Proceeding of The International Conference on Economics and Business
Volume. 3, Nomor. 2, Tahun 2024
e-ISSN: 2963-3370; p-ISSN: 2963-3656, Page 49-58
DOI : https://doi.org/10.55606/iceb.v3i2.447
Available online at: https://ijconf.org/index.php/iceb

Integration of Sharia and Conventional Financial Instruments in Achieving Inclusive Economic Development

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Abstract. *Islamic finance has increased rapidly lately. The increase is due to the fact that people are starting to use sharia and Islamic principles in transactions because they prioritize ethics and morals. The rapid development of course there are still challenges faced, one of which is about the less massive use by the community. This certainly needs to be studied again, such as the integration between Islamic financial instruments and conventional finance so that there can be an inclusive collaboration in the financial world. This research uses an analytical description method with secondary data sources. The results of this study indicate that the role of Islamic finance on economic development is very significant, this is because the principles of sharia prioritize ethics and morals in transactions so that people trust more than conventional finance. With an increasing role, of course there are still obstacles faced, one of which is limited public access to Islamic finance and an integration with conventional finance is needed. With integration with conventional finance, it turns out to be able to realize an inclusive economy such as the presence of Islamic capital markets, Islamic banking, and others so as to bring up other alternatives in the financial world.*

Keywords: *Finance, Sharia, Inclusive, Conventional.*

1. BACKGROUND

The Islamic finance sector has emerged and expanded worldwide in recent decades. This is due to the growing demand for ethical financial solutions and the influence of Islamic principles in the economic sphere (Alaoui, 2022). The term “Islamic finance” refers to the financial systems and conditions of society that are based on Islamic sharia principles and utilize financial products and services. These principles are based on contracts that involve the idea of yield, buying and selling, and the provision of services, while rejecting the idea of interest. In the Islamic financial system, transactions are carried out in a manner that complies with Islamic law, which emphasizes fairness. For example, in the concept of yield, profits and losses are not shared with fixed interest as in the conventional financial system (Yuliyanti, 2024).

Along with increasing globalization, there has been a paradigm shift in the global financial system. The ethical aspects of financial transactions are increasingly recognized, and the need to align economic activity with moral principles is increasingly urgent. By emphasizing fairness, sustainability, and balance in business and financial practices, Islamic economics is changing the conventional perspective (Mufid, 2021). The growth of the Islamic economy is not limited to areas where the majority of the population is Muslim

Received: December 01, 2024; Revised: December 15, 2024; Accepted: December 29, 2024; Published: December 31, 2024

(Noviarita, 2021). Islamic financial markets have gained worldwide recognition and growing acceptance. Sukuk and Islamic insurance have become an important part of the global financial structure. This growth demonstrates the ability of the Islamic economy to adapt to complex and diverse markets around the world (Muharam, 2023).

According to Soemitra (2012), the integration of the Islamic economy promises to shift the overall paradigm of business and finance. It will also impact the market growth and expansion of the Islamic finance industry. Islamic economics is based on ethics and morals. The concept of social responsibility and balance brought into it allows them to address global issues such as economic inequality and climate change (Rahmawaty, 2013). The ethics and morals brought by Islamic economics will certainly have an impact on inclusive economic development.

2. RESEARCH METHODS

This research is a type of descriptive research that uses a qualitative approach. The writing method used produces descriptive data consisting of the words of people and behaviors observed indirectly. The qualitative paradigm emphasizes understanding social life problems based on reality or natural settings that are holistic, complex, and detailed (Nur, 2009). Secondary data is the type of data used in this writing. Secondary data is usually in the form of records, evidence, or historical reports stored in archives, both published and unpublished Nur (in Nurfalah, 2019).

3. RESULTS AND DISCUSSION

Benefits of Inclusive Economic Development

The approach known as inclusive economic development emphasizes improving the well-being of every citizen and increasing equality of opportunity. This includes empowering vulnerable groups, including women, children, the elderly, local communities and marginalized groups. Inclusive economic development focuses on structural changes and innovations in the economic, social, and cultural spheres that will improve people's quality of life and shift traditional economic policies in a more sustainable direction. This concept also emphasizes wise and sustainable resource management and ensures that vulnerable people are involved and take advantage of existing opportunities (Sitorus & Arsani, 2018).

According to Anwar (2022), achieving inclusive economic development requires economic policies that consider the interests of all people, not just elite groups or large companies. Inclusive economic development should make all groups of people feel the benefits of economic development, both economically and socially. It can create new jobs and increase people's incomes, which in turn can result in economic improvement. It can also improve the overall well-being of society as people will feel involved in the economic and social development of their country. For example, government programs that help the poor, financing of small and medium enterprises, and training and skills development for less skilled people. Social infrastructure such as education and health should also be improved (Anggoro, 2023).

The concept of inclusive economic growth emphasizes economic sustainability by considering the needs of all levels of society, including marginalized groups such as the poor, minorities, and people with disabilities. This concept emphasizes that sustainable economic development must consider all levels of society, not just certain groups. Financial inclusion services help people in various ways. First, a wider network to the formal financial sector will allow more people, especially the lower middle class, to access different types of business loans and utilize bank and insurance products on easier terms. This will also increase investment for businesses.

Third, easy access to formal financial services will stop loan sharks, who usually provide loans with high interest rates. The last advantage is that accounts created by the community in formal financial institutions can be used for various purposes and businesses in the future (Wahid, 2014). Bank Indonesia has been trying hard to improve people's knowledge about finance. The Financial Inclusion Index (IKI) is another way to measure financial inclusion. The IKI assists Bank Indonesia by combining various indicators from the banking sector to create a comprehensive picture of the access, availability and quality of inclusive banking services (Bank Indonesia, 2014). IKI uses a multidimensional index based on macroeconomic data mainly related to the banking industry (Ridha, 2023). Furthermore, with an inclusive economy, it will certainly be able to reduce inflation. Although according to Anggara (2023), inflation can only be reduced, not eliminated.

Islamic Finance in Economic Development

The need for future Islamic economic integration includes increasing Islamic financial literacy worldwide, increasing international cooperation in regulation, and active support from governments and financial institutions for the creation of Islamic financial products (Lubis, 2019). Educational programs aimed at the general public, business people, and financial professionals can help increase knowledge about Islamic finance. In addition, international cooperation is essential to address the issue of regulatory harmonization. An equivalent regulatory framework around the world can help create a stable business environment and encourage investment in the Islamic economy worldwide. Involving more countries and resolving regulatory differences, these steps will support the overall growth of the Islamic economy.

To encourage the development of Islamic financial products, the government and financial institutions must provide full support. Regulatory policies and fiscal incentives that support the development of Islamic financial goods and services can encourage industry players. In order for the Islamic economy to provide the most benefits to the world community, sustainability and inclusion must be the basis of policy and product development. Indonesia can serve as a model for other countries in strengthening the role of the Islamic economy at the international level in this regard. Other countries that want to follow in the footsteps of the Indonesian government can take examples from the steps they have taken to develop the Islamic financial sector, such as establishing supportive regulations and developing new products.

Overall, the incorporation of Islamic economics into the financial system is producing very favorable results. A more sustainable and inclusive future is created by Indonesia's rapid growth, diversified investment portfolio, and pivotal role. To ensure that the Islamic economy continues to thrive and deliver wider benefits, challenges such as regulatory understanding and harmonization require concerted attention. The future of Islamic economics can be a driver for a more ethical, stable, and sustainable financial system through close cooperation, enhanced Islamic financial literacy, and full support from policy makers.

The role of Islamic finance in promoting financial inclusion by providing financial services to underserved and marginalized groups. To reduce the financial access gap and enhance socio-economic empowerment, Islamic banking institutions provide sharia-compliant goods and services to small businesses, rural communities, and low-income people. Based on Islamic principles of fairness, honesty, and social responsibility, Islamic finance focuses on ethical and sustainable financial practices, and prohibits investments in areas deemed unethical or harmful to society, such as gambling, alcohol, and tobacco. Instead, Shariah-compliant investments prioritize socially beneficial initiatives.

Empirical studies show that Islamic finance benefits economic growth and stability. By investing in money-generating sectors of the economy, such as entrepreneurship, innovation, and infrastructure development, Islamic finance helps increase GDP, employment, and income (Yuliyanti, 2024). In addition, Islamic finance's feature of sharing profits and losses (mudarabah) and risks (musyarakah) helps financial stability by mitigating systemic risks and increasing resilience to external changes. Although Islamic finance offers many opportunities, several institutional and regulatory issues hinder its full inclusion into the conventional financial system. Islamic finance policies differ across jurisdictions, leading to ambiguity and inconsistency in compliance requirements. In addition, there is a lack of financial experts and professionals.

Integration of Islamic and Conventional Financial Institutions Towards Inclusive Economy

Over time, Islamic economics has become one of the strategic fields that has the capacity to contribute significantly to Indonesia's economic growth. Due to its significant Muslim population worldwide, Indonesia has great potential to make the Islamic economy a key pillar of the nation's development. Indonesia's Sharia Banking Development Roadmap 2020-2025 emphasizes opportunities in the areas of Islamic banking, Islamic capital markets, and others.

a. Islamic Bank

   An Islamic bank is a financial institution whose operations are adjusted to the principles of Islamic Sharia and whose main purpose is to provide credit and services in terms of payments and money circulation (Hosen, 2008). Thus, the term “Sharia Bank” means a bank whose operational procedures are based on Islamic procedures, which refer to the verses of the Quran and Hadith. Customs regulate relationships between people, both individually and between individuals and their communities. Buying and selling (ba'i), interest (riba), accounts receivable, pawning (rahn), transferring debt (hawalah), trading (qira'ah), guarantee (dhomah), renting (syirkah), and hunting (ijarah) are all examples of these businesses (Warkum, 2004).

b. Islamic Capital Market

   Capital markets sell a variety of long-term financial instruments, such as debt, stocks, equities, and derivatives. The capital market provides various facilities for buying and selling and other related activities because it is a means of funding for companies and other institutions, including the government (Nurhayati, 2013). The Islamic capital market is a capital market that is regulated in accordance with sharia principles, where every securities transaction is in accordance with sharia rules.

   Islamic capital markets exist and are developing in Indonesia as well as in other countries, such as Malaysia. The Amanah Income fund, established by members of The North American Islamic Trust, based in Indiana, USA, was the first institution to pay attention to operating its portfolio through sharia portfolio management in the sharia market (Yuliana, 2010). On the other hand, the Islamic capital market is defined as a capital market whose entire operation is based on sharia principles, especially in terms of issuers, types of securities traded, and trading methods (Soemitra, 2017).

Islamic finance is gaining interest around the world in the current era of globalization. This is due to the need for a more inclusive and moral financial system. Islamic finance is based on clear principles, such as avoiding excessive speculation, investment in haram sectors, and usury. It is crucial to analyze the current performance of Islamic finance to understand the development and issues facing the industry, especially in Indonesia, the country with the largest Muslim population in the world. With a significant increase in assets and profits, the Islamic finance industry demonstrates the public's trust in Islamic financial institutions. Islamic financial performance not only has a financial impact but also a broader social impact.

The Islamic finance industry faces several problems despite its positive growth. One of them is that institutions differ in the way they understand and apply sharia principles. To ensure compliance with those principles consistently, complex sharia audits are required. In addition, the lack of information between stakeholders and management can also hinder accountability and transparency. In addition, specialized information used to evaluate the performance of Islamic banks is limited. Therefore, there is an opportunity for additional research that looks at a broader range of performance. The Islamic finance industry has a great opportunity to innovate amidst these challenges. One strategic step to increase the accessibility of Islamic financial services is the integration of financial technology (fintech). Islamic banks can offer products and services that are more effective and accessible to the wider community by using digital technology. With the integration of instruments from Islamic and conventional finance such as fintech, it will certainly increase public interest in using Islamic finance, especially trusting Islamic banking.

The aim of the program is to enhance cooperation between industry players and other stakeholders. In addition, the investment sector is showing promising growth; by the end of 2021, Islamic capital market assets in Indonesia will reach Rp1,235 trillion (Student Forum, 2024). This shows that sharia-based investment instruments such as sukuk and sharia stocks have great potential. Overall, evaluating the success of Islamic finance requires a holistic approach that is based on sound principles in both financial and social terms. How transparent and fair Islamic financial institutions are will be the key to the success of this industry, with the support of government policies and increased public awareness of sharia-based financial products. The industry has the potential to continue to grow, and supporting research on performance indicators will be crucial to maximize this potential in the future, giving rise to an inclusive economy.

Economic Development In The Era Of Susilo Bambang Yudhoyono

The 6th President of the Republic of Indonesia was Susilo Bambang Yudhoyono, who served for two terms from 2004 to 2014. He prioritized the national interest and global economic openness during his term in the Democratic Party coalition. According to him, fiscal decentralization should be expanded. A portion of Income Tax and Value Added Tax should be distributed so that the benefits are felt by society as a whole, not just certain communities or regions (Setiawan, 2004).

During his leadership, he fully supported MSMEs, cooperatives, management of the country's natural resources, the Islamic banking system, income distribution for economic equity, and other activities that promote Indonesia's economic growth. Direct Cash Assistance (BLT) and fuel subsidies were the focus of his policies, as well as policies focusing on the real sector (all businesses that sell goods and services that have economic value) and financial policies aimed at maintaining economic stability.

It is important to note that President Susilo Bambang Yudhoyono has achieved a considerable degree of success in maintaining macroeconomic stability. However, he has had a number of failures, including the issues of fuel subsidies, improving the investment climate, equalizing income distribution, equalizing infrastructure development, and reforming taxation policies, which led to low total revenues relative to GDP. In 2005, he called on the private sector to participate in infrastructure development. However, the government did not make any reforms or regulations to improve the investment climate (Soesastro & Atje: 2005). During the presidency of Susilo Bambang Yudhoyono, the average economic growth was 5.78%.

Economic Development In The Era Of Joko Widodo

The 7th President of Indonesia is Joko Widodo, who served for two terms (2014-2024). In addition, during his presidency, there were various economic development policies, and various situations beyond human control also arose. At the beginning of the administration, he emphasized the importance of rapid fieldwork rather than focusing on a grand vision. At the beginning of his term, he faced a number of problems, such as sluggish economic growth, which only reached a growth percentage of 5.0%, and global economic problems such as the decline in export commodity prices. To boost economic growth, a supply-side approach was needed, namely infrastructure development and improving the efficiency of the investment climate. However, during his tenure, economic growth slowed down due to the unimproved investment climate.

In addition, Joko Widodo made major cuts from fuel subsidies or assistance to help streamline the fiscal burden. This can help focus on other programs, such as infrastructure development. However, the process of infrastructure development has also been slow. This is due to inconsistent understanding of the President's intentions which are then passed on to lower Ministries and Government. In addition to misunderstanding, another problem is the complex system or bureaucracy that requires a long time and process.

The most unexpected thing was when the COVID-19 pandemic hit the world, which began to hit Indonesia in February 2020. In addition, it had a negative impact on the economy, with a decline of -0.207 percent. After various efforts made by the government, the economy in 2021 remained stagnant, still affected by the pandemic. However, the government was able to boost economic growth to 3.7 percent through social protection such as a priority focus on public health, additional PKH assistance, and other social assistance for people who lost their jobs due to the pandemic. The implementation of the National Economic Recovery program) which focuses on businesses through various programs described in the previous four points. Economic growth during the Joko Widodo administration averaged 4.12% (2014-2022) (Habib, 2024).

4. CONCLUSION

The role of Islamic finance in economic development is very significant, this is because the principles of sharia prioritize ethics and morals in transactions so that people trust it more than conventional finance. With an increasing role, of course there are still obstacles faced, one of which is limited public access to Islamic finance and an integration with conventional finance is needed. With integration with conventional finance, it turns out that it can realize an inclusive economy such as the presence of Islamic capital markets, Islamic banking, and others so as to bring up other alternatives in the financial world.

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