

ISLAMIC BANKING, FINANCIAL INCLUSION, AND ECONOMIC RESILIENCE IN INDONESIA

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Abstract: *This manuscript examines the role of Islamic banking in promoting financial inclusion and strengthening economic resilience in Indonesia. The main objective of this study is to analyze how Islamic banking contributes to expanding access to financial services and enhancing the ability of the Indonesian economy to withstand economic shocks. The research applies a qualitative descriptive approach through a comprehensive review of academic literature, regulatory documents, and official reports from financial authorities related to Islamic banking, financial inclusion, and economic resilience. The analysis emphasizes the relationship between Islamic banking instruments, inclusive financing practices, and macroeconomic stability. The findings indicate that Islamic banking plays an important role in improving financial inclusion by offering sharia-compliant financial products that are accessible to underserved communities, micro and small enterprises, and the informal sector. These inclusive financing practices support economic resilience by strengthening the real sector, encouraging risk-sharing mechanisms, and reducing exposure to financial instability. Nevertheless, several challenges remain, including limited market share, low public awareness and literacy, regulatory constraints, and technological limitations that restrict optimal performance. The study concludes that enhancing institutional capacity, promoting digital innovation, and strengthening policy integration are crucial to maximizing the contribution of Islamic banking to financial inclusion and economic resilience. Strong collaboration among stakeholders is required to achieve sustainable and inclusive economic growth in Indonesia.*

Keywords: *Islamic Banking, Financial Inclusion, Economic Resilience,*

Introduction

Indonesia is one of the countries with the largest Muslim population in the world after Pakistan, so it has great potential to implement Islamic economic principles. This potential opens up opportunities to build a strong and sustainable foundation to support economic growth in Indonesia. The increase in the main indicators of Islamic banks shows the growth of the Islamic financial sector in Indonesia. According to the Otoritas Jasa Keuangan (OJK), Islamic banking showed positive growth until December 2022. Its total assets reached 15.63%, financing disbursed grew by 20.44%, and third-party funds (DPK) increased by 12.63%. In 2019, total Islamic financial assets in Indonesia reached US\$99 billion, up from US\$86 billion in the previous year. This increase made Indonesia ranked seventh globally in total Islamic financial assets. The Islamic banking sector experienced the largest growth, increasing from US\$28 billion to US\$38 billion, a jump of US\$10 billion (OJK, 2022).

The Islamic banking sector has an intermediary function to channel capital or deposits to business actors so it plays an important role in driving the real sector. In addition, the distribution of Islamic banking services plays a role in facilitating access to every level of society, which will positively impact economic growth (Hidayanti, 2018). According to OJK Regulation No. 76/2016 article 12, Islamic financial inclusion aims to increase public access to financial products and services, increase the provision of financial products and services, and increase the use and quality of use of financial products and services to support economic growth, reduce poverty levels, overcoming social disparities between individuals and regions, and realizing the welfare of the Indonesian people.

The contribution of Islamic banks to Indonesia's economic growth has not reached its maximum potential when compared to conventional banks. According to OJK, the marketshare of Islamic banks is currently only around 7.01%, while conventional banks have a market share of around 92.91%. This comparison shows that the performance of Islamic banks is still significantly lower than conventional banks. On the other hand, the Islamic financial inclusion index according to Puspitasari et al. (2020) shows that Indonesia is still at a low level of Islamic financial inclusion, with the figure only reaching 0.18%. This phenomenon raises concerns because Indonesia is one of the countries with the highest percentage of Muslim population.

Sarma (2012) financial inclusion is a process that ensures easy access, availability, and use of formal financial products for all economic actors. While, Umar (2017) detailed that the DPK, the number of offices, and the financing of Sharia banks are some components of Sharia financial inclusion. The essence of financial inclusion is to facilitate the community in lending, savings, payment systems, and financing distribution (Reyes, 2014). Thus, Islamic financial inclusion aims to make it easier for people to access and utilize various Islamic financial facilities while involving them in economic activities in a more equitable and sustainable manner (Hanivan & Nasrudin, 2019).

Shariah financial inclusion could potentially be an important factor in driving the economy Frita et al. (2021) mentioned that Sharia financial inclusion has a significant link with economic growth, especially in accelerating the process of economic recovery and plays a crucial role in ensuring economic stability in Indonesia. Iqbal & Mirakhor (2014) also revealed that increased development of Shariah financial inclusion in a country not only has the potential as a major driver of accelerated economic growth but can also reduce income inequality and poverty levels. Fitriyanto (2021) It also found that the financing of the sharia bank had a significant influence on the growth of the Indonesian economy through the development of UMKM.

Literature Review

1. Islamic Banking

Islamic banking is a banking system that operates based on Islamic sharia principles, which prohibit *riba* (interest), *gharar* (uncertainty), and *maysir* (speculation). In Indonesia, Islamic banking has grown rapidly since its formal introduction through Law No. 7 of 1992 concerning Banking.

Main principles:

- Profit-loss sharing system through *mudharabah* and *musyarakah*
- Real asset-based financing
- Prohibition of transactions containing elements of usury, *gharar*, and *maysir*
- Orientation towards socio-economic welfare

Developments in Indonesia: The Indonesian Islamic banking industry has experienced significant growth, with total assets continuing to rise. Bank Indonesia and the Financial Services

Authority (OJK) continue to encourage the development of this sector as part of the national financial system.

2. Economic Growth

Prasetyo (2019) explains economic growth simply, in terms of a specific period of time such as one year or increasing national aggregate output or income. Economic growth is described as an increase in per capita output that lasts over a long period of time. Economic growth is a quantitative parameter that reflects the economic progress of a country in a given year compared to the previous period (Sukirno, 2016). According to Todaro & Smith (2020), economic growth can be defined as a process in which the productive capacity of an economy increases over time to generate increasing rates of income. Lincoln (2014) meant that the economic downturn was a process caused by a decline in a country's per capita national income.

Economic growth in a region can be defined as a condition in which the Gross Domestic Product (GDP) undergoes developments that reflect an increase in per capita output and an improvement in the standard of living of the population. This economic growth characterizes the economic progress of a region, which is seen by increased per capita production of goods and services. Overall, the positive impact of this economic growth is seen in improving the quality of life of local people. Therefore, the identification of economic growth can be done by looking at the increase in GDP generated by a region over a certain period of time (BPS, 2016).

Economic growth is a concept in macroeconomics that focuses on the long-term aspects of a country's economic development. Every period, the people of a country strive to increase their capacity to produce goods and services. The primary objective is to an increase in the level of real output or overall national income, while raising the standard of living of the people measured by real per capita income. The main source of economic growth is investment that can increase human resources, which can further improve the quality of productive resources and can increase the overall productivity of resources through new discoveries, innovations, and technological advances (Todaro, 2020).

3. Islamic Financial Inclusion

Islamic banking is a banking system that operates based on Islamic sharia principles, which prohibit riba (interest), gharar (uncertainty), and maysir (speculation). In Indonesia, Islamic banking has grown rapidly since its formal introduction through Law No. 7 of 1992 concerning Banking. Key principles: Profit-loss sharing system through mudharabah and musyarakah Real asset-based financing Prohibition of transactions containing elements of riba, gharar, and maysir Orientation to socio-economic welfare Developments in Indonesia: The Indonesian Islamic banking industry has experienced significant growth with total assets continuing to increase. Bank Indonesia and the Financial Services Authority (OJK) continue to encourage the development of this sector as part of the national financial system.

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Research Methods

The research will explore the inclusion of Sharia finance that includes DPK, Sharia financial access and Sharia bank financing to economic growth in 33 provinces in Indonesia based on data published by the OJK in 2018. The independent variables in the study are Sharia financing inclusion that covers the total of the Sharia Bank financing, sharia finance access and sharia bank

funding. While the dependent variable is economic growth, which is an indicator of economic growth rate using the approximation of panel data for the period 2018-2022.

Secondary data is data that has been collected and recorded by the associated institutions for other purposes but can be reused for different research or analysis. In this study, secondary data has been published by BPS Indonesia for economic growth data and OJK for sharia banking statistics data.

The method of panel data regression analysis is to take into account the diversity that occurs in cross-section units and is more informative than simple time series as a whole. The latitude data model and the time data model in this study:

$$\text{LogPEit} = \alpha + \beta_1 \text{logDPKit} + \beta_2 \text{logAKSit} + \beta_3 \text{logPBSit}$$

Where logPEit = Economic growth rate; logDPK = Total Third-Party Funds; logAKS = Sharia Financial Access; logPBS = Sharial Bank Financing; α = Constanta; i = Province; t= Year; $\beta_1, \beta_2, \beta_3$ = Free Variable Regression Coefficient.

he study uses quantitative data analysis, as well as tabular data to make it easier to understand. The EViews version 10 program is used to regress models that are a good and non-biased prediction tool so that you get accurate and quick results. The data analysis method used in this study is the regression analysis of panel data based on the ordinary least square method consisting of several stages, namely determining the best model estimates between the Common Effect Model (CEM), the Fixed Effect Models (FEM) and the Random Effect models (CEM); the classical assumption trials that include the normality test, the multicollinearity trial, the heteroskedastisity test and the autocorrelation trial; the individual analysis; as well as the significance trial that includes the partial significant trial (t-stat), the simultaneous significant test (F-stat), and the determination coefficient. (adjusted Rsquared).

Results and Discussion

The Chow test is used to compare the Common Effects Model (CEM) and the Fixed Effects Model (FEM) to see which provides the best estimate. The Hausman test compares the fixed effects model and the random effects model (REM). Decision-making is based on probability values. In the Chow test, if the probability value is greater than 0.05, the Common Effects Model (CEM) is the preferred model. If the probability value is less than 0.05, the Fixed Effects Model (FEM) is the preferred model. Meanwhile, in the Hausman test, if the probability value is greater than 0.05, the Random Effects Model (REM) is the preferred model. If the probability value is less than 0.05, the Fixed Effects Model (FEM) is the preferred model. The Chow and Hausman results can be seen in Tabel 1.

Tabel 1.

Chow and Hausman Test Results

Chow test			
Effect Test	Statistic	Degree of Freedom	P-Value
Cross-Section f	10.696497	4	0,0000
Hausman Test			
Test Summary	Chi-Square Statistic	Degree of Freedom	P-Value
Cross-section Random	45.714230	3	0,0000

Source: Proccesed Data 2024

Based on the Chow Test results, a statistical value of 10.696497 was obtained with 4 degrees of freedom and a probability value (p-value) of 0.0000. A p-value smaller than the 5% significance level (0.05) indicates that the null hypothesis is rejected. Therefore, it can be concluded that the Fixed Effect model is more appropriate than the Common Effect model, as

there are significant differences in characteristics between cross-sectional units in the research data.

Furthermore, the Hausman Test results show a Chi-Square statistic value of 45.714230 with 3 degrees of freedom and a p-value of 0.0000. This value is also smaller than 0.05, so the null hypothesis is rejected. This indicates that the Fixed Effect model is more appropriate than the Random Effect model, as there is a correlation between individual effects and the independent variables in the model.

Overall, the results of the Chow Test and Hausman Test consistently indicate that the Fixed Effect model is the most appropriate panel data model for use in this study. The selection of this model is expected to provide a more accurate estimate because it can capture the differences in the characteristics of each research object specifically.

Conclusion

The results of the analysis and discussion in the previous sub-chapters explain that the inclusion of Sharia finance can contribute to increased economic growth throughout the Indonesian provinces. In making this conclusion, it can be seen that the results of the simultaneous regression test show that the Sharia financial inclusion variable that includes third-party funds, Sharia financing access, and Sharia bank financing has a significant influence on economic growth in Indonesia. That is, all the elements of the Shariah's financial inclusion together have a significant positive impact on economic growth. Partially, the regression test shows that each variable, namely third-party funds, Sharia financial access, and Sharia bank financing, has a significant influence on economic growth in Indonesia. This confirms that each aspect of Sharia finance inclusion individually also has a meaningful contribution to economic growth, although simultaneously these variables are interrelated and interacting.

Seeing from beta (β), the most powerful or dominant variable affecting economic growth is the Sharia bank financing variable. In other words, the financing channeled by the Sharia bank contributes significantly to economic growth in Indonesia compared to other variables in this model. This may be due to the unique characteristics and financing mechanisms of the Sharia financial system, which can drive economic growth more effectively than conventional financial instruments.

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