

## Contribution of Indonesian Sharia Banking to Sustainable Economic Development Until 2023

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#### ABSTRACT

Sharia banking as one of the pillars of the country's economy has an important role in realizing sustainable economic development. This article aims to present empirical facts about the contribution of Indonesian sharia banking in realizing a sustainable economy through data collected from various sources, academic references and facts in the field obtained from direct observation. News records published by trusted institutions, company activity reports and financial reports are considered important sources in this research. The method used in preparing this article is descriptive qualitative with secondary and primary data from various relevant sources. The research results show that the important role of sharia banking in Indonesia is not only contained in government regulations, the central bank, the financial services authority, agreements, and policy directions on paper but has become a real action in the context of realizing a developed Indonesia in 2045. Improvement and development of programs It is also discussed so that it can become a reference for achieving sustainable economic goals in harmony with current digital technology

**Keywords:** Digital Technology, Sharia Banking, Sustainable Economy

## **INTRODUCTION**

The deteriorating condition of nature across various sectors is at the root of the problem for the sustainability of living organisms in the future. This concern has garnered attention from governments and activists worldwide, leading them to participate in preserving the environment. The form of this participation is defined by the UN in a sustainable development program involving all member countries.

Each country that signs up for this sustainable development commitment is responsible for following up and taking concrete actions within their borders. Derived regulations are then formulated by member countries in accordance with agreed-upon indicators, namely in the economic, environmental, and social domains.

Concrete actions for environmental sustainability involve government roles in issuing regulations to protect nature, while activists actively work in the field to safeguard protected forest areas, cleanliness, and environmental order. In the economic sphere, there's active campaigning within the creative industry for the use of environmentally friendly materials, aiming for income generation to ensure societal well-being and reduce unemployment with governmental support. Meanwhile, in the social realm, efforts are made to reduce unemployment rates and enhance workforce productivity. Infrastructure development continues for fuel and communication efficiency, alongside crucial advancements in education to support national development, aligned with Indonesia's government-declared SDGs program (Hannase, Arifah, & Annas, 2020).

Indonesia is one of the countries aligned with the UN to maintain global order and support sustainable development. In the financial and banking sector, Indonesia actively participates by implementing sustainable finance ideas. Since 2012, Indonesia has been a member and a founding entity of the Sustainable Banking Network (SBN). Subsequently, the Financial Services Authority (OJK) prepared a roadmap for sustainable finance phase 1, followed by the ratification of the Paris Agreement under Law No. 16 of 2016. In 2017, OJK issued regulations No. 51 and 60, forming the basis for sustainable financial regulations and green bonds.

The height and sustainability of economic growth are among the primary requirements for the continuity of economic development and the means to enhance well-being. One of the efforts undertaken by the Indonesian government to achieve economic development is by bolstering the economy at the regional level. Regional governments are tasked with monitoring the progress and issues occurring in each area through regional autonomy and granting special autonomy to specific regions like Aceh, Yogyakarta, and Papua (Rokhman, 2023).

From the data regarding the issues and potentials held by each region, the Indonesian government, represented by the Central Statistics Agency, accumulates national data. This data is computed and used as an indicator for subsequent decision-making, encompassing environmental, economic, and social aspects. Subsequently, this data is compared with indicators specified in various regulations, enabling the measurement of Indonesia's achievements in supporting sustainable development.

The 2022 Sustainable Development Goals (SDGs) indicator document mentions 17 points, 169 targets, and 289 indicators prioritized by Indonesia to support global sustainable development. Goal number 8 specifically details "promoting inclusive and sustainable economic growth, employment, and decent work for all", highlighting indicators most related to the banking system (Badan Pusat Statistik [BPS], 2023).

As a key pillar of the economy, the banking industry plays a crucial role in realizing sustainable economic development in Indonesia. Acting as a supporter of the country's economic growth and stability, the banking sector significantly influences monetary policies and credit allocation for real sector growth. Indonesia currently operates under a dual banking system, comprising conventional and Shariah banking, each with distinct operational systems and economic impacts.

Although the theoretical function of Shariah banking is not drastically different from conventional banking as a financial intermediary institution, their differing operational principles result in varied ways of supporting sustainable economic development.

In Indonesia, the impact of Islamic economic growth is becoming increasingly evident, seen through the rise in Sharia-compliant investment products and financing options, including government Sharia bonds, cooperatives, and private financing. The philosophy of Islamic financial literacy has elucidated to the general public how financial literacy can serve as a beneficial instrument to transform irrational human behavior into rational behavior, such as utilizing money for savings, investments, protection, and fulfilling basic needs while maintaining ecosystem sustainability (Mujiatun, 2023).

The growing awareness among the populace regarding Sharia financial products demonstrates the integration of knowledge and the merits of the Sharia financial system. This signifies the increasing consciousness, particularly among Muslims, to apply economic principles taught by religion in social life while simultaneously preserving the environment. The current situation, where the capitalization of Sharia financial assets still lags significantly behind conventional financial assets, is not evidence of defeat, considering that the Sharia financial system is still considered new and continues to evolve to be widely recognized and eventually become "conventional" in due course.

This article aims to uncover the contribution of Indonesia's Shariah banking to sustainable economic development, supported by data. Despite its perceived small market share, the actual level of contribution might be substantial. Researchers found an interesting fact that the liquidity per rupiah asset created by Shariah banks surpassed conventional banks before and during the pandemic (Viverita, Bustaman, Danarsari, & Nugrahani, 2022). However, there might still be many programs requiring attention and substantial efforts to enhance their future role.

## **LITERATURE REVIEW**

Several studies on support for sustainable development goals have been conducted, indicating that Islamic banking has been striving to its maximum capacity as an intermediary institution and an economic growth supporter. In many countries, the quality of competition and banking stability continues to rise, propelling long-term economic growth. Through funding sectors, the banking industry generates well-organized investment funds (Abuselidze, 2021). Such sound financial resources have the potential to be utilized in supporting sustainable development.

Developing countries like China, Brazil, India, and Bangladesh have established primary frameworks for managing environmental, social, and market risks towards a green economy. Policy frameworks have been designed to guide the banking system in implementing roadmaps for achieving sustainable development (Huy, An, Anh, & Nung, 2021).

In practice, the current banking world operates under a dual system: conventional and Shariah. Financing within the Shariah banking system has been acknowledged by the banking world as an alternative choice besides the conventional financial system and presents opportunities due to its adherence to Shariah principles (Khavarinezhad, Biancone, & Jafari-Sadeghi, 2021).

The Sustainable Development Goals (SDGs) align with Islamic values and teachings. Islamic perspectives and values reinforce moral consciousness, encourage pro-social behavior, and instill environmental ethics that can help influence our approach to sustainable development challenges (Ismail & Shaikh, 2017).

Green financial systems are positioned within the financial industry to support sustainable economic development and environmental protection. Financial industries like banks can play a relevant role in promoting environmental conservation by financing projects responsible for environmental and social concerns (Stojanović, 2020).

Islamic banking can support sustainable development as an ethical, socially responsible banking system that does not negatively impact the environment. This banking system is dedicated to humanity and global society. The Islamic banking system holds great potential to contribute to a sustainable financing ecosystem for a green economy and a world conducive to all creatures (Uddin & Ahmmed, 2018).

Even if the capitalization figures for Islamic banking in developing countries like Indonesia and many other nations are smaller compared to conventional banking asset values, it does not necessarily mean their economic impact is lesser. Previous research results indicate that Islamic banks create the highest liquidity per unit asset under a non-fat cat approach throughout all periods. This finding is consistent with the characteristics of Islamic banks focusing on balance sheet-based business models and infrequently engaging in off-balance ventures (Viverita, Bustaman, Danarsari, & Nugrahani, 2022). Research conducted by Rio in 2014 discussed the efficiency comparison between conventional and Shariah banks, stating that the presence of Islamic banks can mitigate the effects of a global crisis (Novandra, 2014).

As a developing nation, Indonesia greatly requires infrastructure development support in transportation, healthcare, and education to drive other sectors of life (Hannase, Arifah, & Annas, 2020). This infrastructure development could serve as a gateway for both conventional and Shariah banking industries to support sustainable financial plans.

Economic and social sustainable development goals applied by the banking industry directly relate to customer trust in banking, pricing determination, image, and loyalty (Stauropoulou, Sardianou, Malindretos, Evangelinos, & Nikolaou, 2023). If a customer's chosen bank is perceived as upholding fairness in pricing and supporting social welfare and environmental sustainability, the customer's trust automatically strengthens.

In general, both conventional and Shariah banks are concerned with efforts to improve societal welfare. Research by Ghoniyah and Hartono (2020) reveals a negative relationship between Shariah bank profits and SDGs, indicating the Shariah bank's orientation towards achieving social goals.

However, Shariah banks in Indonesia still need to achieve high profits to attain excellence and stability as they are still in a developmental phase and far below the market share of conventional banks. In practice, Shariah banks disburse financing in the real sector through *murabahah* contracts, generating margins and investments through profit-sharing systems. Meanwhile, conventional banks applying interest-based systems in their loans tend to invest funds in financial sectors, money markets, and foreign exchanges. This fact demonstrates that Islamic banking has contributed more significantly in the real sector compared to conventional banks (Ghonyah & Hartono, 2020).

## RESEARCH METHOD

The method used in this research is qualitative descriptive, utilizing both secondary and primary data from various relevant sources. This study employs a normative juridical approach, prioritizing qualitative analysis of legal sources including legislation, government regulations, financial authorities, as well as secondary data such as journals, previous research, and progress reports.

## RESULTS

Sustainable Finance in Indonesia is defined as comprehensive support from the financial services industry for sustainable growth derived from the alignment of economic, social, and environmental interests (Otoritas Jasa Keuangan, 2017).

From a Shariah principle's perspective, sustainable financial business aligns with the values and objectives of Islamic law in all fields, including economics (*maqasid Shariah*). The three domains in the objective of sustainable development—social, economic, and environmental—are defined as people, profit, and planet in the concept of sustainable finance. When juxtaposed with *maqasid Shariah*, the principle of people corresponds to the concept of preserving religion, safeguarding life, and intellect. The profit principle aligns with the concept of preserving wealth, and the planet principle corresponds to the goal of preserving lineage in Shariah concepts.

In principle, Islamic banking systems should play a more effective and active role in supporting the country's economic development (Eti, Kalkavan, Dinçer, & Yüksel, 2019). This can only be achieved if Islamic banking continues to grow supported by regulations and opportunities across all related sectors.

Up until 2023, the implementation of support for sustainable development goals is guided by POJK Number 51/POJK.03/2017 regarding the application of sustainable finance (Otoritas Jasa Keuangan, 2017). In the technical guidelines of the OJK regulations, the implementation of sustainable finance is mandated to adopt and internalize 8 principles in the vision, mission, strategic plans, and organizational work programs, they are (1) Responsible investment principle; (2) Principles of sustainable business strategy and practice; (3) Principles of managing social and environmental risks; (4) Governance principle; (5) Principle of informative communication; (6) Inclusive principle; (7) Priority development principle for leading sectors; and (8) Principles of coordination and collaboration.

Meanwhile, based on Article 7 paragraph 1 of the Sustainable Finance POJK, the priority of implementing sustainable finance includes three aspects as follows (1) Development of sustainable financial products/services, whether in financing, investment, or project placements aligned with sustainable development goals; (2) Enhancement of internal capacities within companies or financial institutions; and (3) Adjustment of organization, risk management, governance, and operational procedural standards in accordance with the 8 principles of sustainable finance.

According to the statistical data released by the OJK in June 2023, there are currently 13 Shariah Commercial Banks and 20 Shariah Business Units operating in Indonesia. In this study, we collected sustainability report data from the five largest Shariah Commercial Banks meeting the criteria of having more than 20 branch offices. Selecting data from banks with a minimum of 20 branch offices aims to represent the real conditions of Shariah banking in Indonesia. The five banks currently owning more than 20 branch offices are Bank Aceh Syariah, Regional Government Bank of Riau Islands Syariah, Bank Muamalat Indonesia, Bank Syariah Indonesia, and Bank Mega Syariah.

This research compares and qualitatively analyzes the sustainability reports of these Shariah banks with POJK 51 of 2017. As per the regulations, the priority of sustainable finance encompasses economic, environmental, and social aspects.

The sustainability financial reports presented by Shariah banks in Indonesia have addressed these three aspects and provided detailed explanations of achievements in each reporting period. However, there is a unique aspect in the sustainability financial reports of Shariah Commercial Banks that must be submitted alongside their annual financial reports to the OJK. It is noted that the scoring for each aspect in these reports differs among banks.

This indicates that regulations concerning sustainability reports do not yet have clear standards for all Shariah Commercial Banks in Indonesia, aligning with the conclusion that regulations pertaining to sustainable development goals are scattered and partial (Abubakar & Handayani, 2019).

In the economic aspect of sustainability financial reporting, Bank Syariah Indonesia (Bank Syariah Indonesia, 2022), Bank Aceh Syariah (Bank Aceh, 2022), and Bank Mega Syariah Indonesia (Bank Mega Syariah Indonesia, 2022) include SME financing as a reporting point, while this point is absent in the sustainability financial reports of BRK Syariah (BRK Syariah, 2022) and Bank Muamalat Indonesia (Bank Muamalat, 2022). Green financing or financing products meeting sustainable business criteria is mentioned in the sustainability reports of Bank Mega Syariah Indonesia, BRK Syariah, and BSI. However, there is no report regarding sustainable business-based financing in the reports held by Bank Muamalat Indonesia and Bank Aceh Syariah.

Regarding the environmental aspect, sustainability financial reports of all Shariah banks mention the total use of fossil fuels and energy consumption during a reporting period. This illustrates that Shariah banking has been striving for energy efficiency before fully transitioning to emission-free renewable energy sources. Besides energy conservation in operational systems, Shariah banking also endeavors to reduce carbon footprints and consumption of disposable goods to maintain a healthy ecosystem.

Technological advancements and the digital trend have significantly helped companies reduce paper waste, ultimately preventing deforestation. This simultaneously facilitates customers and the wider community in accessing necessary information without significant costs or other resource expenditures.

In the social aspect, sustainability financial reports describe company support activities for the careers and performance of employees. Special training and education for employees have been conducted by each Shariah Commercial Bank to enhance employee understanding and competence in implementing sustainable finance concepts. Solid understanding and competence among employees can decrease turnover rates, maintaining turnover levels within a reasonable range.

The effectiveness of the work environment is one of the focuses of the Islamic banking industry in supporting sustainable development (Faliza, Yana, Qamarius, & Matriadi, 2023). This represents a form of internal social responsibility within the company, realized through internal CSR. Employees are the subject of skill development, empowerment, and the provision of a conducive work environment.

The focus on developing and empowering employees and optimizing the work environment is a fundamental effort that must be undertaken before improving the broader ecosystem environment. When the human resources driving the Islamic banking industry possess strong competencies, they can automatically be effectively empowered within the financial industry, thus supporting sustainable development.

Apart from focusing on employees, the social aspect in sustainability financial reporting also concentrates on customer services such as satisfaction surveys and complaint services. This demonstrates that Shariah banking aims to focus on stakeholders within its responsibility to contribute maximally to the common goal of a sustainable financial system.

In addition to internal initiatives, the social aspect in sustainability financial reporting also indicates that the wider community benefits from the presence of Shariah Commercial Banks. This is showcased through activities such as SME development by Bank Syariah Indonesia, fund allocations to supported partners by BRK Syariah, realization of CSR and financial literacy programs by Bank Muamalat Indonesia, social, and community development investments by Bank Aceh Syariah, and zakat distribution through zakat management institutions by Bank Mega Syariah Indonesia.

The social activities undertaken by several Shariah banks indicate tangible support from the Islamic banking industry toward the welfare of the general public. However, in terms of numbers, these efforts are still inferior when compared to conventional banks with significantly larger asset capitalization.

Overall, the implementation of sustainable finance reported by Shariah Commercial Banks until 2022 has been fairly adequate as it covers three crucial aspects in supporting the achievement of sustainable development goals: economic, environmental, and social. This progress also demonstrates that efforts by Shariah Commercial Banks to achieve *maqasid Shariah* have been well-attempted, although still far from perfect. Moving forward, a good synergy among all parties—employees, stakeholders, and customers—is crucial to integrate all financial products and services effectively in sustainable financial activities (Nugroho, Badawi, & Hidayah, 2019).

## **DISCUSSION**

Supportive activities towards achieving a sustainable financial system have been undertaken by Shariah banking in Indonesia and are evidenced through annual published reports. The figures in these reports also indicate positive growth up to the latest report published in 2022. However, this growth is not significant enough, leaving the market share of Shariah banking in Indonesia far below that of conventional banking. Moreover, the Covid-19 pandemic in Indonesia during 2020-2022 significantly impacted various economic sectors and lowered statistical figures.

After the pandemic status was lifted, and the government designated Covid-19 as an endemic situation in 2023, it is hoped that the economic sector across the board will start actively moving and continue to develop. The sustainability financial report for 2023 is not accessible as of November, but the condition of sustainable finance in 2023 can be glimpsed from the statistical data published in June this year.

The latest statistical data shows that in 2023, the condition of SME financing, which is one of the indicators of sustainable finance, continued to increase from Rp 124.866 billion in December 2022 to around Rp 135.662 billion in June 2023. The net profit of Indonesian Shariah banking in June 2023 recorded growth of about 13% from the profit in December 2022. Practically, profit figures alone do not sufficiently represent sustainability financing without specific records indicating that these figures were attained from financing that fully supports green finance initiatives.

Furthermore, Shariah banking needs to maintain consistency in financing priorities supporting sustainable development goals and increase the scope of benefits from every fund management undertaken. This way, the public will recognize Shariah banking as an institution that effectively implements sustainable financial systems.

From a regulatory standpoint, technical guidelines for implementing sustainable finance have been comprehensively developed but are not fully implemented based on the annual reports of Shariah banks. Clear rules within Shariah law that can accommodate each sustainable development goal should ideally motivate Shariah banks in Indonesia to become a prime example of implementing sustainable financial systems.

The government's and OJK's contribution in issuing appropriate regulations has paved the way for Islamic banking to support sustainable development. Over time, Islamic banks can take full responsibility for playing a supportive role in financing environmentally safe projects, ranging from small-scale such as UMKN to a national scale, such as supporting infrastructure development that preserves the environment.

In principle, Islamic banking also has the right to reject financing applications that endanger environmental sustainability, social life, and economic continuity. Islamic banks also have the right to propose changes in the business design to be financed, making it more environmentally friendly and supportive of the socio-economic life of the wider community. For instance, in culinary businesses, prioritizing the use of eco-friendly packaging over single-use plastics can be encouraged.

Practically, the Shariah banking industry is not directly involved in environmental preservation efforts, but it can support financing for businesses prioritizing environmental conservation in their operations. Additionally, social funds managed by Shariah banks can be used in projects to maintain a balanced ecosystem. Shariah banks can also support the implementation of green finance campaigns alongside efforts to enhance financial literacy and Shariah financial inclusion in Indonesia.



Practically, the community cannot directly perceive the role of Islamic banking in environmental preservation, except through the implementation of CSR programs widely publicized through various media. However, in reality, as long as Islamic banking can control the capital of a project, the larger the portion of capital involved, the more dominant the opportunity to steer the project concept towards goals aligned with sustainable development.

This is an important aspect that the general public, especially the Muslim community, should realize in order to support the Islamic banking industry in achieving better performance than conventional banking in the future. Indonesia's Islamic banking contribution to supporting sustainable development will expand further as society becomes more aware of its role and support through the growth of its assets.

### **CONCLUSION**

The Shariah Commercial Banks in Indonesia have received technical guidelines for implementing sustainable finance from the Financial Services Authority (OJK) but lack detailed reporting standards. As a result, assessment indicators can be interpreted freely according to each company's circumstances. While this presents an opportunity for innovation, it also means that Shariah banking can implement programs according to their capabilities. However, nationally, data cannot be easily collected and identified.

The realization of sustainable finance in the five Shariah banks with the widest reach in Indonesia has involved implementing sustainable finance projects, although there is still a need to enhance business capacity and the benefits for future social life. Furthermore, the Financial Services Authority needs to establish more detailed regulations concerning the technical aspects of reporting on sustainable finance implementation. This would enable Shariah banks throughout Indonesia to have clear standards when compiling reports, allowing the general public to easily comprehend the presented data.

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### **DECLARATION OF CONFLICTING INTERESTS**

The authors declared no potential conflicts of interest.

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