products. Strengthening Collaboration: Synergy is needed between the government, private sector, Islamic financial institutions, and civil society organizations in creating a financial ecosystem that supports the achievement of SDGs. Technology Development and Digitalization: Encouraging digitalization through the development of Islamic fintech will be a key factor in expanding access and efficiency of Islamic financial services, especially to support MSME financing and a sustainable green economy.

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