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OPTIMIZATION OF ISLAMIC FINANCE FOR DEVELOPMENT AND ECONOMIC STABILITY IN INDONESIA

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Abstract

This research examines the contribution of the Islamic financial system to national economic development, its role in preventing financial crises, and the challenges in its implementation in Indonesia. Using a qualitative descriptive approach, the study analyzes secondary data from scholarly journals, policy reports, and financial statistics. The findings indicate that Islamic finance significantly supports national development through mechanisms such as real-sector investment, inclusive financial access via microfinance, and infrastructure funding using sukuk instruments. Its principles, such as the prohibition of riba (usury) and gharar (speculation), promote financial stability, reducing systemic risk and preventing economic crises. Theoretically, the study reinforces the understanding of Islamic finance as a robust alternative system resilient to financial instability. Practically, it offers recommendations for policymakers and industry practitioners, including enhancing financial literacy, developing innovative financial products, and expanding human resource capabilities. The novelty of this study lies in its exploration of Islamic finance as both a complementary and primary tool for economic resilience and sustainable growth in Indonesia. The findings bridge theoretical perspectives with actionable strategies, providing insights into optimizing Islamic finance to achieve national economic goals.

Keywords*:* Islamic Finance, Economic Development, Financial Stability, Sukuk, Inclusive Growth

Introduction

The Islamic financial system in Indonesia has experienced rapid development and has become one of the important pillars in national development. Furthermore, with the largest Muslim population in the world, Indonesia has great potential to make the Islamic finance sector a catalyst for inclusive and sustainable national economic growth. However, despite this great potential, there are a number of challenges that need to be overcome to ensure that the Islamic financial system can make maximum contributions to economic development and stability (Naveed et al., 2013). On the other hand, the development of the Islamic financial system in Indonesia began with the enactment of Law Number 10 of 1998, which provided a legal basis for Islamic banking to grow side by side with conventional banking. This regulation is an important milestone in building an Islamic financial ecosystem that is in accordance with Islamic principles, such as the prohibition of riba (interest), gharar (uncertainty), and maysir (speculation). Various contracts, such as mudharabah (profit sharing), musharakah (business cooperation), and murabahah (buying and selling with margin), are the main foundation in financial operations. sharia in Indonesia (Saadah & Wisyananto, 2018).

In addition, the Islamic financial system is not only limited to the banking sector, but also includes the money market and the Islamic capital market. Instruments such as State Sukuk and the Sharia Interbank Money Market (PUAS) have become integral in supporting financing infrastructure development and liquidity management in the financial sector (Wijaya, 2021). The profit-sharing system in contracts such as mudharabah and musharakah provides a fair risk-sharing mechanism, so that it is able to create economic stability, especially in the face of financial crises (Saadah & Wisyananto, 2018). Furthermore, in recent years, Islamic financial literacy in Indonesia has increased sharply, from 9% in 2022 to 39% in 2023. This increase shows that public awareness of Islamic financial products and services is getting higher (Agustin & Hakim, 2022). Indonesia also managed to climb to third place in the Global Islamic Economic Indicators (GIEI) in 2023, reflecting significant progress in the development of the Islamic economic sector. Therefore, one of the advantages of the Islamic financial system is its resilience to financial crises. Sharia principles that prohibit speculation and riba directly reduce the risk of market volatility and create better stability than the conventional financial system. This makes Islamic finance a more sustainable alternative in facing global economic challenges.

In accordance with the phenomenon and gap phenomenon above, the formulation of this research problem is as follows:

- How can the Islamic financial system contribute to national development?
- How can the Islamic financial system contribute to preventing financial crises?
- What are the challenges in implementing the Islamic financial system in Indonesia?

Based on the formulation of the problem, the objectives of this study are as follows:

- Identifying the contribution of the Islamic financial system to national development
- Identify the contribution of the Islamic financial system in preventing financial crises.
- Identify.

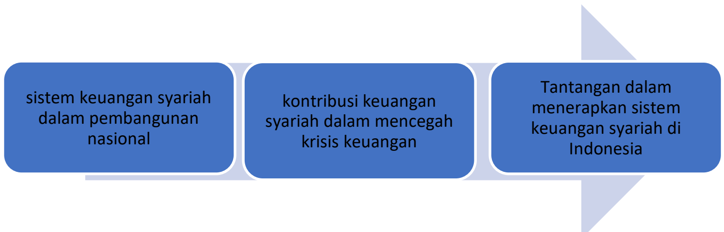
Furthermore, the practical implication of this study is that the Islamic financial system can be a driving force for national development by strengthening infrastructure financing, education, and health through sharia-based instruments such as Sukuk and profit-sharing systems, which also support economic stability. Meanwhile, the theoretical implications of this study are related to strengthening the theory that Islamic finance has advantages in reducing systemic risks and providing better stability than the conventional financial system, especially in facing global crises. In addition, the latest of this research is the role of Islamic finance not only as an alternative financial system, but also as the main instrument in supporting national development and preventing financial crises.

In the Islamic financial system, which plays an important role in national development and economic stability, the Tawhidi String Relationship (TSR) and Sharia Enterprises Theory (SET) offer a complementary conceptual framework (Nugroho et al., 2020). TSR is rooted in the principle of monotheism, while SET integrates sharia values in economic management. These two theories are not only theoretically relevant, but they also offer practical guidance for the holistic and sustainable development of Islamic finance.

Tawhidi String Relationship (TSR) is a methodology based on the concept of monotheism, the oneness of Allah SWT, which is the core of Islamic epistemology. TSR blends spiritual values with scientific knowledge to create a holistic approach in various fields, including economics and finance (Nugroho & Mariyanti, 2021). Therefore, TSR is oriented towards maslahah (welfare), with an interactive, integrative, and evolutive learning process (IIE). This approach encourages harmonious interaction between economic elements such as producers, consumers, and governments, to create a sustainable system.

In addition to TSR theory, this study also uses Sharia Enterprises Theory (SET) developed to provide a conceptual foundation for sharia accounting. This theory focuses on orientation to stakeholders, not just shareholders, by placing Allah SWT as the main owner of all resources (Nugroho et al., 2022). SET places God as the creator and sole owner, while humans act as managers. This principle binds all economic actors to be accountable to God and fellow humans. In addition, morals and ethics are key elements in this theory. Interaction between business actors must be based on moral values to create a harmonious and mutually beneficial relationship (Nugroho, 2014).

Based on the review of the Tawhid String Relationship Theory and Sharia Enterprise Theory, this study formulates a conceptual framework to understand the relationship between the Islamic financial system, its contribution to national development, financial crisis prevention, and challenges in its implementation in Indonesia which can be illustrated as follows



Source: From various sources that have been processed by the author
Figure 1: conceptual framework of the research

In accordance with Figure 1 above, the conceptual framework of this study can be described as follows.

- Islamic financial system in national development: The Islamic financial system supports investment in the real sector, which has a direct impact on economic development and job creation, as well as encouraging inclusion through instruments such as Islamic microfinance, which are accessible to a wider range of society.
- The contribution of Islamic finance in preventing financial crises: The Islamic financial system prohibits high-risk speculative activities, thereby creating a more stable financial environment. This

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system prioritizes profit-sharing contracts, which reduce credit risk and help economic stability in times of crisis.
- Challenges in implementing the Islamic financial system in Indonesia: There is a need for regulations and infrastructure that support the development of Islamic finance, in order to be able to compete and develop sustainably.

Methods

This study uses a qualitative approach with a descriptive method to analyze the contribution of the Islamic financial system to national development, financial crisis prevention, and challenges in its implementation in Indonesia. This approach aims to understand the phenomena that occur in depth through the collection and analysis of relevant secondary data. The research steps are as follows:
- Phenomenon identification: Identifying the contribution of the Islamic financial system to national development
- Data collection: Gathering relevant literature, including scientific journals, reports, and policy documents.
- Data analysis: Analyzing data with TSR and SET theories in answering problem formulations
- Drawing Conclusions: Drawing conclusions based on the results of data analysis and theory.

Results and Discussions

Sharia Financial System Contributes to National Development

The Islamic financial system has a significant role in Indonesia's economic development. The Islamic finance sector has contributed to several important aspects of national development, as follows:
- Infrastructure Financing

In the Islamic financial system, instruments such as the State Sukuk have become an important financing alternative in supporting major infrastructure projects in Indonesia. Sukuk as a sharia-based financing instrument allows the government to obtain funds in a manner that is in accordance with sharia principles. State Sukuk has succeeded in becoming one of the effective alternatives in funding infrastructure development in Indonesia, with total Sukuk emissions increasing every year (Asiva Noor Rachmayani, 2015). This shows how Islamic finance can contribute to the development of the real sector that supports physical and social development in the country.
- Financial Inclusion

Sharia microfinance also helps increase access to finance for people who were previously unreachable by conventional banks. Sharia Microfinance Institutions, especially Baitul Maal wat Tamwil (BMT), play an important role in national development efforts. Its main role is to provide access to financial services to the poor and micro businesses who have difficulty accessing formal banking services. Through the financing disbursed, BMT helps the poor to open and develop small businesses, which in turn creates jobs and increases their income (Fitriana et al., 2024). Thus, this directly supports inclusive economic development, as well as helps in Indonesia's national development.
- Strengthening the Real Sector and Investment

Islamic finance also strengthens the real sector by providing financing oriented to long-term investments. Sharia instruments such as murabahah provide solutions for entrepreneurs to obtain capital in a way that is not burdensome, focuses on the fair distribution of business proceeds, and supports economic sustainability. Based on research conducted by (Saadah & Wisyananto, 2018) it is concluded that the sharia financing system contributes greatly in diversifying investment, especially in the real sector, which plays a role in increasing Indonesia's competitiveness in the international market. Furthermore, Islamic finance also encourages investment in sectors that are not only financially profitable, but also socially and environmentally beneficial, in accordance with sharia principles.

Thus, the Islamic financial system has a significant contribution to Indonesia's national development, both in terms of infrastructure financing, financial inclusion, and strengthening the real and investment sectors. Through instruments such as State Sukuk and Islamic microfinance, the Islamic financial system is able to support large projects, increase access to finance for underserved communities, and strengthen the real sector with sustainable investment. Thus, Islamic finance not only provides financial solutions that are in accordance with sharia principles, but also plays a role in creating inclusive and sustainable development in Indonesia.

The contribution of Islamic finance in preventing financial crises

- Reducing Speculation Risk (Gharar and Maysir)

In an effort to prevent financial crises, one of the main principles in Islamic finance is the prohibition of speculation or activities that contain uncertainty (gharar) and gambling (maysir). In the Islamic financial

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system, products and transactions that are unclear or high-risk are strictly prohibited. Thus reducing the possibility of a crisis due to excessive speculation. Financial products based on opaque and speculative transactions are one of the main causes of the global financial crisis (Wijaya, 2021). Therefore, an Islamic financial system that focuses on transparency and accountability reduces the uncertainty that exists in the market.

▪ Fair Risk Sharing (Mudharabah and Musyarakah)

Islamic finance uses a profit-sharing mechanism (mudharabah and musyarakah) that encourages a fair distribution of risks between the lender and the recipient of capital. This risk sharing is what makes the Islamic financial system more resilient to economic shocks and financial crises, because all parties are involved in the benefits and losses that occur in a transparent and proportionate manner. According to (Saadah & Wisyananto, 2018), this profit-sharing system makes Islamic finance more stable and resistant to the negative impact of the global financial crisis, because risks are shared between the lender and the recipient of capital.

▪ More Prudent Financing Management

Furthermore, the Islamic financial system prioritizes financing based on the real sector, not speculation or derivative transactions. The system is more cautious in providing financing, thus reducing the risk of bad loans that could contribute to a financial crisis. According to research by (Agustin & Hakim, 2022), the stability of the Islamic financial sector is better maintained compared to the conventional financial sector, especially during the economic crisis. Because Islamic finance tends not to be exposed to high-risk practices that cause market volatility.

With the above principles, Islamic finance has proven to be more stable and resistant to global financial crises.

Challenges in Implementing the Sharia Financial System in Indonesia

▪ Regulatory and Infrastructure Limitations

The main challenge in the implementation of the Islamic financial system is the lack of comprehensive supportive regulations. Although Indonesia already has a Law on Sharia Banking, there is still uncertainty in some legal aspects related to sharia products, such as the application of sharia contracts to capital market instruments or sukuk. According to (Nugroho et al., 2020), the existence of legal uncertainty related to sharia products makes it difficult for the Islamic financial sector to compete with the more established conventional financial sector. Therefore, more comprehensive regulations and supporting infrastructure (such as more and more growing Islamic financial institutions) are needed for this sector to compete with the established conventional financial system.

▪ Lack of Islamic Financial Literacy

Furthermore, although there is an increase in Islamic financial literacy, the low literacy rate shows that the Indonesian people have not fully understood the benefits and mechanisms of the Islamic financial system. Based on a survey by (Index et al., 2022) shows that even though the number of Islamic financial literacy is increasing, the majority of people still do not fully understand existing sharia products. Therefore, there is a need to increase education and socialization about sharia products and services so that in the future more people can take advantage of this sharia financial system.

▪ Limited Competent Human Resources

In Islamic financial management, human resources are needed who have a deep understanding of sharia principles and financial practices in accordance with regulations. However, until now the number of professionals who have competence in this field is still limited, so it is an obstacle in the development of the Islamic financial system industry. (Nugroho et al., 2022) noted that the limited number of competent professionals in the field of Islamic finance hindered the development of this industry. Therefore, there is a need for more intensive training and development of human resources so that this sector can grow more rapidly and can compete with other sectors.

Based on the perspective of Tawhidi String Relationship (TSR) and Sharia Enterprises Theory (SET), the Islamic financial system has a very important role in national development and financial crisis prevention. TSR teaches that the economy must be managed with the principle of monotheism, integrating spiritual and moral values in economic interaction. on the other hand, Sharia Enterprises Theory (SET), focuses on social and moral responsibility, which emphasizes the importance of safeguarding common prosperity and managing resources fairly and ethically.

Conclusions

The Islamic financial system has a very important role in supporting Indonesia's national development. The various contributions provided include infrastructure financing through instruments such as State Sukuk, which is an alternative to financing. In addition, the Islamic financial system also encourages financial inclusion, by providing access to financing to people who have not been reached by the conventional banking sector, as done by the Sharia Microfinance Institution (BMT). This supports poverty reduction and job creation, which contributes to inclusive economic development.

Furthermore, Islamic finance also strengthens the real sector by offering financing that is more oriented towards long-term investments, diversifying investments, and encouraging investments that are not only financially profitable but also beneficial to society and the environment. Furthermore, the Islamic financial system plays a role in preventing financial crises by reducing risky speculation (*gharar and maysir*), and applying fair risk sharing through the principles of *mudharabah and musharakah*. This makes the Islamic financial system more stable and resistant to economic shocks and crises.

However, in addition to that, the challenges in its implementation are still quite large, especially related to the limitations of supporting regulations and infrastructure, the low level of Islamic financial literacy in the community, and the limitation of competent human resources in this field. Therefore, improvements in regulations, increased public education, and more intensive human resource development are needed so that the Islamic financial sector can grow rapidly and compete with the conventional financial system.

Overall, Islamic finance not only provides financial solutions that are in accordance with sharia principles, but also plays an important role in creating inclusive, sustainable development, and maintaining national economic stability.

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