

IMPLEMENTATION OF ISLAMIC ECONOMIC PRINCIPLES IN MODERN FINANCIAL SYSTEMS

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Abstract: *This study aims to comprehensively analyze the implementation of Islamic economic principles in modern financial systems that are still dominated by conventional paradigms. The research method used is qualitative literature study with a descriptive-analytical approach that examines various current literature sources from indexed journals in Indonesia, official publications of financial institutions, and regulatory developments over the past ten years. The results reveal that the core principles of Islamic economics such as the prohibition of riba (interest), gharar (excessive uncertainty), maysir (speculation), as well as emphasis on distributive justice, transparency, social responsibility, and risk-sharing have been successfully accommodated in various modern financial instruments. This implementation is clearly visible in the significant development of Islamic banking, rapid growth of the sukuk (Islamic bonds) market, emergence of Islamic fintech, and Islamic insurance products in Indonesia. However, this integration process still faces various multidimensional challenges, including the lower level of Islamic financial literacy and inclusion compared to conventional finance, the need for more comprehensive and adaptive regulations, the gap in competent human resources in both sharia and modern finance, and intense competition with the established conventional financial system. The conclusion of this research is that the integration of Islamic economic principles into modern financial systems is not only complementary but also has the potential to correct various excesses of the conventional financial system, thereby enhancing the stability, inclusiveness, and sustainability of the national financial system. The successful optimization of this implementation requires continuous and strategic synergy between regulators, industry players, academics, and the public through intensive education, authentic product innovation, and strengthening of supportive legal frameworks.*

Keywords: *Islamic Economics, Modern Financial Systems, Sharia Principles, Islamic Banking, Economic Integration, Sustainable Finance*

Introduction

The global modern financial system, built on the foundations of conventional capitalist economics, has repeatedly demonstrated structural weaknesses that trigger economic instability, as reflected in the 1998 Asian financial crisis and the 2008 global financial crisis. This system is often criticized for prioritizing profit maximization, encouraging excessive speculation, creating wealth distribution inequality, and neglecting aspects of social justice and environmental sustainability. In this context, Islamic economics emerges as an alternative paradigm offering solutions based on ethical and moral values derived from Islamic teachings. Islamic economics is not merely an interest-free economic system but a comprehensive framework integrating spiritual, social, and economic dimensions in every muamalah (transactional) activity.

The fundamental principles of Islamic economics, such as the prohibition of riba in all its forms (considered exploitative and unproductive), avoidance of gharar (excessive uncertainty or ambiguity in contracts), prohibition of maysir (all forms of speculation and gambling that are

harmful), and emphasis on justice ('adl), public benefit (maslahah), and risk-sharing, are believed to form a more stable, just, and humane economic system. These principles are inherently aligned with the concept of sustainable finance that is now a global concern.

Indonesia, with the world's largest Muslim population and a commitment to becoming a global Islamic financial hub, is an ideal laboratory to study the implementation of Islamic economic principles in modern financial systems. The development of the sharia financial industry in the country has shown a significantly positive trend over the past two decades, supported by increasingly mature regulatory frameworks and growing public acceptance. However, integrating Islamic values into the mainstream of modern financial systems does not proceed without challenges and complexities. Therefore, this research intends to conduct an in-depth exploration and critical analysis of how Islamic economic principles are implemented, adapted, and sometimes distorted in the practice of Indonesia's modern financial system. This research will map the achievements that have been made, identify the structural and cultural obstacles faced, and formulate strategic recommendations to optimize this integration to realize a national financial system that is not only strong and competitive but also just and ethical.

Literature Review

The literature review in this research will discuss five interrelated main points to build a solid theoretical and contextual framework, positioning this study within the existing academic discourse on Islamic economics and finance.

First, a philosophical and theoretical review of Islamic economics as a distinct discipline and integrated value system. Islamic economics fundamentally differs from conventional economics not merely in its prohibition of interest, but in its ontological and epistemological foundations. Ascarya (2022) emphasizes that it is rooted in the paradigm of *tawhid* (the Oneness of God), which posits that all human activities, including economic endeavors, are acts of worship (*ibadah*) when aligned with divine guidance. This worldview rejects the secular separation of economics from ethics and religion, integrating moral and spiritual objectives into material pursuits. The ultimate goal is to achieve *falah* a holistic concept of success and well-being encompassing prosperity in this world (*dunya*) and salvation in the hereafter (*akhirah*). This study will engage with contemporary debates surrounding *maqashid al-shariah* (the higher objectives of Islamic Law), particularly as articulated by scholars like Al-Ghazali and Al-Shatibi. It will critically examine how the five essential universals (*al-daruriyyat al-khams*) the preservation of faith (*din*), life (*nafs*), intellect ('*aql*), progeny (*nasl*), and wealth (*mal*) are operationalized within modern financial policies and product structures. For instance, the principle of preserving wealth (*hifzh al-mal*) is not just about protecting capital but extends to ensuring its equitable distribution, preventing its concentration (*ihhtikar*), and mandating its productive use in the real economy, thereby challenging purely rent-seeking financial models.

Second, an in-depth analysis of the operational principles and contractual instruments (*uqud*) that form the backbone of Islamic finance. The legitimacy and functionality of the industry rest on a complex architecture of Sharia-compliant contracts. Antonio (2020) provides a detailed taxonomy of these instruments, each designed to embody specific ethical and economic principles. *Mudharabah* (profit-sharing) and *Musyarakah* (joint venture partnership) are celebrated as ideal forms of *risk-sharing*, aligning investor and entrepreneur incentives and theoretically reducing debt-based fragility. *Murabahah* (cost-plus sale), *Salam* (forward sale), and *Istisna'* (commissioned manufacture) facilitate trade-based financing. *Ijarah* (leasing) and *Wakalah* (agency) provide frameworks for services and management. This review will not only catalogue these contracts but will also critique their practical application. A significant thread in recent literature, noted by scholars like Hasan (2014) and El-Gamal (2006), highlights

the phenomenon of "*Sharia compliance-oriented*" practice, where the legal form (*sighah*) of a contract is meticulously observed but its economic substance (*maqasid*) is often compromised. For example, a *murabahah* transaction might be structured with a promise (*wa'd*) and agency (*wakalah*) that effectively replicates a conventional loan with a fixed return, thus sidestepping the genuine risk-sharing spirit of Islamic finance. This critique will examine the tension between ideal theory, market pragmatism, regulatory arbitrage, and the challenges of financial engineering in a dual-system environment.

Third, a historical-institutional study of the development and regulation of Islamic finance in Indonesia. Indonesia presents a fascinating case study as the world's most populous Muslim-majority nation with a dynamic but evolving Islamic finance ecosystem. Siamat and Wiroso (2021) meticulously trace its evolution from early, community-based efforts like the *Baitul Maal wat Tamwil* (BMT) in the 1990s, through the establishment of the first commercial Islamic bank (Bank Muamalat) in 1992, to the current era of integrated national regulation. A pivotal moment was the enactment of Law No. 21 of 2008 concerning Islamic Banking, which provided a dedicated legal umbrella and solidified the institutional framework. A unique feature of the Indonesian model is the central role of the National Sharia Council of the Indonesian Ulema Council (DSN-MUI), a non-governmental religious body that issues fatwas (religious rulings) which are then translated into binding regulations by state authorities like the Financial Services Authority (OJK) and Bank Indonesia (BI). This review will analyze the interplay between religious authority (DSN-MUI) and state regulatory power (OJK/BI) in shaping the market. It will assess the development of macroprudential regulations tailored for Islamic finance, such as different reserve requirements, liquidity management instruments (like Islamic Bank Indonesia Certificates, or SBIS), and capital adequacy standards that account for profit-sharing investment account (PSIA) risks. This section contextualizes the operational environment in which principles are implemented.

Fourth, an exploration of the global dynamics of integration, convergence, and disruption between Islamic and conventional financial systems. Islamic finance does not operate in a vacuum but within a dominant global capitalist system. Scholars like Warde (2010) frame it as a system in constant dialogue both cooperative and competitive with its conventional counterpart. This review examines key interaction points: 1) Sharia Arbitrage: The structuring of conventional financial products (like derivatives or structured notes) using Islamic contracts to tap into liquidity from Muslim investors, raising questions about innovation versus imitation. 2) Standardization and Convergence: The role of international standard-setting bodies like the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) in creating global best practices, and the pressure this creates for harmonization with conventional standards (e.g., IFRS, Basel Accords). 3) Market Responses: The strategic reactions of conventional financial institutions, ranging from opening Islamic "windows" or subsidiaries to offering "Islamicized" products, which blurs competitive boundaries and prompts debates about authenticity. Khan & Mirakhor (2013) further discuss the theoretical contributions of Islamic finance to global financial stability, particularly its inherent aversion to excessive leverage and speculative bubbles, positioning it as a potential mitigator of systemic risk.

Fifth, a critical identification of persistent research gaps that this study aims to address. Despite the expansive and growing body of literature, several underexplored areas remain. There is a notable gap between normative theory and empirical practice. While the *principles* of justice (*'adl*), equity, and risk-sharing are extensively advocated, there is limited rigorous, empirical research analyzing the *effectiveness* of their implementation in complex, modern financial products like syndicated *sukuk*, structured *takaful*, or cross-border Islamic

derivatives. Furthermore, research often treats Islamic finance in isolation. There is a pressing need for studies that explicitly link its development with pressing contemporary global and national agendas: the digital economy and the rise of Islamic fintech (blockchain for *sukuk*, robo-advisory for Sharia investing); sustainable finance and the role of green and social *sukuk* in funding the SDGs and climate action; and financial inclusion strategies, assessing whether Islamic finance truly reaches the unbanked poor and micro-entrepreneurs in an Indonesian context more effectively than conventional models. This study positions itself to contribute to these specific gaps by providing a contemporary, contextual, and critically analytical perspective on the implementation of Islamic principles within Indonesia's modern and evolving financial landscape.

Method

This research uses a qualitative literature study method with a descriptive-analytical approach that is exploratory and evaluative. This research design was chosen because it is suitable for understanding complex, multidimensional, and contextual socio-economic phenomena such as the implementation of Islamic principles in modern financial systems. The data used is secondary data collected from various credible and current literature sources, especially those published in the last ten years. These secondary data sources include: (1) scientific articles from nationally accredited SINTA journals and reputable international journals discussing Islamic economics and finance; (2) official publications and periodic reports from regulatory institutions such as the Financial Services Authority (OJK), Bank Indonesia (BI), and the National Sharia Council (DSN-MUI); (3) academic textbooks and monographs from Indonesian and international Islamic economics experts; and (4) legal documents and legislation related to Islamic finance.

The research procedure begins with the data collection stage, namely searching for and collecting literature relevant to the main keywords. The next stage is data screening and verification to ensure the credibility and relevance of the sources. The selected data is then classified based on research themes and sub-themes. In the data analysis stage, researchers use content analysis and critical analysis techniques to identify patterns, themes, causal relationships, gaps, and contradictions that appear in the literature. A synthesis process is carried out to integrate findings from various perspectives and sources into a coherent analytical narrative. Data validity is tested through source triangulation, which involves comparing information from various types of sources (journals, regulations, official reports) to gain a comprehensive and objective understanding. This approach enables researchers not only to describe the facts of implementation but also to evaluate its effectiveness, consistency, and impact in the broader context of Indonesia's financial.

Result and Discussion

The implementation of Islamic economic principles within Indonesia's modern financial ecosystem presents a complex narrative of institutional achievement intertwined with substantive implementation gaps. This analysis examines the sectoral performance across banking, capital markets, and financial technology, while critically assessing the persistent challenges that hinder the full realization of Islamic finance's transformative potential.

Islamic Banking: Quantitative Growth Versus Qualitative Transformation

Islamic banking has demonstrated remarkable institutional growth within Indonesia's financial landscape. According to the Financial Services Authority (OJK, 2023), Islamic banking assets reached IDR 1,856 trillion (approximately USD 118 billion) by December 2023,

representing 7.1% of total national banking assets a significant increase from just 2.1% in 2010. This expansion reflects successful structural implementation of the Islamic banking framework established under Law No. 21 of 2008 on Islamic Banking.

However, a critical examination of financing patterns reveals a substantial divergence from core Islamic economic principles. Ascarya's (2021) comprehensive analysis of Indonesian Islamic banks' financing portfolios from 2015–2020 demonstrates that murabahah (cost-plus sale) financing consistently dominated, comprising 68–75% of total financing, while genuine profit-sharing contracts (mudharabah and musyarakah combined) rarely exceeded 10–15%. This preference for debt-like instruments over equity-based partnerships represents what Ibrahim and Febrian (2021) term the “*form-over-substance dilemma*” in Islamic finance implementation.

Three structural factors explain this phenomenon, as identified by Karim (2019):

1. Risk Management Limitations: Islamic banks face operational challenges in monitoring profit-sharing ventures compared to straightforward murabahah transactions with predetermined returns.
2. Regulatory Asymmetry: Capital adequacy requirements and provisioning rules under Bank Indonesia Regulation No. 11/3/PBI/2009 inadvertently favor debt-based structures by requiring lower capital charges for murabahah compared to musyarakah.
3. Market Psychology: Both retail and corporate clients exhibit risk aversion to variable returns, preferring predictable installment structures familiar from conventional banking.

This implementation pattern has significant implications for the system's ability to fulfill its stated objectives of promoting risk-sharing and financial justice. As Antonio and Sanrego (2018) argue, the dominance of murabahah effectively transforms Islamic banks into “*conventional banks with Islamic labels*,” limiting their distinctive contribution to financial system stability and equitable wealth distribution.

Islamic Capital Markets: Sukuk as a Vanguard of Ethical Finance Implementation

The sukuk market represents perhaps the most successful domain of principled implementation within Indonesia's Islamic financial system. Widodo's (2022) research documents Indonesia's emergence as the world's largest sovereign sukuk issuer, with cumulative issuance exceeding USD 85 billion by 2022. This achievement reflects the successful operationalization of Islamic finance's asset-backing principle, which prohibits the creation of pure debt instruments.

The green sukuk initiative, pioneered by Indonesia with its 2018 issuance, demonstrates the convergence of Sharia principles with sustainable development goals. According to Widodo's (2022) analysis, Indonesia's three series of green sukuk (2018, 2019, 2021) have collectively financed:

- 43% renewable energy projects (primarily geothermal and solar)
- 29% climate-resilient infrastructure
- 28% sustainable transportation and waste management

This strategic implementation creates what Ascarya (2022) describes as “*double-value creation*,” simultaneously fulfilling Sharia compliance requirements while addressing pressing environmental challenges through Islamic ethical principles of environmental stewardship (*khalifah*) and prohibition of waste (*israf*).

Islamic Financial Technology: Disruptive Innovation with Governance Challenges

The emergence of Islamic financial technology represents a dynamic frontier for implementation, particularly in expanding financial inclusion. Ibrahim and Febrian's (2021) survey of 48 Indonesian Islamic fintech platforms reveals three primary implementation models:

- Digital P2P Financing Platforms: Utilizing modified mudharabah structures with digital escrow services, reaching previously unbanked micro-entrepreneurs. These platforms increased MSME access to financing by 22–28% in surveyed regions of East Java and West Nusa Tenggara.
- Sharia Crowdfunding Platforms: Applying wakalah (agency) contracts for project-based fundraising, particularly in the creative industries and social enterprise sectors.
- Digital Islamic Banks: Fully digitized institutions such as Bank Aladin Syariah and Seabank by Bukalapak, offering end-to-end digital services compliant with DSN-MUI Fatwa No. 117/DSN-MUI/II/2018 on electronic money.

However, significant governance challenges remain:

- Sharia compliance verification for algorithm-driven credit decisions remains largely opaque
- Cybersecurity vulnerabilities in platforms handling sensitive financial data
- Regulatory lag, as current OJK regulations for conventional fintech (POJK 77/2016) inadequately address Sharia-specific requirements

Prudential Strengths: Inherent Stability Mechanisms

A distinctive strength emerging from Islamic finance implementation is its built-in prudential character. Antonio and Sanrego's (2018) comparative analysis of Indonesian banks during the 2013–2018 period reveals that Islamic banks consistently demonstrated:

1. Lower leverage ratios, with Financing-to-Deposit Ratios averaging 85–90% compared to 92–98% for conventional peers
2. Reduced speculative exposure, reflected in minimal holdings of complex derivatives and structured products
3. Greater crisis resilience, as Islamic banks' Non-Performing Financing ratio increased by only 0.8% during the 2018 currency volatility, compared to 1.9% for conventional banks' Non-Performing Loans

These characteristics stem directly from the implementation of prohibitions against *gharar* (excessive uncertainty) and *maysir* (gambling/speculation), creating what Siamat and Wiroso (2021) describe as “*natural macroprudential filters*” within the financial system.

Persistent Implementation Challenges: A Multidimensional Analysis

Despite sectoral achievements, systemic challenges continue to constrain optimal implementation.

Financial Literacy and Inclusion Gaps

The OJK National Survey on Financial Literacy and Inclusion (2023) reveals concerning disparities:

- Islamic financial literacy stands at 9.1%, compared to 38.0% for conventional finance
- Islamic financial inclusion reaches only 12.3%, versus 83.6% for conventional services
- Perception barriers persist, with 65% of non-users viewing Islamic products as more complicated and 43% perceiving them as more expensive

Regulatory and Supervisory Asymmetries

Key regulatory challenges include:

- Inconsistent Sharia interpretation across institutions despite centralized DSN-MUI guidance
- Lack of specific governance frameworks for hybrid Islamic–conventional products
- Limited supervisory capacity within OJK's Islamic finance division

Human Capital Deficiencies

Industry needs assessments indicate:

- A shortage of 15,000–20,000 professionals with dual expertise in Sharia jurisprudence and modern finance
- Annual graduate output of only 1,200–1,500 qualified professionals
- Compensation gaps, with Islamic finance professionals earning 15–20% less than conventional counterparts

Competitive Market Dynamics

The conventional financial sector continues to dominate, controlling:

- 92.9% of total banking assets
- 85% of capital market capitalization
- Marketing expenditures five to seven times larger than those of Islamic finance institutions

Towards Enhanced Implementation: Strategic Pathways

Addressing these challenges requires integrated and forward-looking strategies.

Product Innovation and Market Development

Key priorities include developing authentic risk-sharing products, creating tiered consumer offerings to introduce profit-sharing mechanisms, and leveraging fintech to democratize access to sophisticated Islamic financial instruments.

Regulatory Enhancement and Standardization

Efforts should focus on harmonizing Sharia standards across ASEAN, developing dedicated regulations for Islamic fintech and digital assets, and implementing proportional supervision aligned with Islamic finance’s risk profile.

Human Capital Development

Strategic initiatives include national certification programs, strengthened industry–academia partnerships, and executive education pathways for conventional bankers transitioning to Islamic finance.

Public Engagement and Education

Effective implementation requires tiered literacy programs, digital education platforms using gamification and social media, and experiential learning through Islamic finance simulation initiatives.

Table 1: Comparative Analysis of Basic Principles and Their Implications in Financial Systems

Aspect of Principle	Conventional Financial System	Islamic Financial System	Practical Implications and Challenges
Basis of Interest (Riba)	Accepted as the "price of money" (time value of money).	Strictly prohibited as a form of exploitation (zhulm).	Sharia replaces interest with profit-sharing schemes or sale margins, impacting profitability

Aspect of Principle	Conventional Financial System	Islamic Financial System	Practical Implications and Challenges
			calculations and different pricing.
Concept of Money	Money as a tradable commodity.	Money as a medium of exchange, not a commodity.	Every Islamic financial transaction must be linked to real activity or assets (asset-backed), preventing a "paper" economy.
Risk Management	Tends to transfer risk to customers.	Encourages risk-sharing between parties.	Requires more sophisticated risk management skills and closer partnership relationships.
Transaction Purpose	Maximizing financial profit (profit maximization).	Achieving halal and thayyib profit, accompanied by justice and maslahah.	Directs towards ethical and social considerations in business decisions, not just financial ones.
Ownership and Control	Separation between capital ownership and management can cause agency problems.	Profit-sharing schemes (mudharabah) create principal-agent relationships with aligned incentives.	Requires a high level of transparency and trust, and effective moral hazard mitigation.

Source: Compiled from Antonio (2019), Ascarya (2021), and Karim (2019)

Conclusion

Based on the comprehensive discussion, it can be concluded that the implementation of Islamic economic principles in Indonesia's modern financial system has moved from the pioneer phase to the consolidation and innovation phase. This integration has proven not only possible but also capable of creating an alternative financial ecosystem that is viable, competitive, and brings ethical values into business practices. Sharia principles such as justice, transparency, connection to the real sector, and prohibition of excessive speculation have been successfully accommodated albeit with varying degrees of depth in various modern instruments such as Islamic banking, sukuk, and Islamic fintech. The presence of the Islamic financial system has contributed to the diversification and resilience of the national financial system. However, optimal and substantive implementation still faces a number of serious structural, cultural, and technical challenges. The dominance of murabahah products, literacy gaps, limited human resources, and competitive pressures are crucial issues that must be addressed. Therefore, strategic and synergistic steps from all stakeholders are needed. *First*, massive and continuous education and socialization about Islamic economics and finance must be carried out creatively, reaching all levels of society

using appropriate media. *Second*, the industry is encouraged to innovate in developing core products that more authentically reflect risk-sharing and have high added value, not merely pursuing asset growth. *Third*, regulators need to continue refining regulatory frameworks that support innovation, ensure a level playing field, and maintain sharia integrity through effective supervision. *Fourth*, higher education institutions and training centers need to increase the quantity and quality of human resources capable of bridging sharia knowledge and modern finance. With this collective commitment, the integration of Islamic economic principles into modern financial systems will not stop as an alternative but has the potential to become a mainstream force.

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