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The Role of Islamic Banking in the Indonesian Economy

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Abstract

Islamic banking has played a strategic role in driving Indonesia's economic growth through the application of Islamic financial principles oriented toward justice, transparency, and inclusiveness. Unlike the conventional banking system, Islamic banking avoids practices such as *riba* (usury), *maysir* (speculation), and *gharar* (uncertainty), and implements Sharia-compliant contracts such as profit-sharing (*mudharabah*, *musyarakah*) and sales-based contracts (*murabahah*). Beyond its function as a financial intermediary, Islamic banking also actively manages social funds such as *zakat*, *infaq*, and *shadaqah*, which are distributed to improve the welfare of underprivileged communities. Furthermore, its contribution to the Micro, Small, and Medium Enterprises (MSME) sector through productive financing helps create jobs and strengthens the national economy's competitiveness. Thus, Islamic banking serves as a vital instrument in realizing an inclusive, sustainable, and just economy.

Keywords

Islamic Banking, Sharia Principles, Profit Sharing, MSMEs, Productive Financing

1. Introduction

Indonesia's economy has shown significant development, as reflected in the World Bank's 2022 classification, which placed Indonesia in the upper-middle-income country category (Sholichah, 2022). The increase in per capita income is one of the indicators of this achievement (Megamawarni & Perwithosuci, 2023). However, the threat of a global financial recession poses a serious challenge that tests the resilience of the national economy (Abdul et al., 2022). In facing these dynamics, various sectors, including banking, have been mobilized to maintain stability and promote sustainable economic growth (Apriyanti, 2018).

Banking plays a crucial role as the financial backbone of both society and the state. These institutions are responsible for collecting funds from the public, managing them, and distributing them in the form of financing or investment to support various needs, ranging from consumption and production to the distribution of goods and services (Rysaldi & Santoso, 2022). In Indonesia, banking operates not only under the conventional system but also under the Sharia (Islamic) system based on Islamic principles. Sharia banking offers financial solutions free from *riba* (interest) and practices that contradict Islamic law, making it a relevant alternative for the predominantly Muslim population in Indonesia (Bangsawan, 2017).

Sharia banking has unique characteristics compared to conventional banks. Instead of using an interest-based system, which is considered *riba* in Islam, Sharia banks apply transparent contracts, such as profit-sharing and sale-purchase agreements (Nst & Nurhayati, 2022). These contracts ensure that the profits gained do not harm any party and are based on mutual agreements (Luntajo, 2021). Through this approach, Sharia banking not only supports economic activities but also promotes justice and income distribution, which is one of the pressing needs in Indonesia's current economy (Apriyanti, 2018).

The existence of Sharia banking in Indonesia has received official recognition through a strong legal foundation. The Banking Act No. 7 of 1992, later amended by Act No. 10 of 1998, provides legitimacy for the operations of Sharia banks (Rahmawati et al., 2022). This recognition strengthens the foundation of Sharia banking to contribute to national economic development (Megamawarni & Perwithosuci, 2023). Amid growing public pressure to move away from a capitalist economic system, which is increasingly seen as less relevant, toward a Sharia-based system, Islamic banking emerges as a first step toward a gradual transformation (Bangsawan, 2017).

Through this article, we will outline the tangible role of Sharia banking in promoting a more inclusive and equitable economic growth in Indonesia. By upholding Sharia principles, Islamic banking not only serves as a financing provider but also plays a role in economic redistribution through the management of *zakat* (almsgiving), *infaq* (voluntary charity), and *shadaqah* (charity). These efforts are expected to support community welfare—which is a benchmark of a country's economic success—while also creating a healthy and sustainable economic environment.

2. Result and Discussion

2.1 Principles and Operations of Islamic Banking

Sharia banking, as regulated in Law No. 10 of 1998, is defined as a business entity that collects public funds in the form of deposits and distributes them in the form of financing or investment to improve the standard of living of the community (Haikal & Efendi, 2024). Unlike conventional banks that rely on interest as a source of profit, Sharia banking operates based on Islamic principles that prohibit *riba* (interest), *maysir* (speculation), *gharar* (uncertainty), *zalim* (injustice), and all practices that contradict Islamic teachings (Haikal & Efendi, 2024). These principles make Sharia banking unique, as every transaction must be based on a clear contract agreed upon by both parties, ensuring transparency and fairness (Febriadi, 2017).

One of the main mechanisms in Sharia banking is the profit-sharing system. In this system, profits derived from financing or investment are shared between the bank and the customer

according to a predetermined ratio agreed upon at the beginning (Fitriani et al., 2023). For instance, if a customer applies for financing to run a business, the bank will provide the funds and share in the profits generated by the business without burdening the customer with fixed interest payments. This system not only encourages mutually beneficial cooperation but also reduces the risk of excessive financial burdens for customers, especially in times of economic uncertainty (Abubakar & Handayani, 2018).

In addition to the profit-sharing system, Sharia banking also offers solutions through sale and purchase schemes, such as the *murabahah* contract (Khusna et al., 2021). In this scheme, a customer in need of a specific item—such as a vehicle or business equipment—can request the Sharia bank to purchase the item. The bank then sells the item to the customer at the original purchase price plus a mutually agreed margin, with payments made in installments over a specific period, for example, from one month to one year (Ryan & Kholis, 2024). This contract ensures that transactions are conducted transparently, with clearly stated prices and profits from the outset, thus eliminating the element of uncertainty prohibited in Sharia (Khusna et al., 2021).

Sharia banks are also required to adhere to the principles of prudence, confidentiality, and trust, as stipulated in banking regulations (Rahmawati et al., 2022). Based on these principles, Sharia banking functions not only as a financial service provider but also as a partner that supports the community's economic activities (Riziqiyah & Prayogi, 2022). These operational principles form the foundation for Sharia banks to generate positive impacts, both on an individual and national scale, which will be further discussed in the following section.

2.2 Contribution of Islamic Banking to the Indonesian Economy

Sharia banking has demonstrated a tangible contribution to driving Indonesia's economic growth, particularly through an approach centered on justice and equitable income distribution (Tarique et al., 2021). One of its key roles is in managing social funds, such as *zakat*, *infaq*, and *shadaqah* (Nugraheni & Muhammad, 2023). These funds are collected from the public and distributed to those in need, such as underprivileged communities, to meet their basic needs. This well-targeted distribution not only helps reduce economic disparity but also boosts people's purchasing power, ultimately strengthening the economic cycle (Bayinah, 2017).

In addition, Sharia banking plays a role in increasing the efficiency of fund mobilization. Funds collected from customer deposits are utilized for productive financing, such as investments in small and medium enterprises (SMEs), which are the backbone of Indonesia's economy (Kara, 2013). By providing Sharia-compliant financing, Islamic banks help entrepreneurs grow their businesses without being burdened by loan interest (Mukhibad et al., 2019). This creates a domino effect, where SME growth leads to job creation, increased household income, and ultimately accelerates national economic growth (Hamid et al., 2017).

Sharia banking also supports the development of transparent social and business networks. Through Sharia investment products such as *mudharabah* and *musyarakah*, Islamic banks facilitate partnerships between investors and business actors, emphasizing the principles of fairness and profit sharing (Asiyah et al., 2019). Although Sharia banks cannot guarantee returns due to the nature of investment being dependent on business outcomes, they are required to provide fair returns to customers (Muhibuddin et al., 2023). This approach not only strengthens public trust in the Sharia financial system but also encourages active participation in productive

economic activities (Abbas et al., 2023). The presence of Sharia banking in Indonesia—which has a majority Muslim population—has shown significant growth year by year and has had a positive impact on public welfare. By upholding Sharia principles, Islamic banking not only supports economic stability but also realizes a vision of an inclusive and just economy, ultimately serving as a benchmark for the success of national development.

3. Conclusion

Islamic banking has transformed into a vital pillar in supporting Indonesia's economic growth and stability, especially amidst global economic challenges and the need for a fair financial system. Grounded in Sharia principles that prohibit *riba* (interest), *maysir* (speculation), *gharar* (uncertainty), and practices inconsistent with Islamic law, Islamic banking offers a unique approach through transparent contracts such as profit-sharing and sale-based agreements. These mechanisms not only ensure fairness in financial transactions but also strengthen public trust in financial institutions aligned with Islamic values. Furthermore, Islamic banking makes a real contribution to achieving an inclusive economy through equitable income distribution and efficient fund mobilization. The management of social funds such as *zakat*, *infaq*, and *shadaqah* has helped underprivileged communities meet their basic needs, while also boosting purchasing power and driving the economy forward. At the same time, productive financing for small and medium-sized enterprises, as well as the formation of Sharia-based business networks, has created sustainable economic opportunities, supported job creation, and improved overall societal welfare.

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