The Role of Islamic Economics on Regional Economic Development: A Case in Indonesia

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The monetary crisis that shocked Indonesia past years ago has alerted many parties to the importance of strong economic fundamentals and empowerment of the people’s economy. A monetary sector that is not supported by a strong real sector is suspected of harboring a time bomb waiting for a moment to collapse the achievements of national economic development. The monetary crisis also made us realize the importance of empowering the people’s economy. A development paradigm that does not leave economic growth entirely to the role of large entrepreneurs, but to all parties, especially micro, small and medium enterprises (MSMEs). This study tries to see the important role of Islamic economics in regional economic development.

Keywords: Islamic economics, Regional economic, Economic development
INTRODUCTION

One of the messages of reformasi was to reduce central hegemony over the regions through centralization of policies in various fields. Reform mandates the need to decentralize development by giving greater confidence to the regions. Therefore, on January 1, 2001, Regional Autonomy (OTDA) came into effect.

Regional Autonomy is a political decision that turns bureaucratic centralized governance into participatory decentralized governance. Law No. 22/1999 on Regional Government has created a new paradigm in the implementation of regional autonomy, which places full, broad, and responsible autonomy on regencies and cities. This change is intended to increase the effectiveness of community services, foster a spirit of democratization and the implementation of sustainable regional development, and furthermore is expected to ensure the achievement of a balance of authority and responsibility between the center and the regions.

On the other hand, after the 1997-1998 monetary crisis, the Islamic economic movement seemed to receive a blessing in disguise. Although Islamic economics in Indonesia had started in the early 1990s, it was slow until the crisis. The national Islamic economy seems to have found momentum since 1999 until now. Public knowledge about Islamic economics is also growing, including in the regions. Along with that, the Islamic financial industry has experienced accelerated growth. Islamic financial institutions are also expanding to the regions.

The question is, what is the role of Islamic economics in regional development? Before answering that question, let’s take a moment to look at its development in the country.

Development of Sharia Economics in Indonesia

In simple terms, these developments are grouped into the development of the Islamic financial industry and the development of the non-financial Islamic economy. The Islamic financial industry can relatively be seen and measured its development through existing financial data, while non-financial ones need deeper research to find out.

In the banking sector, as of May 2007 there were three Islamic Commercial Banks (BUS), 23 Islamic business units of conventional banks, 532 branch offices (including Sub-Branch Offices (KCP), Islamic Service Units (UPS), and Cash Offices (KK)), and 106 Islamic People's Credit Banks (BPRS). Islamic banking assets as of May 2007 were more than Rp. 29 trillion with total third-party funds (DPK) reaching 22.5 trillion. Although Islamic banking assets only reached 1.63 percent and third-party funds collected only reached 1.69% of total national banking assets (as of April 2007), the growth is quite rapid and promising. It is projected that in 2008, the share of the Islamic banking industry is expected to reach 5 percent of the total national banking industry. To see several studies related to Islamic banks in Indonesia, you can see the study of Izza (2022), Sari et al., (2016), Maulida & Rusydiana (2022), and Cahyani (2019).

In the capital market sector, Islamic financial products such as mutual funds and Islamic bonds also continue to increase. Currently, there are more than 20 Islamic mutual funds with total managed funds reaching 638.8 billion rupiah. The number of Islamic bonds has reached 17 with an issuance value of Rp2.209 trillion.

In the stock sector, on July 3, 2000 BEJ launched the Jakarta Islamic Index (JII). The JII, which is a sharia-based stock price index, consists of 30 stocks of issuers that are considered to have met the principles of sharia. Data at the end of June 2005 showed a market capitalization value of Rp325.90 trillion or 43% of the total market capitalization value at BEJ. Meanwhile, the trading volume of JII shares amounted to 348.9 million shares or 39% of the total stock trading volume and the trading value of JII shares amounted to Rp322.3 billion or 42% of the total stock trading value. The most awaited role of the government by sharia finance players in Indonesia is the issuance of the Sharia Banking Law and the Sharia Government Securities Law (SBSN). Updated studies on this sector can be seen at Prakoso (2022), Muharam et al., (2019), Rusydiana & Prakoso (2021), and Nugroho (2020).

In the insurance sector, by August 2006, there were more than 30 companies offering sharia insurance and reinsurance products. However, the market share of Islamic insurance is still only about 1% of the national insurance market. The multifinance sector is also growing with the increasing interest of several multifinance companies in sharia financing. These numbers are expected to increase further as demand and rate of return of the respective Islamic financial products increase.

In the micro sector, the development is quite encouraging. Islamic microfinance institutions such as Baitul Mal wa Tamwil (BMT) continue to grow, as do...
their assets and disbursed financing. Other microfinance products are now being developed, such as micro-insurance and possibly micro-mutual funds. Research on Islamic microfinance in Indonesia can be seen at As-Salafiyyah & Kartikawati (2022), Sari (2022) and Fianto & Gan (2017).

Non-Financial Side

The Islamic financial industry is one part of the Islamic economic building. Similar to conventional economics, Islamic economics also recognizes macro and microeconomic aspects. However, what is more important than that is how people can behave sharia economically such as in terms of consumption behavior, giving behavior (generosity), and so on. The business behavior of Muslim entrepreneurs is also included in the target of the Islamic economic movement in Indonesia.

Although it seems a bit slow, the non-financial side of this economic activity is also growing. This is marked by increasing public awareness of Islamic consumption behavior, an increasing level of generosity marked by the increase in zakat, infaq, waqaf, and sadaqah funds collected by the agencies and institutions managing these funds. In addition, new sharia disciplines such as sharia marketing and sharia management have also emerged.

Driving Factors

The development of Islamic economics in Indonesia is inseparable from several driving factors. In simple terms, these factors are categorized into external and internal factors.

External factors are causes that come from abroad, in the form of the development of Islamic economics in other countries, whether they have a majority Muslim population or not. These countries have developed Islamic economics after the realization of the need for a new identity in their economy. This awareness then 'spread' to other countries and eventually reached Indonesia.

Internal factors include the fact that Indonesia is destined to be the country with the largest Muslim population in the world. This fact raises awareness in some scholars and economic practitioners about the need for an economy that is in accordance with Islamic values to be run by Muslim communities in Indonesia.

Of course, business factors also come into play. The improvement in the "relationship" between Islam and the state towards the end of the last millennium brought fresh air to the development of the economy with sharia principles.

The increasing religiousness of society is also a driving factor for the development of Islamic economics in Indonesia. The emergence of an educated and religious urban Muslim middle class brings new enthusiasm and hope for the Islamic finance industry. They have an awareness that religion is not just prayer, fasting, and other mahdah worship. However, religion must be applied holistically in every aspect of life, including economics.

The next factor is the experience that the Islamic financial system seemed strong enough to face the 1997-1998 monetary crisis. Islamic banks were still able to stand firm when the "storm" hit and destroyed the financial industry in Indonesia. In addition, the factor of business rationality also contributed to the growth of the Islamic economy. For groups of people who are not able to accept the Islamic financial system based on personal attachment to Islam, the profit factor encourages them to enter the Islamic business.

ANALYSIS

Implications for National Economic Development

There are at least three things that the Islamic economy contributes to the national economy. First, Islamic economics contributes to the development of the real sector. The prohibition of bank interest and speculation requires that funds managed by Islamic financial institutions be channeled to the real sector.

Second, the Islamic economy through the Islamic finance industry has contributed to attracting foreign investment to Indonesia, especially from Middle Eastern countries. The existence of various Islamic investment opportunities in Indonesia has attracted investors from these petro-dollar countries to invest in Indonesia. Their interest continues to grow and it is precisely our country that seems unprepared to accept their presence due to various 'acute diseases' that are not investor friendly, such as bureaucratic complexity, security factors, corruption, and so on.

Third, the Islamic economic movement encourages ethical economic behavior in Indonesian society. Islamic economics is an economy that favors truth and justice and rejects all forms of bad economic behavior such as the usury system, speculation, and uncertainty (gharar).
Banking Industry and Regional Economic Development

The problem that is often complained about by MSMEs is the difficulty of obtaining credit or financing from banks. There are many reasons why banks are "rather stingy" in lending, such as the prudential principles that must be adhered to by banks so that business people are divided into two, bankable and non-bankable. Unfortunately, most MSMEs fall into this second category. In addition to this issue, Bank Indonesia has long issued SBIs (Bank Indonesia Certificates) that promise attractive interest rates to the banking world to store funds collected from regions throughout Indonesia. The determination of an attractive interest rate has always been used as an easy reason for the banking world not to channel its funds as credit to the business world. The SBI interest rate once reached 17.5% per year, which of course became a very strong reason for each bank to send third-party funds collected in banks in regions throughout Indonesia to be sent to Jakarta. This is the factor that causes the low value of LDR (Loan Deposit Ratio) in each region, so that when many poor / disadvantaged areas cry out for cheap and easy credit, the banking funds collected in such areas are actually sent to the head office of the bank concerned. Banks that send more funds from the regions to the head office always find it easy to explain this wrong behavior because of the "difficulty of identifying" bankable economic and business projects that can be funded, when the truth is that these banks feel safer using the funds raised by buying SBIs. It is not surprising that regional development funds that should be used for regional economic development are also invested in SBIs because of the uncreativity of local governments and their bankers to find and stimulate economic potential in their regions. According to one source, the amount of decentralization funds invested in SBIs is unmitigated, which is around Rp43 trillion or 19.5 percent of the total funds distributed to regions in the form of decentralization funds worth a total of Rp220.07 trillion.

It is clear from this analysis that banking in Indonesia is nothing but a profit-seeking institution, and not an agent of development at all. If our banks are more companies that prioritize interest income, in order to pay attractive deposit interest services to depositors, even including additional attractive prizes such as cars and luxury houses, then it is very difficult to make banks a driver of people's economic activities. As a result, banks are also unlikely to play a role as institutions that support major efforts to eradicate poverty.

Islamic Banking as an Alternative

As is well known, Islamic finance is one that does not recognize the interest regime. Instead, Islamic economics offers mutually beneficial cooperation between the owner of capital (shahibul mal) and the entrepreneur (mudharib) through mudharabah or musyarakah schemes. In addition, the birth of Islamic economics, among others, is aimed at mobilizing the economy of the people, most of whom are in the lower middle class. Therefore, Islamic banking as a form of implementation of the concept of Islamic economics also has the same spirit of siding with the real sector, especially middle to lower class businesses.

Since Islamic banks are interest-free banks, they cannot expect SBI interest like other conventional banks. Likewise, idle money in Islamic banks cannot be invested in other interest-based financial instruments. Therefore, Islamic banks must think hard to channel the funds they hold into non-interest sectors that are based on profit sharing, margins, or fees.

The performance of Islamic banking so far shows the distribution of funds collected from the public to businesses that need funds. Data released by Bank Indonesia always shows that the ratio of financing channeled by Islamic banks to third party funds (DPK) or FDR is always around 100 percent or even more. This means that the intermediation function carried out by Islamic banking is running well. The problem is that the funds raised by the Islamic financial industry are still very small compared to the total assets of national banks. Until now, the ratio of Islamic banking assets to total national banking assets has not managed to break the 2 percent mark. This means that even though the FDR is high, but because the figure is still very small, the effect on the national economy has not been felt, although there is a lot of evidence in the field that makes us breathe a little easier.

The spirit of the birth of the Islamic finance industry in addition to fulfilling the public's thirst for Islamic financial products, is also to help reduce poverty levels in the community by raising people's economic levels to a better direction. Therefore, in Islamic finance, Islamic microfinance institutions (BMT) are recognized as the spearhead that is in direct contact with small business people and entrepreneurs. Islamic banks that cannot touch this lowest level of business due to various regulations that must be
adhered to can partner with existing BMTs and BPRS in channeling financing and collecting public funds.

The development of Islamic Banks in Indonesia clearly aims to implement ethical banking, which is not just selling banking services or products by charging interest, but "working with clients" to improve the welfare or improve the economic life of clients. In Indonesia, village banks such as BKK in Central Java or Lumbung Piteh Nagari in West Sumatra, which were formed from the bottom with clients, are the ethical banks in question. Unfortunately, since banking liberalization in 1983, 1988 and 1992, such banks have been "killed" or "dwarfed". The experience of the 1997/1998 banking crisis, which has not yet been resolved, has provided a bitter, hopefully valuable, lesson for the Indonesian banking world. The lesson is to no longer develop a capitalistic banking system that prioritizes the business interests of bank owners, not the interests of clients and the wider community. The issue on Islamic banking as an alternative, please also see Pesendorfer & Lehner (2016), and Raquib (2011).

Implications of Sharia Economics for Regional Economic Development

The Islamic finance industry in Indonesia is approaching 20 years of age. Many things have been done by the Indonesian sharia economic community to develop this alternative economic system which is believed to be more just and prosperous. Supporting institutions are also growing, including Islamic economic education institutions that already exist in almost all provinces. Islamic financial institutions have also been almost evenly distributed throughout the archipelago. All that remains now is to develop the Islamic financial industry and its supporting institutions along with legislation that provides signs for Islamic economic actors.

If this is the case, how does the Islamic economy affect regional economic development? To answer this question requires a more in-depth study. What we can put forward here are some indicators that can show the role of Islamic economics on regional development.

The first indicator is the increasing number of national Islamic banks that open branches in the regions. The opening of these branch offices certainly has implications for local economic development because of the intermediation activities carried out by Islamic banking, namely channeling funds from surplus parties to shortage parties.

In addition to national Islamic banks, both Islamic commercial banks (BUS) and Islamic business units (UUS), regional development banks are also busy opening their Islamic business units. Currently, there are 11 Regional Development Banks (BPD) that have opened UUS and will be followed by other BPDs. This development is expected to increase the stretch of regional economic development through the Islamic financial system.

The next thing that is no less important is the role played by Islamic micro and small financial institutions such as BMT, Sharia Cooperatives, and BPRS which are also almost evenly distributed throughout the country. Of course, there have been many roles played by these Islamic financial institutions and there have also been many influences on the improvement of the regional economy.

These institutions are diligently socializing sharia economics to the public. Islamic economics is an economic concept that teaches entrepreneurship and ethical investment to the community. Thus, people are educated to become true entrepreneurs who strive to raise their standard of living and other communities to a better direction.

What is lacking now is support from the government for the Islamic economy itself. Islamic economics is still underestimated and not made the main thing. Even though there is already a lot of evidence that shows the role of Islamic economics in lifting the people's economy. For this reason, we need greater support from the government for the development of Islamic economics in the country.

Perhaps we need to learn a lot from the Malaysian government, which provides great support for the Islamic economy there. No wonder, we are still far behind the neighboring country in the field of Islamic finance.

CONCLUSION

One of the keys to successful governance in facing the global era is to develop regional autonomy and fiscal decentralization. Thus, it is expected that a policy formulation mechanism that accommodates the aspirations of local communities can be built, so that the existence of regional autonomy will be more meaningful and will ultimately improve the quality of service to the community.

In line with that, the Regional Government must be able to utilize the potential of regional resources optimally. With the decreasing level of dependence of the Regional Government on the
Central Government, the Region is required to be able to improve the professionalism of the Regional Government apparatus, implement regional financial accounting reform and regional financial management, implement strategic planning correctly, so that it will spur the realization of real, dynamic, harmonious, and responsible regional autonomy, which can strengthen the regional economic base, and strengthen national unity in welcoming the era of the global economy.

Islamic economics has proven its contribution to regional economic development. Although still relatively small, it is not worthless at all. Islamic economics has taught the importance of independence, hard work, entrepreneurial spirit, good governance, and the application of sharia values in the economy. All of these things are needed to achieve the ideals of the 1945 Proclamation for the welfare of the nation’s life, which is united, sovereign, just and prosperous.

Hopefully.

REFERENCES


